MOODY'S
INVESTORS SERVICE

ISSUER COMMENT
23 April 2020

Rate this Research

Contacts

Michael Rohr +49.69.70730.901
Senior Vice President
michael.rohr@moodys.com

Mark C Jenkinson +44.20.7772.5432
Associate Analyst
mark.jenkinson@moodys.com

David Fanger +1.212.553.4342
Senior Vice President
david.fanger@moodys.com

Laurie Mayers +44.20.7772.5582
Associate Managing Director
laurie.mayers@moodys.com

Ana Arsov +1.212.553.3763
MD-Financial Institutions
ana.arsov@moodys.com

Credit Suisse Group AG

Solid wealth management and Swiss businesses help offset coronavirus reserve builds

In Q1 2020[1], Credit Suisse Group AG (CS, Baa2 positive[2]), the parent holding company of Credit Suisse AG (A1 positive/A1 positive, baa2[3]) reported[4] adjusted pretax profits of CHF933 million[5], which we estimate to equate to a net profit of CHF700 million, down 13%[6] from the prior-year result.

The underlying decrease in earnings (excluding CHF268 million of one-time gains) is largely attributable to the economic and market stresses caused by the coronavirus pandemic. The magnitude of CS's reduced earnings, however, compares favorably with many of its US peers, reflecting CS's favourable business mix and lower exposure to unsecured lending and sectors most affected by the pandemic. The net return on tangible equity (ROTE) - excluding one-time gains - stood at 7.0% (Q1 2019: 7.8%), while the similarly adjusted annualized return on assets (RoA) stood at 0.34% (Q1 2019: 0.38%).

The rapid global spread of the coronavirus coupled with more volatile oil prices has led to a deteriorating economic outlook and broad financial market upheaval. Reported net income of CHF1.3 billion digested reserve builds totaling CHF1.0 billion, comprised of CHF376 million of estimated life-of-loan losses from first-time adoption effects related to the Current Expected Credit Losses (CECL) framework that became effective on 1 January 2020; CHF209 million of additional loan loss provisions; and CHF444 million in markdowns on loans and underwriting commitments recorded at fair value.

Operating leverage improved. CS reported an underlying 3% revenue growth year-over-year, as solid revenues from CS's universal banking and wealth management businesses[7] were supported by revenue growth in the group's capital markets-related businesses[8], where strong fixed income sales and trading revenues offset an expectedly weak performance in primary revenues. At the same time, total adjusted operating expenses decreased 5% to their lowest level recorded since 2015.

Capital metrics only erode slightly. CS reported a BIS fully-applied Common Equity Tier 1 (CET1) capital ratio of 12.1% in the quarter, down 50 basis points year-over-year (see Exhibit 1 overleaf). Higher risk-weighted assets (+4% year-over-year), lower retained earnings and CHF325 million of share repurchases up to 13 March 2020[9] put some strain on the bank's CET1 ratio, although it was maintained close to the group's prior 12.5% target level. Management guided towards a CET1 ratio of around 11.5% for the remainder of the year, reflecting expected RWA inflation as well as regulatory measures. CS further reported an improved 4.2% CET1 leverage ratio and 5.8% Tier 1 leverage ratio[10] (Q1 2019: 4.1% and 5.2%, respectively).

