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ISSUER COMMENT
16 December 2020

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RATINGS

Credit Suisse Group AG

Senior Unsecured (Foreign)	Baa1, Stable

Credit Suisse AG

LT Bank Deposits (Domestic)	Aa3, Stable
LT Issuer Rating	Aa3, Stable
Baseline Credit Assessment	baa1

Source: Moodys.com

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Credit Suisse Group AG

Maintaining positive operating leverage will be key to supporting ongoing earnings resilience

On 15 December, Credit Suisse Group AG (CS, Baa1 stable[1]), the parent holding company of Credit Suisse AG (Aa3/Aa3 stable, baa1[2]), hosted its annual investor day where it announced that it aims to achieve a normalized net return on tangible equity (ROTE) of around 10% in 2021, up from below 8% in 2020, adjusted for one-offs and significant items[3]. We continue to view the bank as being on track to achieving its medium-term target of a 10-12% ROTE over the next two to three years. On 1 December, and reflecting the progress the bank has made in improving its profitability towards guidance levels, we upgraded CS's long-term ratings with a stable outlook.

CS confirms key financial targets, growth ambition centered around wealth management businesses. CS today confirmed its key strategic commitments, aiming to largely preserve current capital levels into 2021 and potentially beyond. Supporting its ROTE target, CS aims to expand its client and product base in wealth management, thereby fostering growth in assets under management and lending volumes. Provided these strategic refinements bear fruit, CS will be in a position to grow its wealth management-related pretax profits to CHF5.0-5.5 billion by 2023, up from approximately CHF4.0 billion in 2020. At the same time, CS expects costs to remain well contained: Operating expenses of CHF16.2-16.5 billion in 2021 are expected to remain flat from an estimated CHF16.5 billion in 2020; and already include planned investments into growth. Lower loan loss charges should also help support CS in achieving its medium-term goals provided the global economies do not deteriorate further.

The bank will maintain its solid capitalization. We estimate CS will be able to maintain a Common Equity Tier (CET1) ratio of above 12% during the 2021-23 period (Q3 2020: 13.0%), during which we would not expect significant further regulatory tightening[4]. In addition, CS kept unchanged its conservative distribution strategy, which we estimate should help it retain about CHF4 billion of core capital over the next two to three years, while delivering constant returns to its shareholders through dividends and share buybacks.

Significant positive structural liquidity and comprehensive liquidity management set to continue. We expect CS to maintain a peer-leading liquidity profile, reflecting a conservative liquidity management that will lead to a Liquidity Coverage Ratio (LCR) of between 180%-200% in 2020 and likely beyond. Moreover, the group's improved total loss-absorbing capacity (TLAC) – and the resulting longer tenure of its debt issuances – have lowered its refinancing risk. If maintained, CS's improved ability to manage funding and liquidity needs across the group will increase its resilience to periods of high volatility or funding market dislocation, as observed during the coronavirus pandemic.

Key investment initiatives focus on stronger controls while maintaining return levels and resource consumption

As part of its second-quarter earnings release, CS already announced various strategic initiatives[5]. To achieve its goals, CS will incur restructuring expenses of CHF300-CHF400 million during Q3 2020 - Q2 2021, and anticipates the measures to yield approximately CHF400-450 million of annual savings from 2022 onwards, of which CS expects to realize CHF250-300 million already in 2021. The savings will be reinvested into the businesses, subject to market conditions. We summarize CS's key growth and return levers below.

1 Grow wealth management pretax income

Wealth management has taken a more prominent role in CS's business mix since it initiated its 2015-18 restructuring program. The businesses, comprised of Asia Pacific (APAC), International Wealth Management (IWM) and the Swiss Universal Bank (SUB), are currently consuming and are expected to continue to consume approximately two thirds of the group's risk-weighted assets and capital deployed to them. Most of the marginal capital generated over the next two to three years will be invested into these businesses.

