FITCH DOWNGRADES CREDIT SUISSE GROUP TO 'A-'; AFFIRMS CREDIT SUISSE AG

Fitch Ratings-London-24 May 2016: Fitch Ratings has downgraded Credit Suisse Group AG's (CSGAG) Long-Term Issuer Default Rating (Long-Term IDR) to 'A-' from 'A' and affirmed Credit Suisse AG's (Credit Suisse) Long-Term IDR at 'A'. The Viability Ratings (VR) of both Credit Suisse and CSGAG have been downgraded to 'a-' from 'a'.

The Outlook on Credit Suisse's Long-Term IDR has been revised to Stable from Positive. CSGAG's Long-Term IDR Outlook remains Stable. A full list of rating actions is available at the end of this rating action commentary.

KEY RATING DRIVERS

VR, IDRs and Senior Debt

Credit Suisse:
The downgrade of Credit Suisse's VR reflects vulnerabilities in the business model to challenging capital markets as demonstrated by losses recorded for the two quarters since the group was recapitalised. The group's business will remain weighted towards capital markets and is more vulnerable to developments in these than most banks with VRs in the 'a' category. We expect execution of strategic restructuring to remain more challenged by prevailing unfavourable fixed income and equities capital markets than was the case when it was announced in October last year, particularly in Europe and Asia. A slowdown in Asia Pacific (APAC) economic growth will also add negative pressure to the targeted business model, although the group successfully accumulated CHF4.3bn net new assets in APAC in 1Q16.

The Global Markets (GM) division's securitised trading and leveraged finance franchises have negatively impacted group results and organic capital generation significantly for three consecutive quarters. The group booked CHF1,076m mark-to-market losses in 4Q15 and 1Q16, predominantly related to securitised products, distressed credit, and certain underwriting positions in the corporate bank and leveraged finance. Total revenue in the group's securities businesses (GM, Investment Banking and Capital Markets (IBCM) and the APAC divisions) was 24% lower year-on-year in 2H15 and 46% lower yoy in 1Q16 and accounted for 50% of group revenue, excluding the Strategic Resolution Unit (SRU).

The announced exit from distressed credit and European securitised trading and sharp reduction in these exposures in 4Q15 and 1Q16 should help to improve earnings resilience. The strategy of growing APAC wealth management is showing signs of success. However, we expect performance in 2016 to remain challenged by a combination of subdued client activity in debt and equity capital markets, larger-than-expected restructuring costs (CHF1bn in 2016, in addition to between CHF0.7bn and CHF1.2bn in planned costs to achieve savings between 2016 and 2018) and an initially significant drag from activities earmarked for wind-down and booked in the SRU.

The bank's strategy to reduce fixed costs and capital consumption in capital markets businesses and discontinuing selected activities should improve earnings stability in the medium term. The acceleration of the group's restructuring efforts announced on 23 March 2016 highlights the need for capital and cost efficiency in challenging market conditions. The group targets CHF3bn net cost reduction by end-2018, CHF1bn higher than initially planned. We believe this is achievable, with

the bulk of gross savings coming from the wind-down of the SRU and larger-than-expected cost reductions in GM, including workforce reductions and platform rationalisation.

Escalated deleveraging has enabled capitalisation to remain stable despite booking losses. The group's capitalisation and leverage is in line with global trading and universal bank peers, including its new target Common Equity Tier 1 (CET1) ratio of 11%-12% for 2016. However, notable double leverage at the legal entity Credit Suisse (the parent bank) puts its capitalisation behind its peer group. Under revised Swiss 'too-big-to-fail' proposals, the group will have to meet gone-concern capital requirements equivalent to its total going-concern capital requirements (5% of leverage exposure and 14.3% of risk-weighted assets (RWAs)). We expect the group to reach its 3.5%-4% CET1 leverage target by 2017 (3.3% at end-March), and to comfortably reach its gone-concern requirements by issuing a further CHF30bn in total loss-absorbing capacity (TLAC) eligible holding company senior debt or lower Tier 2 instruments by end-2019.

Credit Suisse's VR also reflects Fitch's view that risk controls are sound, despite publicity around poorly communicated distressed debt positions. Domestic asset quality is strong, and the funding and sound liquidity profile remains solid. As with peers, we expect conduct and litigation risk to continue to represent material contingent liabilities for the foreseeable future, although expected settlement of US mortgage matters during 2016 should remove much of the uncertainty.

Credit Suisse's IDRs and senior debt ratings are one notch above the bank's VR because we believe that the risk of default on senior obligations, as measured by the Long-Term IDR, is lower than the risk of the bank failing, as measured by its VR.