Detailed considerations

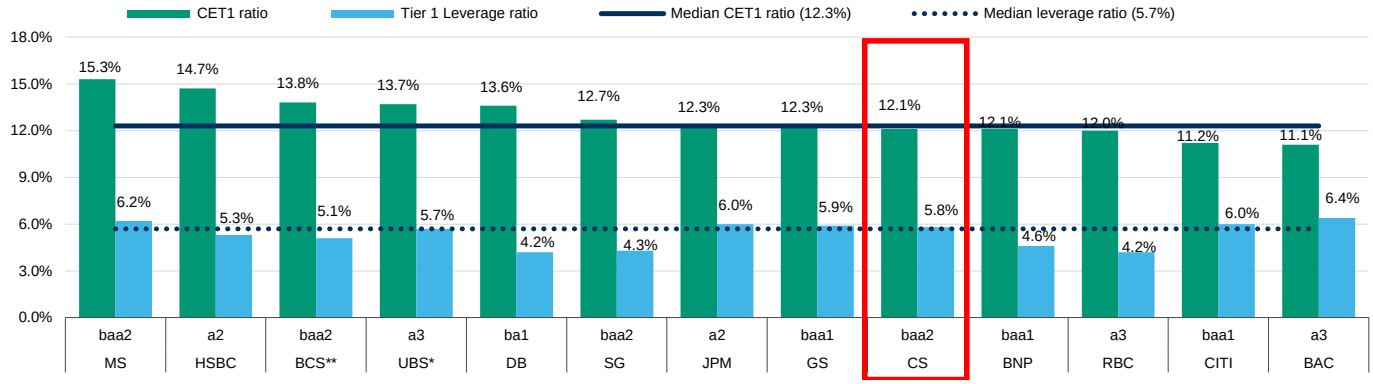
Credit Suisse largely maintained its CET1 risk-based capital ratios during the quarter (Exhibit 1). Crisis-response programs being implemented by the Federal Reserve and US Treasury, the European Central Bank and the Swiss National Bank, among others, are helping contain the economic fallout and will collectively reduce risks to CS and other financial institutions.

Our global investment banks' (GIB) coronavirus profitability shock scenario analysis indicates that the GIBs are reasonably well-placed to weather a profitability-shock scenario in 2020; and our latest global macro outlook suggests that although the G-20 economies will experience an unprecedented shock in the first half of this year and will contract in 2020 as a whole, they will pick-up in 2021. However, should economic conditions not improve toward the end of 2020 and into 2021, the shock to CS's and its peers' profitability and overall creditworthiness would likely be more pronounced. We continue to closely monitor developments, and note that the economic and market environment remains distinguished by a tremendous level of uncertainty, with the balance of risk tilted firmly to the downside.

As the coronavirus pandemic unfolds, CS and its peers will face a delicate act to balance earnings pressures, customer forbearance and efforts to support the economy while maintaining strength in capital and liquidity. We see CS entering this period from a position of strength. CS also announced measures to preserve its capital by splitting its 2019 dividend payment (a total of CHF678 million) into two parts to be paid in May and autumn this year, with the second cash distribution being subject to market and economic conditions.

Exhibit 1

Common Equity Tier 1 (CET1) ratios and Tier 1 leverage ratios for Global Investment Banks, as of 31 March 2020



Notes: (1) As of Q4 2019 for Barclays plc, BNP Paribas, Deutsche Bank AG, HSBC Holdings plc, Société Générale and UBS Group AG; Q1 2020 for the rest; (2) Basel III fully phased in advanced approach for all US banks; (3) Tier 1 leverage ratio for US banks is the supplemental leverage ratio (SLR).
*UBS and CS leverage ratio reflect Common Equity Tier plus Low Trigger Additional Tier 1 and High-Trigger Additional Tier 1 securities.
**Barclays leverage is reflective of the spot UK leverage ratio.
Sources: Companies' results presentations and financials, Moody's Investors Service

Strong balance sheet liquidity maintained

CS reported a strong Liquidity Coverage Ratio (LCR) of 182% in Q1 2020, a slight decline from Q1 2019 (191%). The ratio continues to display CS's conservative management of liquidity as well as its superior liquidity profile. The group's total loss-absorbing capacity (TLAC) improved to CHF92.9 billion as of the end of the first quarter (Q1 2019: CHF86.4 billion), corresponding to a TLAC ratio of 30.8%, well above the 2020 regulatory requirement of 28.6%. At the same time, leverage exposures – including CHF88 billion of cash held at central banks – rose to CHF958 billion from CHF902 billion in Q1 2019.