CS also aims to invest CHF100-150 million of the aforementioned savings into new financial advisors to foster growth in ultra-high net worth (UHNW) and entrepreneur clients over the next two to three years with a particular focus on Asia, as well as broaden its onshore franchises with a particular focus on China. In IWM, CS targets to double the contribution of UHNW clients to revenue growth, also by collaboration with the IB, GTS and its new sustainability hub (see below). This will help it expand its lending relationships with those target clients, and is likely to deepen the share of wallet, driving growth in assets under management and net loans. CS further aims to grow mandate penetration in an effort to sustain and improve margins, as well as leverage on its strong position in private markets and alternatives.

2 Sustain Investment Bank (IB) returns

During the first nine months of this year, CS's newly-formed IB segment delivered an adjusted pretax profit of CHF1.44 billion, up 44% year-over-year, and equivalent to an adjusted return on regulatory capital (RORC) of 14.1%. CS aims to sustain these return levels over the medium-term (10-15% RORC target range), supported by normalizing loan loss charges; an expected recovery in M&A and asset finance capital markets activity; and growth in the bank's integrated global trading solutions business (GTS). Owing to its smaller flow business in fixed income than many of its peers, CS's success is more skewed towards a pick-up in client demand for yield products that it can cross-sell from its wealth management businesses into the IB, and vice versa. At the same time, CS's restructured and reintegrated capital markets businesses effectively reduced revenue volatility, improving earnings predictability.

3 Implementing a sustainability strategy

CS has created a new executive board seat (taken by former chief compliance officer Lydie Hudson) to develop Sustainability, Research & Investment Solutions (SRI) that will cater to the increased client demand for sustainable finance, investment and advisory. CS aims to provide CHF300 billion of sustainable financing over the next ten years, and it has further outlined it will reposition its portfolio to mobilize capital to support clients in transitioning to a sustainability strategy. CS already stated that it intends to limit its exposures to traditional oil and gas businesses as well as restrict lending to thermal coal extraction and coal power; and refrain from financing related to offshore and onshore oil and gas projects in the Arctic region. We consider a strong and well-articulated, as well as culturally-adapted, ESG strategy as key to CS's underlying ambitions in wealth management and related businesses. Being one of the first banks globally firmly enshrining sustainability principles in its processes and aligning those with its financing guidelines and criteria could, if executed successfully, turn out to become a key differentiating factor against competition.

Detailed considerations

CS maintains its key medium-term targets

CS affirmed its key financial targets over the medium-term, including a return on tangible equity of 10-12% (unchanged); a CET1 capital ratio of at least 12.5% during at least the first half of 2021 given the ongoing coronavirus pandemic (was greater than 12% in the medium-term); and a return on regulatory capital (RORC) in its wealth management-related business segments of between 20% and 25% and in its Investment Bank of between 10% and 15%.

Solid capital markets results have lifted CS's returns in 2020, with support from stable wealth management and universal banking businesses and strong operating leverage post restructuring

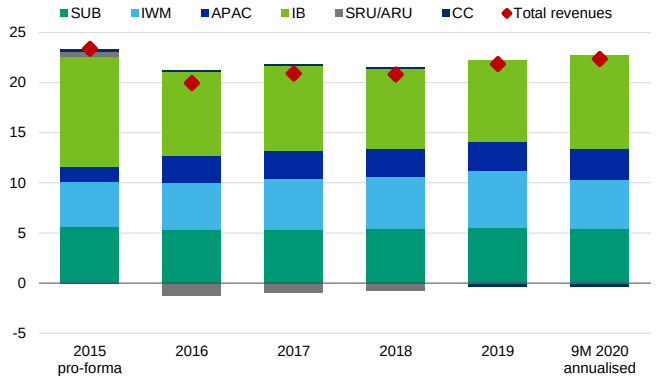
With a 9M 2020 net return on tangible equity (ROTE) already close to the lower end of its medium-term target range of 10-12%, CS is on track to sustain its structurally higher earnings profile and return potential, supporting improved credit strength. Adjusting for the one-time effects burdening the bank's fourth-quarter results, we would expect a full-year 2020 ROTE of around 8%.

The higher return level was achieved because of a 22% decline in operating expenses and flat revenue since CS initiated its restructuring[6] that boosted the operating leverage of the group, substantially improving its loss-absorption capacity and lowering its break-even point (see Exhibits 1 and 2).

