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DEALS

# Deutsche Bank and Commerzbank Enter Formal Merger Talks

Move marks stark acknowledgment of the pressures both lenders face


Banners of Deutsche Bank and Commerzbank are pictured at the stock exchange in Frankfurt, Germany. **PHOTO:** KAI PFAFFENBACH/REUTERS

*By Jenny Strasburg, Patricia Kowsmann and Bojan Pancevski*

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Deutsche Bank AG DB **-0.34%** ▼ and rival Commerzbank AG CRZBY **1.83%** ▲ on Sunday confirmed they are formally discussing a merger, marking a new phase after years of speculation about the troubled fates of Germany's two biggest banks and a stark acknowledgment of the pressures both lenders face.

Deutsche Bank said the talks are part of a review of "strategic options." The banks have considered a tie-up for years, under different chief executives. But previous talks ended before any formal announcements were made.

A union between the two would be a reluctant marriage. A succession of management teams has tried to right Deutsche Bank, once Europe's most aggressive and globally ambitious major bank. But its performance continues to lag behind competitors and its share price continues to fall. Combining the banks as they look now would produce a German lending giant with a roughly $2 trillion balance sheet and could help address government skepticism about the health of both.

Both banks have spent billions of dollars restructuring, overhauling management and cutting staff, and have tried to remain independent. But both have failed to convince the German government that they can succeed alone. Years of low interest rates and the headwinds of Germany's home market—which lacks the fee-rich spoils that drive U.S. investment-banking profits—have weighed on both lenders.

Many European banks are trading significantly below their book value, with Deutsche Bank and Commerzbank among the furthest, a sign investors doubt management can create value and believe the lenders are hobbled by Europe's sclerotic economy and their own structural deficiencies.

Bankers speculating about how a deal could look say the bigger of the two, Deutsche Bank, could combine its retail-banking business with Commerzbank's to reduce funding costs in Deutsche Bank's bigger investment bank. Unknowns include whether the banks would look to sell pieces of certain businesses, or whether regulators in Europe or the U.S. would push them to do so.

The Wall Street Journal and other media reported earlier this month that the two lenders' chief executives were speaking about a potential deal. The German finance ministry stands ready to support a deal, the Journal reported in January.

German securities laws require companies to disclose publicly information material to investors about potential deals when talks reach a certain threshold, such as formal endorsements by senior bank officials. Deutsche Bank's management board met Sunday morning to discuss various options for the bank, including a potential merger with Commerzbank, people close to Deutsche Bank said.

"There is no certainty that any transaction will occur," Deutsche Bank said in its statement Sunday. The lender said it is focused on improving its "growth profile and profitability." The statement gave no further details aside from confirming Deutsche Bank is in discussions with Commerzbank.

Analysts have said the German government could end up owning roughly 5% of a combined bank. Deutsche Bank has long been seen as having the implicit backing of the German government during difficult times; a stake in a merged bank would connect the two more explicitly.

Investors have been skeptical that the payoffs of a merger would offset the pain, including years of integration work and possible dilution of shareholders. What's more, European banking regulators in private discussions about merger speculation have cautioned that any merged bank would have to adhere to strict stability guidelines.

Two weakened banks, as regulators and investors view Deutsche Bank and Commerzbank, face hurdles to combining technology and managing the costs and headaches of eliminating tens of thousands of jobs.

Both banks sought assurances from government officials that they wouldn't stand in the way of massive job cuts in Germany, however politically painful that might be. Deutsche Bank CEO Christian Sewing has told people close to the bank that he received such assurances.



One question investors have is whether a merger will require fresh capital. It couldn't be determined how any potential deal now being contemplated could affect the banks' capital needs, or whether any capital raise would be necessary.

The nonstop speculation about the two banks' plans created such pressure that Mr. Sewing and other executives have been constantly drilled by clients and investors wondering whether the bank planned to seek a deal. Employees, whose bonuses have suffered along with Deutsche Bank's share price, also have sought to determine what direction the bank is heading. Mr. Sewing privately has insisted for months that he is focused on Deutsche Bank's stand-alone strategy, not a merger.

In a note to employees posted on Deutsche Bank's website, Mr. Sewing said executives have a responsibility to consider options like possible mergers. He asked employees to stay focused on clients, adding that no deal is certain.

"Experience has shown that there may be a lot of potential economic and technical factors that could hinder or prevent such a step," Mr. Sewing wrote.

Until recently, Commerzbank had engaged bankers but they told peers no deal was actively being negotiated. The tone of that message changed in the past week, suggesting talks were on and details being hammered out, according to people close to the Frankfurt-based banks.

The German finance ministry has signaled to the banks that it supports a deal and stands ready to support tens of thousands of job cuts the banks say are necessary for a deal to make economic sense, according to an official close to Finance Minister Olaf Scholz.

Government officials, particularly in the finance ministry, have been concerned about the decline of the country's biggest banks, which has contrasted with rising power among banks in the U.S., China and elsewhere. The idea of creating a "European champion" to compete with stronger foreign institutions in banking and other industries has fueled the finance ministry's support for a merger, according to people involved in government discussions.

Commerzbank is 15% owned by the German government after it received a bailout during the 2008 financial crisis. Since 2016, it has cut staff and narrowed its focus to deposit-taking and commercial lending. It has boosted its customer base and loan volumes to the prized German midsize companies.

But the bank continues to struggle in a highly competitive German market, home to almost 1,600 banks.

Deutsche Bank, which is far more dependent on trading and investment-banking businesses, has lost market share in core areas, ceding business to U.S. banks. Deutsche Bank has struggled with higher funding costs than many rivals, making profits harder to come by.

Deutsche Bank executives privately have said that a combined Commerz-Deutsche Bank would benefit from lower funding costs, using a bigger pool of retail deposits to its advantage.

*—Ben Dummett*
*contributed to this article.*

**Write to** Jenny Strasburg at jenny.strasburg@wsj.com, Patricia Kowsmann at patricia.kowsmann@wsj.com and Bojan Pancevski at bojan.pancevski@wsj.com