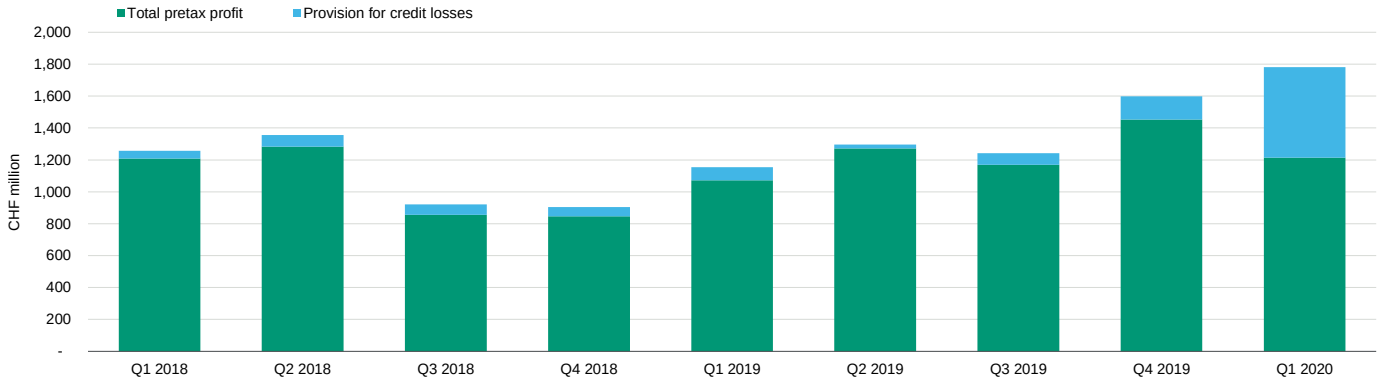
Higher provisions pinch profits

As the coronavirus outbreak became a pandemic, the deteriorating economic outlook and broad financial market distress led to a sharp rise in provisions for credit losses within CS's consumer and wholesale loan portfolios. The bank's adoption of the CECL framework on 1 January 2020 resulted in so-called Day-One increases to loan loss reserves on the implementation date. Under CECL, the sudden effects of the coronavirus pandemic required new life-of-loan loss estimates and led to meaningful provision increases (light blue bar in Exhibit 2). Nonetheless, core pre-provision profitability for Q1 2020 was fairly resilient to the pandemic's negative economic shock.

Exhibit 2

Coronavirus-related reserve builds prevent strongest quarterly result post restructuring

Adjusted pretax profits and loan loss provisions, CHF million



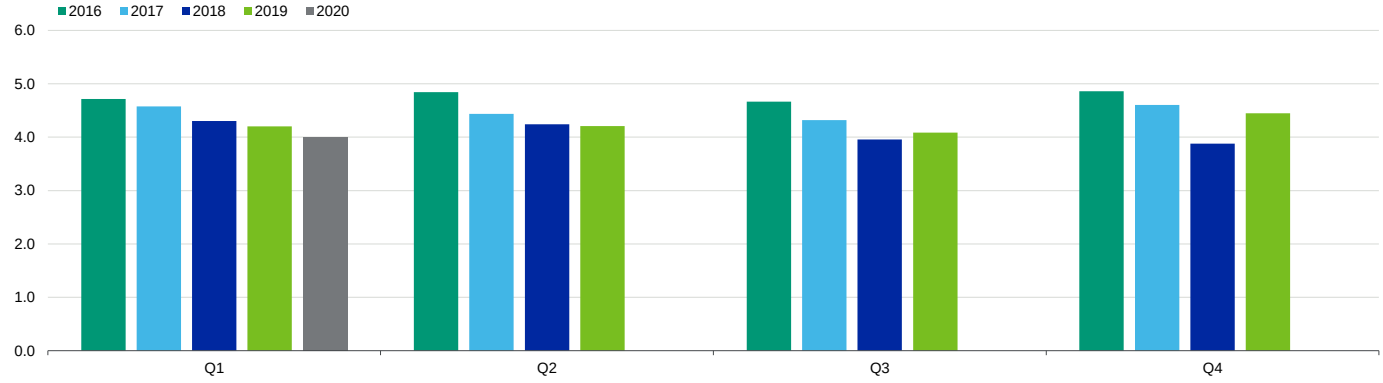
Sources: Company financials, Moody's Investors Service

Pressure on pre-provision profitability is very likely to increase during the remainder of the year as the full effect of the economic shock unfolds and client-driven trading revenue normalizes. In this regard, CS's structurally lower - and further reduced - cost base post restructuring will help shield some of its earnings against the market-induced revenue strain; and CS will likely continue using additional flexibility in its cost base (Exhibit 3) as explained on its 2019 Investor Day to further mitigate coronavirus-related effects on its earnings. During its Q1 2020 earnings call, CS guided towards total adjusted costs of around CHF16.0 billion for full year 2020, even slightly below the low end of the range provided at its Investor Day.