Exhibit 1

CS managed to sustain revenue near pre-restructuring levels

Revenue by segment, 2015 - 9M 2020



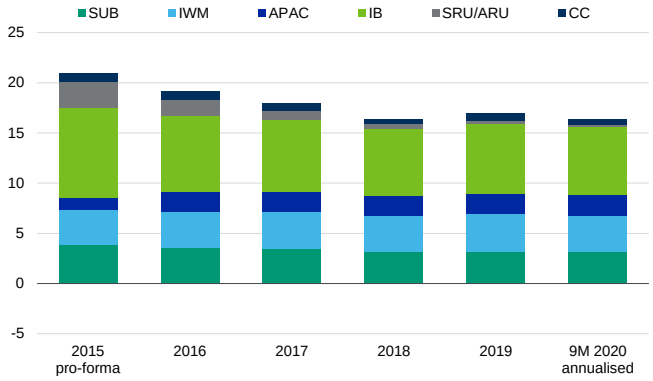
Note: SUB = Swiss Universal Bank, IWM = International Wealth Management, APAC = Asia-Pacific (formerly APAC Wealth Management & Connected), IB = Investment Banking (combines former APAC Markets, Global Markets and Investment Banking & Capital Markets), ARU = Asset Resolution Unit (pre-2019: Strategic Resolution Unit), CC = Corporate Center, excluding ARU. 2015 pro forma APAC represents former APAC Wealth Management & Connected and IB reflects former Global Markets, APAC Markets and Investment Banking & Capital Markets.

Sources: Company reports, Moody's Investors Service

Exhibit 2

The group has sustainably lowered its operating expense base

Operating expenses by segment, 2015 - 9M 2020



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Sources: Company reports, Moody's Investors Service

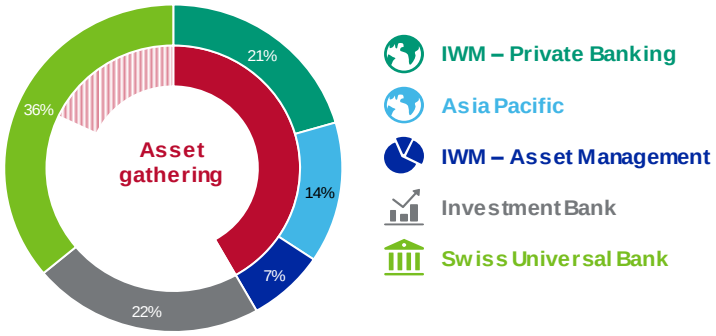
However, sustaining earnings resilience will be harder for CS in more adverse market conditions. Significant revenue risk arises from the bank's capital markets franchise, which even at reduced size continues to rely on healthy fixed income and equity markets, in particular solid client activity for yield products in debt capital markets and leveraged finance markets.

At the same time, the increased proportion of earnings generated from the group's asset and wealth management businesses, as well as its Swiss universal banking businesses, provide adequate loss absorption capacity to mitigate the risks and the inherently greater earnings volatility of the group's capital markets businesses (Exhibit 3). This is likely to continue to support the sustained stability of the group's profitability and capital position even under more adverse market conditions.

Exhibit 3

Asset-gathering and Swiss universal banking businesses help offset capital markets-related earnings volatility

Cumulative pretax profit by segment (2017- 9M 2020)



Note: Excludes Corporate Center. The Swiss Universal Bank also generates a meaningful part of its pretax profit from CS's Swiss private banking (asset-gathering) business.
Sources: Credit Suisse Group AG and Moody's Investors Service estimates