The one-notch uplift for the Long-Term IDR above the VR reflects further increase in the bank's buffer of qualifying junior debt (QJD) combined with senior debt at the holding company. These buffers could be made available to protect Credit Suisse's senior obligations from default in case of failure, either under a resolution process or as part of a private sector solution (such as a distressed debt exchange) to avoid a resolution action. As a result, the Outlook on the Long-Term IDR has been revised to Stable, following the application of the uplift previously envisaged in the Positive Outlook.

Absent such a private sector solution, we would expect a resolution action being taken on Credit Suisse when it comes close to breaching minimum capital requirements. Currently, we assume this to be at a CET1 ratio of no lower than 6% (after high-trigger capital instruments but before low-trigger capital instruments have been triggered). We then assume that the regulator would require Credit Suisse to be recapitalised to a CET1 ratio of above 14.3%. This assumes a restoration of its 10% minimum CET1 ratio as well as its 4.3% Tier 1 high-trigger capital buffer (since the bank post-resolution action would not be in a position to issue capital instruments in the market).

Our view of the regulatory intervention point and post-resolution capital needs taken together suggest a junior debt buffer above 9% of RWAs could be required to restore viability without hitting senior creditors.

Between March 2015 and April 2016 CSGAG issued around CHF19.5bn of senior TLAC, which was downstreamed on a subordinated basis to Credit Suisse's London branch. Together with existing subordinated debt (excluding legacy subordinated debt likely to be called), the total buffer amounted to 13% of RWAs. We believe the revised Swiss going- and gone-concern capital requirements provide strong and transparent incentives to ensure that these buffers remain in place.

CSGAG:
CSGAG's VR is equalised with that of Credit Suisse, which accounts for 98% of CSGAG's consolidated assets, reflecting its almost exclusive role as Credit Suisse's holding company. Double

leverage at CSGAG (106% at end-2016 according to our calculation) is below the maximum 120% threshold, where we would usually notch the holding company ratings down.

CSGAG's Long-Term IDR and senior debt rating are one notch below Credit Suisse's, because the quantum of qualifying junior debt available as a buffer for holding company senior creditors is insufficient to warrant a one-notch uplift, and we do not expect it to become sufficiently large given the single-point-of-entry resolution strategy focussed on building up TLAC in the form of senior holding company debt.

In line with the downgrade of the Long-Term IDR, CSGAG's Short-Term IDR has been downgraded to 'F2' from 'F1', which is the lower of two options mapping to a Long-Term IDR of 'A-' because group liquidity is managed and retained at Credit Suisse level rather than at CSGAG.

TLAC-eligible senior unsecured debt issued by Credit Suisse Group Funding (Guernsey) Limited and guaranteed by CSGAG is rated in line with the guarantor's Long-Term IDR.

SUPPORT RATINGS AND SUPPORT RATING FLOORS

Credit Suisse and CSGAG:
CSGAG's and Credit Suisse's Support Ratings (SR) and Support Rating Floors (SRF) reflect our view that senior creditors of both the holding and the operating banks can no longer rely on receiving full extraordinary support from the sovereign in the event that Credit Suisse becomes non-viable largely due to progress made in Swiss legislation and regulation to address the 'too big to fail' problem for the two big Swiss banks.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

Subordinated debt and other hybrid securities issued by Credit Suisse, CSGAG and by various issuing vehicles are all notched down from Credit Suisse's and CSGAG's VRs in accordance with Fitch's assessment of each instrument's respective non-performance and relative loss severity risk profiles, which vary considerably. They have been downgraded by one notch in line with the downgrades of the Credit Suisse's and CSGAG's VRs.

Subordinated lower Tier 2 debt is rated one notch below the VR for loss severity, reflecting below-average recoveries.

Low trigger contingent capital Tier 2 notes are rated two notches below the VR, reflecting loss severity, due to contractual full and permanent write-down language.

Upper Tier 2 instruments are rated three notches below the VR, including one notch for loss severity and two notches for incremental non-performance risk reflecting cumulative coupon deferral.

High trigger contingent capital Tier 2 notes are rated four notches below the VR. The notes are notched down twice for loss severity, reflecting poor recoveries as the instruments can be converted to equity or written down well ahead of resolution. In addition, they are notched down twice for high non-performance risk, as the trigger can result in contractual loss absorption ahead of non-viability.

Legacy Tier 1 securities are rated four notches below the VR, comprising two notches for higher-than-average loss severity, and two further notches for non-performance risk, reflecting that coupon omission is partly discretionary.

High and low trigger contingent capital Tier 1 instruments are rated five notches below the VR. The issues are notched down twice for loss severity, reflecting poor recoveries as the instruments can be converted to equity or written down well ahead of resolution. In addition, they are notched down three times for very high non-performance risk, reflecting fully discretionary coupon omission.