Exhibit 3

Additional flexibility in CS's cost base helps mitigate revenue challenges

Adjusted operating expenses, CHF billion



Sources: Company financials, Moody's Investors Service

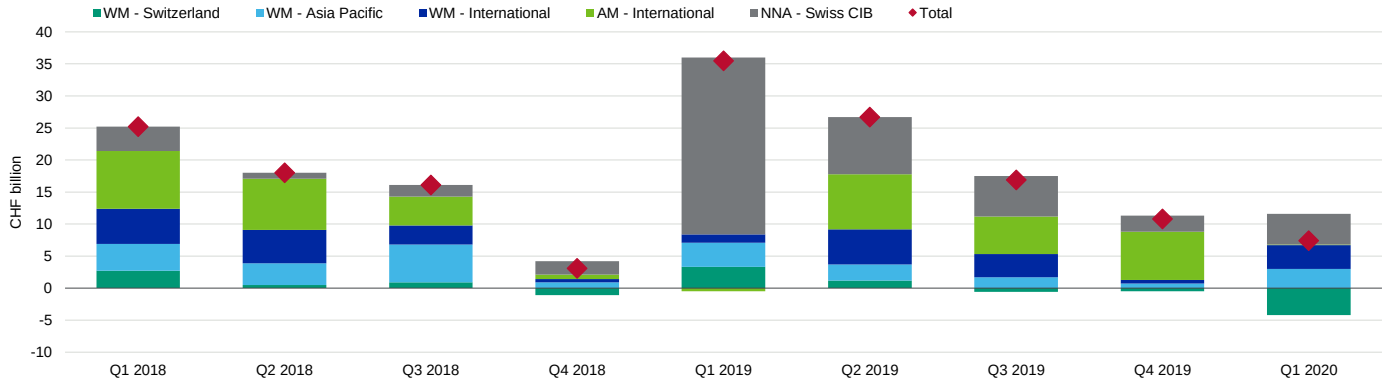
Net new money flows in CS's wealth and asset management businesses stay positive amid clients' de-risking

During the first quarter, CS's wealth and asset management businesses combined recorded net new money inflows of CHF7.4 billion, equivalent to a 2% annualised growth rate over year-end 2019 total AuM (Exhibit 4). Outflows in Swiss Private Banking (CHF4.2 billion) reflect one single low-margin outflow in the ultra-high net worth client segment. All other subsegments and regions recorded net inflows, again speaking to the strength and resilience of CS's underlying global asset and wealth management franchise.

Exhibit 4

Net new asset generation stays positive despite market slump

Net New Assets (NNA) by region, CHF billion



Notes: Excluding former Strategic Resolution Unit and not adjusted for assets managed across businesses (double-counting). WM: Wealth Management (Private Banking), AM: Asset Management, Swiss CIB: Swiss Corporate and Institutional Banking

Sources: Company financials, Moody's Investors Service

Segmental results commentary

Unless indicated otherwise, figures displayed below are on a CS adjusted basis and comparisons are made versus Q1 2019.

Swiss Universal Bank (SUB) reported adjusted pretax profits of CHF589 million, up 7% year-over-year, including a CHF25 million gain generated by the transfer of the InvestLab fund platform to Allfunds Group. Excluding the transfer, adjusted pretax profits improved 3%. Adjusted net revenues increased 10% year-over-year (excluding one time gains in Q1 2019 and Q1 2020), largely due to higher client activity positively affecting transaction-based income, as well as higher net interest and commission income. Adjusted operating expenses remained virtually flat. Assets under management (AuM) across the SUB franchise fell 1% year-over-year to CHF600 billion, and dropped 8% sequentially, largely reflective of the market turmoil caused by the coronavirus outbreak.

International Wealth Management (IWM) reported adjusted pretax profits of CHF537 million, up 3% year-over-year, including a CHF218 million gain generated by the transfer of the InvestLab fund platform and negatively affected by CHF101 million of unrealized losses on fund investments in Asset Management. Excluding the transfer gain, adjusted pretax profits declined 39%.