CS will maintain its solid capitalization

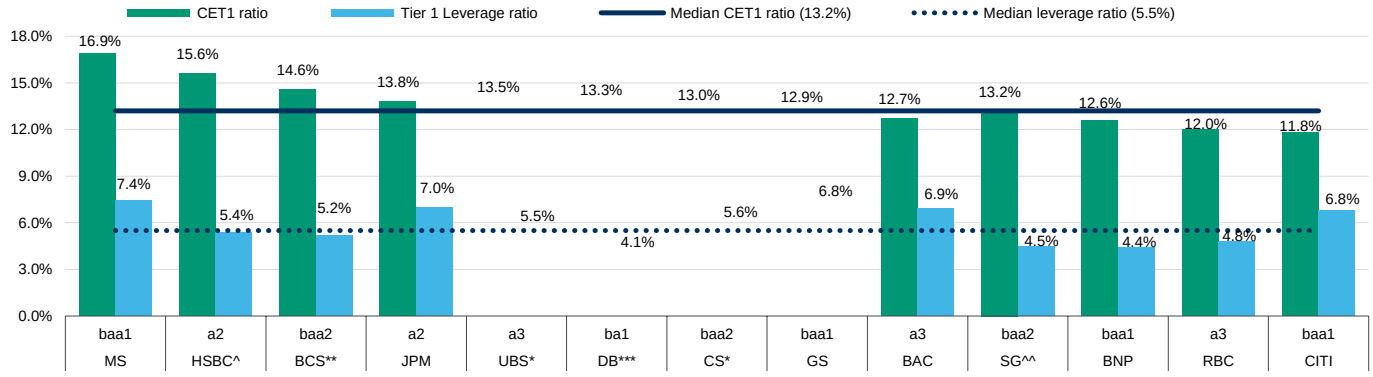
Credit Suisse improved its CET1 capital ratio to 13.0% during the third quarter (Exhibit 4), benefitting from earnings retention and lower risk-weighted assets (declining 5% sequentially to CHF285 billion as of 30 September 2020). We expect these ratios, as well as our Tangible Common Equity (TCE[7]) ratio to be maintained around their current levels, despite the anticipated temporary effects from the coronavirus-related government support programs and moderate underlying business growth.

To preserve capital in 2020, CS has split its 2019 dividend payment (a total of CHF719 million) into two parts paid in May and December this year. Its 2020 share buyback program has also been put on hold. With its third-quarter results on 29 October 2020 – and reiterated at its Investor Day on 15 December 2020 – CS announced that it intends recommencing share buybacks of at least CHF1.0 billion of up to CHF1.5 billion as early as January 2021.

Exhibit 4

Credit Suisse's CET1 and Tier 1 leverage ratios remained stable around the median of Moody's-rated GIBs

Common Equity Tier 1 (CET1) and Tier 1 leverage ratios, as of 30 September 2020



Notes: (1) Basel III fully phased in advanced approach for all US banks; (2) Tier 1 leverage ratio for US banks is the supplemental leverage ratio (SLR).
*UBS and CS leverage ratios reflect Common Equity Tier plus Low Trigger Additional Tier 1 and High-Trigger Additional Tier 1 securities. For the computation of the leverage ratio, the Swiss regulator allowed for a temporary exclusion of cash at central banks until 01 January 2021. The ratios shown here do not include this benefit.
**Barclays (BCS) leverage is reflective of the spot UK leverage ratio.
***DB Q3 2020 leverage exposure includes certain central bank balances ("Euro-based exposures facing Eurosystem central banks") that could normally be excluded following the European Central Bank's decision (EU) 2020/1306 until 27 June 2021. Excluding these items, DB's leverage ratio would have been 4.4%.
^HSBC's Q3 2020 leverage exposure already excludes the aforementioned items since the bank did not provide sufficient disclosures to perform a similar adjustment.
^^For SG the reported CET1 ratio was 13.1% at the end of September, but reaches 13.2% on a pro-forma basis, taking into consideration the announced disposals (+10 basis points).
Sources: Companies' results presentations and financials, Moody's Investors Service

The group's total loss-absorbing capacity (TLAC) also remained strong at CHF96.4 billion as of the end of the third quarter (Q3 2019: CHF95.2 billion), corresponding to a TLAC ratio of 33.7%, well above the 2020 regulatory requirement of 28.6%. At the same time, leverage exposures – including CHF110 billion of cash held at central banks – rose to CHF934 billion from CHF921 billion in Q3 2019.

Significant positive structural liquidity and comprehensive liquidity management

CS's pool of liquid assets largely consists of cash deposits with central banks, unencumbered government securities, and other highly-rated non-sovereign obligations. We expect Credit Suisse to maintain its strong liquidity position, further benefitting from having prepositioned additional high-quality liquid assets (HQLA) with the Swiss National Bank, that - in conjunction with its high cash on balance sheet and some contingent liquidity through mortgage loans - will also act as an additional buffer in times of potential stress.