SUBSIDIARIES AND AFFILIATED COMPANIES

The Long-Term IDRs of Credit Suisse International (CSI) and Credit Suisse (USA) Inc. (CSUSA) have been downgraded to 'A-' from 'A' as a result of the downgrade of Credit Suisse's VR.

CSI is a UK-based wholly-owned subsidiary of Credit Suisse, and CSUSA is a US holding company directly held by Credit Suisse Holdings (USA), Inc., the group's US Intermediate Holding Company (IHC). We view these entities as integral to the group's business and core to Credit Suisse's strategy and their Long-Term IDRs are aligned with Credit Suisse's VR and unlike Credit Suisse's Long-Term IDR, they do not benefit from a one-notch uplift.

We would apply the one-notch uplift to a foreign subsidiary's Long-Term IDR if sufficient qualifying junior debt, including internal TLAC, was allocated to ensure its recapitalisation in a resolution event. The amount of qualifying junior debt to be downstreamed to Credit Suisse's foreign subsidiaries is unclear at this stage. The Positive Outlook on CSUSA's Long-Term IDR reflects our view that the US authorities will require a sizeable amount of internal TLAC to be downstreamed to the IHC and we expect clarity on this within the next two years.

CSI is incorporated as an unlimited liability company, which underpins Fitch's view of an extremely high probability of support from its parent, if needed. However, we have not applied the one-notch uplift because it is not clear what impact unlimited liability status would have in protecting senior creditors in a resolution event.

Given strong funding and liquidity within the Credit Suisse group and the intention to keep this as fungible as possible through the central treasury model at Credit Suisse, we have affirmed CSI's and CSUSA's Short-Term IDRs at 'F1', the higher of the two Short-Term IDRs mapping to an 'A-' Long-Term IDR.

The IDRs of Credit Suisse New York branch are at the same level as those of Credit Suisse as the branch is part of the same legal entity without any country risk restrictions. The alignment of IDRs reflects our view that senior creditors of the branch would be treated identically to other senior creditors of Credit Suisse.

RATING SENSITIVITIES

VR, IDRs and SENIOR DEBT

Credit Suisse:
Credit Suisse's VR is based on our expectation that continued progress towards its strategic goals should improve the earnings profile of the bank and optimise capital usage. Should the group's capitalisation materially deviate from its planned 11-12% CET1 ratios for 2016 and gradual improvement after that, this would put further pressure on the bank's VR. This could arise as a result of higher-than-expected litigation costs, lower-than-expected cost savings or insufficient revenue improvements in its core franchises.

Despite the planned reduction in GM RWAs and leverage exposure to USD60bn (-19%) and USD290bn (-8%), respectively, by end-2016, we expect securities businesses to continue to account for more than 40% of group RWAs, which limits upside to the VR.

Credit Suisse's Long-Term IDR is sensitive both to changes to the VR and to unexpected reductions to the size, or changes to the permanence of the buffer of holding company senior debt and qualifying junior debt.

CSGAG:
CSGAG's Long-Term IDR is primarily sensitive to a change in its VR. The Stable Outlook on CSGAG's Long-Term IDR reflects our view that capitalisation targets will remain materially on track as the group implements its new strategy. The Outlook also factors in our view that qualifying junior debt buffers at the CSGAG level are unlikely to be sufficient to allow us to notch up the Long-Term IDR from the VR, given Switzerland's single point-of-entry approach to bank resolution.

TLAC senior notes are rated in line with CSGAG's Long-Term IDR and are therefore primarily sensitive to a change to the Long-Term IDR.

SUPPORT RATINGS AND SUPPORT RATING FLOORS

Credit Suisse and CSGAG:
An upgrade to Credit Suisse's or CSGAG's SRs and an upward revision to the SRFs would be contingent on a positive change in Switzerland's propensity to support its banks. This is highly unlikely in our view, though not impossible.

SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

Subordinated debt and other hybrid capital ratings are primarily sensitive to a change in the VRs of Credit Suisse or CSGAG. The securities' ratings are also sensitive to a change in their notching, which could arise if Fitch changes its assessment of the probability of their non-performance relative to the risk captured in the respective issuers' VRs. This may reflect a change in capital management in the group or an unexpected shift in regulatory buffer requirements, for example.

SUBSIDIARIES AND AFFILIATED COMPANIES

CSI's and CSUSA's Long-Term IDRs are sensitive to changes in the parent bank Credit Suisse's VR. The subsidiaries' Long-Term IDRs could benefit from a one-notch uplift if we believe that sufficient TLAC will be pre-positioned (downstreamed from the parent to the subsidiaries) to recapitalise them sufficiently in a resolution event.