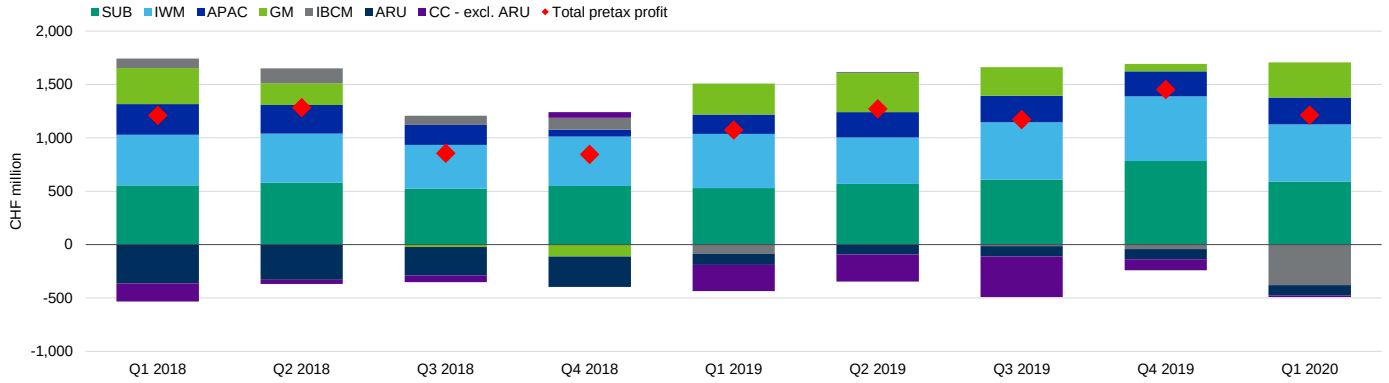
Within IWM, Private Banking adjusted pretax profits (excluding the aforementioned gain) declined 10% to CHF360 million. Adjusted net revenues increased 3% to CHF1,046 million, largely driven by higher transaction-based revenues. Asset Management recorded a pretax loss of CHF41 million, excluding CHF203 million of InvestLab gains and digesting CHF101 million of losses on fund investments.

IWM saw net new asset (NNA) inflows of CHF3.7 billion in Private Banking, primarily from ultra high net worth clients in emerging markets and Europe.

Exhibit 5

Stable businesses delivered as investment bank records a loss in Q1 2020

Credit Suisse Group's adjusted profit before tax by segment, CHF million



Notes: SUB: Swiss Universal Bank, IWM: International Wealth Management, APAC: Asia Pacific, GM: Global Markets; IBCM: Investment Banking and Capital Markets, ARU: Asset Resolution Unit (pre-2019: SRU or Strategic Resolution Unit), CC: Corporate Center.
Beginning in 2019, the Strategic Resolution Unit has ceased to exist as a separate division of the Group. The residual portfolio remaining as of December 31, 2018 is now managed in an Asset Resolution Unit and is separately disclosed within the Corporate Center.
Sources: Company results presentations and financials, Moody's Investors Service

In **Asia Pacific (APAC)**, revenue grew 20% year-over-year while adjusted operating expenses only increased 3%. As a result, the segment reported a 38% increase in adjusted pretax profits to CHF252 million in the quarter, including a CHF25 million InvestLab-related gain. Excluding the transfer, adjusted pretax profits were up 24% from CHF183 million in Q1 2019. APAC Wealth Management & Connected (WM&C) pretax profits fell 50% to CHF85 million (minus 65% excluding InvestLab), largely owing to a significant increase in provisions for credit losses primarily related to a single loss on a share-backed client loan. Moreover, revenues from advisory and financing dropped 78%, taking account of unrealized mark-to-market losses. Transaction-based revenues continued to perform strongly (+67%). Combined with higher net interest income (+18%), this helped more than offset the 7% decline in recurring fee revenues. In APAC Markets, significantly higher fixed income sales & trading revenue (+133%) and equity sales & trading activities (+19%) contributed to a good segment performance.