We believe that maintaining above-average liquidity as well as capital ratios is important in light of the bank's larger global wealth management franchise, where deposits may be more confidence sensitive than traditional retail deposit funding, and may thus expose the bank to potential liquidity stresses in an adverse scenario, for instance a material capital markets event. In addition, we believe that an extended period without access to wholesale funding would still require significant balance sheet shrinkage that could impair earnings and franchise value. CS is also exposed to sizeable contingent liquidity obligations related to its capital market activities that are not captured quantitatively in our initial liquidity and funding ratios.

Moody's related publications

Rating actions

» Moody's upgrades Credit Suisse's ratings with a stable outlook, affirms UBS, December 2020

Credit Opinion

» Credit Suisse Group AG - Update following rating upgrade, December 2020

Credit Suisse results commentaries

» Credit Suisse Group AG - Q3 2020: Continued positive operating leverage supports earnings resilience

» Credit Suisse Group AG - Q2 2020: Strong capital markets businesses more than offset coronavirus disruption

» Credit Suisse Group AG - Q1 2020: Solid wealth management and Swiss businesses help offset coronavirus reserve builds

GIB Outlook

» Global Investment Banks - 2021 Outlook, December 2020

Issuer & Sector In-Depth

» Credit Suisse AG and UBS AG - Both large Swiss banks have built credit-positive bases of shock-absorbing earnings, with UBS on firmer footing, December 2020

» Global Investment Banks – Europe: Q3 2020 Update - Robust investment banking, lower loan loss charges support profit and capital, November 2020

» Global Investment Banks – US: Q3 2020 Update - Capital rises and provisions drop, improving peers' resilience amid economic uncertainty, October 2020

» IBOR phaseout 15 months away, but hurdles could stretch beyond finish line, September 2020

» Biggest banks are better set to withstand COVID-19 stress than banks as a whole, September 2020

» Stable wealth-management arms of largest Swiss and US banks are a credit positive offset to COVID-19 disruption, September 2020

» Global investment banks' strong liquidity helps insulate creditors, May 2020

» Global Investment Banks: Estimated profit hit in coronavirus shock scenario should not take toll on capital, April 2020

» Fintech: GIBs can keep pace with fintechs, but retail banking is most at risk of a digital divide, February 2020

» GIBs heighten readiness against constant cyber threat, October 2019

» Sector stratification will relegate some from top flight of capital markets competition, September 2019

» Global Investment Banks - GIBs generally prepared for stress in leveraged lending; degree of impact varies, May 2019

Rating methodology

» Banks Methodology, November 2019

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

Endnotes

1 The rating shown is Credit Suisse Group AG's long-term senior unsecured debt rating and outlook.

2 The ratings shown are Credit Suisse AG's long-term deposit rating and senior unsecured debt ratings together with their corresponding outlooks, as well as its Baseline Credit Assessment (BCA).

3 This is derived from the current 2020 consensus and excludes the announced one-off impairment charges on York Capital as well as additional RMBS-related litigation charges to be booked in Q4 2020. It also excludes the pretax impact of the CHF268 million gain related to the second tranche of the InvestLab transfer in Q1 2020 and a CHF134 million from the gain related to Pfandbriefbank in Q2 2020.

4 In 2020, Switzerland implemented regulation on the measurement of counterparty credit risk, the so-called SA-CCR, in advance of all other jurisdictions globally. As a result, and also driven by additional measures from the phase-in of Basel 3 reforms, CS risk-weighted assets will increase by approximately CHF12 billion during 2020.

5 See our second-quarter earnings commentary for details. A key structural improvement was the formation of one global Investment Bank (IB) segment, operating on one platform and combining International Trading Solutions (ITS) with its Asian equivalent (APAC Solutions) – creating Global Trading Solutions (GTS) – as well as creating a fully integrated global Equities platform. CS will also combine its previously more fragmented and regionally-oriented origination and execution capabilities.

6 As of 9M 2020.

7 In addition to the CET1 capital ratio, our TCE capital ratio includes going-concern capital instruments such as high-trigger additional Tier 1 (AT1) capital notes.

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