

Issuer Comment: Credit Suisse Group

Credit Suisse Group: Earnings Commentary - Third Quarter 2009

Credit Suisse's 3Q09 results held no rating implications. The bank has a B bank financial strength rating (BFSR) and its deposits and senior debt are rated Aa1, while the senior debt of its holding company, Credit Suisse Group, is rated Aa2. The rating outlook for all ratings is negative.

The ratings reflect Credits Suisse's strong capital and liquidity positions, the more stable earnings contribution from its wealth management and corporate and institutional banking businesses, and the significant efforts the bank has undertaken to reduce risk positions and volatility in its investment bank business. The ratings also reflect the bank's very high systemic importance in Switzerland, which provides two notches of uplift from the bank's Aa3 stand-alone baseline credit assessment.

The negative outlook reflects the uncertainties of the current market environment as well as the challenges posed to the rating if the Investment Bank's risk reduction strategy is not successfully sustained. Many of the bank's peers are undertaking similar restructurings. Moody's believes that over the medium term the increased industry-wide focus on more liquid, client-focused businesses (i.e. on "flow") is likely to pressure margins in those businesses. This will pressure industry participants to once again increase their exposures to more capital-intensive, illiquid businesses.

Credit Suisse Group reported 3Q09 consolidated net income of CHF 2.4 billion. Earnings included CHF 93 million in fair value losses (net of hedge) on own debt due to spread tightening; if fair value losses on own debt (and gains in prior quarters) are excluded, pre-tax quarterly results of CHF 2.9 billion (including discontinued operations) were up from second quarter's CHF 2.6 billion as well as first quarter's CHF 2.3 billion. Pre-tax earnings excluding fair value marks on own debt were CHF 2.0 billion in the Investment Bank, CHF 867 million in Private Banking, and CHF 311 million in Asset Management, whereas the Corporate Center suffered a loss of CHF 480 million.

The Investment Bank had CHF 5.3bn of revenues excluding fair value marks on own debt, down from 6.3bn in the second quarter and 6.1bn in the first quarter. While the bank continued to benefit from market share gains in some areas, declining margins, especially in fixed income, as well as seasonal factors contributed to the decline in revenues. These trends are consistent with Moody's view that as competitive pressures increase over the medium term the bank will be challenged to sustain this performance without increasing its risk profile. Management believes that higher volumes and increased market share will help to offset this pressure. Credit Suisse was able to more than offset the decline in IB revenues during the quarter with a reduction in compensation accruals. As a result, the bank's quarterly compensation to revenue ratio declined to 40%. Management explained that its compensation accrual is based on an economic profit model, recognizing the risk adjusted profitability overall and of each business, as well as the industry environment. However, we believe that the sustainability of a lower compensation ratio depends in part on whether the bank's competitors take a similar approach to compensation.

The bank reported that it continued to reduce risk positions during the quarter. Average 1-day VaR (at 99%) in the Investment Bank was down 25% from 2Q and down 44% from a year ago. Similarly, risk-weighted assets in the IB were down 6% and 34%, while total bank-wide risk-weighted assets were down 5% and 28%, over the same time periods. We consider the continued risk reduction to be positive, especially in the face of declining margins.

Private Banking results included CHF 723 million pre-tax in Wealth Management and CHF 144 million pre-tax in Corporate & Institutional Clients. In Wealth Management, net new asset flows were positive. However, profits in Wealth Management remain under some pressure due to lower asset values and reduced customer transaction volumes. In Corporate & Institutional Clients, lower earnings reflect losses on loan portfolio hedges and net interest margin compression. Loan loss provisions were down from the second quarter, although they are still well above last year's levels. While we expect some further deterioration in the corporate loan book in response to weakness in the Swiss economy, given the conservative underwriting in residential and commercial mortgage lending, and the low concentrations in corporate lending in this segment, we expect that any credit deterioration in this segment will be manageable.

Asset Management remains a challenge for Credit Suisse. Much of the segment's profit in the quarter reflected gains on the bank's stake in Aberdeen received as part of the sale of its traditional asset management business. Excluding that gain, the segment had a pre-tax profit of CHF 104 million during the quarter. However, even those results included CHF 42 million in gains on securities previously purchased from money funds, and CHF 97 million in unrealized investment-related gains (in private equity and credit strategies). Excluding such gains, the

business would have reported a pre-tax loss of CHF -35 million. Further work is needed to improve the profitability of the remaining asset management business. As currently structured, profits in this business remain heavily reliant on private equity gains, limiting its earnings stability. The bank's principal investments (including private equity) totaled CHF 3.7 billion at quarter-end.

Credit Suisse's credit profile continues to be supported by a strong capital position. Tier 1 capital ratio ended the quarter at 16.4% (Basel 2), up from 13.3% at year-end 2008 and 10.0% at year-end 2007. However, Credit Suisse's Tier 1 ratio remains heavily reliant on hybrid capital instruments; hybrid capital represented 32.9% of Tier 1 at September 30, 2009, down only slightly from 35% at year-end 2008. At September 30, 2009, Moody's Equity was approximately 12.7% of Basel 2 risk-weighted assets, up from 8.6% at year-end 2008 and 9.8% at year-end 2007. (Moody's Equity consists of tangible common equity before unrealized gains/losses on securities held for sale and cash flow hedges, less tax-effected gains on debt, plus Moody's hybrid equity credit.)

Credit Suisse's liquidity position remains sound. Although the bank's cash position declined modestly during the quarter, short-term borrowings, due to banks, and wholesale CDs also declined. As a result, the bank's cash position equaled approximately 92% of short-term borrowings (including wholesale CDs and due to banks), down from its peak of 118% in the first quarter, but largely unchanged from year-end 2008. At the same time, total liquid assets exceeded total market funds by 6.0% of total assets, up from 5.7% in the second quarter and 4.9% at year-end. Credit Suisse reported a 2.6% reduction in total assets in the quarter, to CHF 1.06 billion, stemming from reductions in its cash position as well as smaller trading and repo books, and expects to report a decline of approximately 5% in its level 3 assets.

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