Should the US Federal Reserve's rules on the implementation of the TLAC standard in the US be approved as proposed in October 2015, we expect internal TLAC requirements to become binding for Credit Suisse's US IHC from 1 January 2019. Once regulatory requirements on TLAC pre-positioning in the US IHC are in force and the bank commits to pre-placing these debt buffers, this could result in CSUSA's Long-Term IDR being upgraded by one notch and aligned with Credit Suisse's, if we conclude that the buffers provide sufficient additional protection to CSUSA's senior creditors.

Similarly, further clarity on internal TLAC pre-positioning for CSI or clarity favouring support from its Swiss parent in a resolution scenario due to its unlimited liability status could lead to a one-notch upgrade of its Long-Term IDR.

The subsidiaries' IDRs are negatively sensitive to changes in the parent's propensity to provide support.

Credit Suisse's covered bond ratings are not affected by today's rating actions.

The rating actions are as follows:

Credit Suisse:
Long-Term IDR: affirmed at 'A'; Outlook revised to Stable from Positive
Short-Term IDR: affirmed at 'F1'
Viability Rating: downgraded to 'a-' from 'a'
Support Rating: affirmed at '5'
Support Rating Floor: affirmed at 'No Floor'
Senior unsecured debt (including programme ratings): affirmed at 'A'/'F1'
Senior market-linked notes: affirmed at 'Aemr'
Subordinated lower Tier 2 notes: downgraded to 'BBB+' from 'A-'
Subordinated notes: downgraded to 'BBB' from 'BBB+'
Tier 1 notes and preferred securities: downgraded to 'BB+' from 'BBB-'

Credit Suisse Group AG
Long-Term IDR: downgraded to 'A-' from 'A'; Outlook Stable
Short-Term IDR: downgraded to 'F2' from 'F1'
Viability Rating: downgraded to 'a-' from 'a'
Support Rating: affirmed at '5'
Support Rating Floor: affirmed at 'No Floor'
Senior unsecured debt (including programme ratings): downgraded to 'A-'/'F2' from 'A'/'F1' Senior market-linked notes: downgraded to 'A-emr' from 'Aemr'
Subordinated notes: downgraded to 'BBB+' from 'A-'
Additional Tier 1 notes: downgraded to 'BB' from 'BB+'
Preferred stock (ISIN XS0148995888): downgraded to 'BBB-' from 'BBB'

Credit Suisse International:
Long-Term IDR: downgraded to 'A-' from 'A', Outlook Stable
Short-Term IDR: affirmed at 'F1'
Support Rating: affirmed at '1'
Senior unsecured debt: downgraded to 'A-'
Commercial paper programme: affirmed at 'F1'
Dated subordinated notes: downgraded to 'BBB+' from 'A-'

Credit Suisse (USA) Inc.:
Long-Term IDR: downgraded to 'A-' from 'A', Outlook revised to Positive from Stable
Short-Term IDR: affirmed at 'F1'
Support Rating: affirmed at '1'
Senior unsecured debt (including programme ratings): downgraded to 'A-' from 'A'
Commercial paper programme: affirmed at 'F1'
Subordinated debt rating: downgraded to 'BBB+' from 'A-'; withdrawn because Fitch no longer rates any specific issues, so this rating is no longer considered to be relevant to the agency's coverage.

Credit Suisse NY (branch):
Long-Term IDR: affirmed at 'A', Outlook revised to Stable from Positive
Short-Term IDR: affirmed at 'F1'
Senior unsecured debt (including programme ratings): affirmed at 'A'
Commercial paper programme: affirmed at 'F1'
Senior market-linked notes: affirmed at 'Aemr'

Credit Suisse Group Funding (Guernsey) Limited
Senior unsecured notes (with TLAC language): downgraded to 'A-'/'F2' from 'A'/'F1'

Credit Suisse Group (Guernsey) I Limited
Tier 2 contingent notes: downgraded to 'BB+' from 'BBB-'

Credit Suisse Group (Guernsey) II Limited
Tier 1 buffer capital perpetual notes: downgraded to 'BB' from 'BB+'

Credit Suisse Group (Guernsey) IV Limited
Tier 2 contingent notes: downgraded to 'BB+' from 'BBB-'

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Applicable Criteria
Exposure Draft: Global Bank Rating Criteria (pub. 14 Apr 2016)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=878147
Global Bank Rating Criteria (pub. 20 Mar 2015)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=863501
Global Non-Bank Financial Institutions Rating Criteria (pub. 28 Apr 2015)
https://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=865351

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