Global Markets (GM) reported an adjusted pretax profit of CHF328 million in Q1 2020, up from a pretax loss of CHF290 million in Q1 2019. Net revenues increased 11%, while operating expenses declined 2%. Revenue increases were driven by an increase in fixed income sales and trading revenue (+14% in US$ terms), equity sales and trading (+25% in US$ terms), driven by high levels of volatility and trading volumes, and higher underwriting revenues (23% in US$ terms).

Investment Banking and Capital Markets (IBCM) reported an adjusted pretax loss of CHF380 million in the quarter, compared with a CHF86 million loss in the prior-year quarter. The result was driven by a weaker revenue from debt underwriting (-113% in US$ terms), which could not be offset by higher advisory revenues (+12% in US$ terms) and an equity capital markets revenue improvement (+10% in US$ terms). The increase in advisory revenue largely reflects an increase in completed M&A transactions. The decrease in debt underwriting included mark-to-market losses of $147 million on its leveraged finance portfolio and $73 million on hedges. Excluding mark-to-market losses, debt underwriting revenues were stable.

Overall, CS performed below its US peers in combined (as reported in Global Markets and APAC Markets) fixed income sales&trading (+26% year-over-year in US$ terms), but in-line with its peers in combined equity sales&trading (+24% in US$ terms) and above most of its peers in advisory (+12% in US$ terms, excluding APAC). The combined underwriting performance (-84% in US$ terms) was below US peers, although in-line when excluding the mark-to-market losses.

The **Corporate Center**, excluding the **Asset Resolution Unit (ARU)**[11], reported a pretax loss of CHF14 million (incl. ARU CHF112 million). The negative effects from own credit spread movements related to volatility in the mark-to-market valuation of structured notes surrounding COVID-19 and central bank stimulus announcements resulted in a negative treasury result of CHF49 million for the quarter.

Moody's related publications

Credit Opinion

» Credit Suisse Group AG, December 2019

Issuer Comments and In-Depth Reports

» Global Investment Banks – US: Q1 2020 Update: Early effects of coronavirus pandemic pinch first quarter profits at US GIBs, April 2020

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

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

» Outlook for Global Investment Banks Is 'Stable' in 2020, Despite Economic Vulnerabilities, January 2020

» Credit Suisse Group AG: Lower break-even point and sustained execution are likely to support rising returns into 2020, December 2019

» Credit Suisse Group AG: Restructured businesses will be more sustainably profitable and have an improved funding profile, December 2019

» 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

» Global Investment Banks - Readying for Brexit, deal or no deal, January 2019

» Fintech: Most GIBs have means to meet the digital threat, but need agile strategies to respond, November 2018

» Credit Suisse and UBS: Swiss TLAC Regulation Drives Issuance of Loss-Absorbing Debt, Increasing Protection for Senior Creditors, December 2016

Rating Action

» Moody's affirms Credit Suisse AG's A1 senior unsecured debt and deposit ratings; outlook changed to positive, December 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 All figures in this report relate to Q1 2020 and comparisons are made to Q1 2019, unless otherwise indicated.

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

3 The ratings shown are Credit Suisse AG's long-term deposit rating and outlook, its long-term senior unsecured debt rating and outlook and its Baseline Credit Assessment (BCA).

4 Unless indicated otherwise, figures displayed in this report are on a Credit Suisse Group AG adjusted basis.

5 Excluding CHF268 million of gains from the InvestLab sale.

6 This assumes a 25% tax rate on CS's 'adjusted' pretax income, excluding CHF268 million of gains from the InvestLab sale.

7 These are the Swiss Universal Bank, International Wealth Management and Asia Pacific Wealth Management & Connected.

8 Including Asia Pacific Markets, Global Markets and Investment Banking & Capital Markets.

9 Share buyback has been put on hold until at least the this quarter of this year.

10 Excludes CHF88 billion of cash held at central banks as per the temporary exclusion of these amounts by the Swiss regulator for the computation of the leverage ratio. Ratio would be 5.3% if including.

11 Beginning in 2019, the Strategic Resolution Unit has ceased to exist as a separate division of the Group. The residual portfolio remaining as of 31 December 2018 is now managed in an Asset Resolution Unit and is separately disclosed within the Corporate Center.

REPORT NUMBER 1224194

MOODY'S
INVESTORS SERVICE