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11 May 2016

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Credit Suisse Group AG

Earnings Commentary - First Quarter 2016

Credit Suisse Group AG reported a CHF 484 million pre-tax loss in the first quarter, largely attributable to adverse market conditions and USD 443 million in mark-to-market losses due to portfolio de-risking, primarily in its Global Markets (GM) division, against positive contributions from its Swiss Universal Bank (SUB) and International Wealth Management (IWM) divisions. On a Moody's adjusted basis, pretax net income from continuing operations was a negative CHF 427 million, excluding CHF 56 million in losses on business sales. These quarterly results are in line with expectations given the challenging market conditions and the firm's announcement of an acceleration of its restructuring plan[1] in March 2016, following its October 2015 Strategy Update. In consideration of the progress of the restructuring and extent of cost takeout, management indicated that as of 10 May it has achieved 3,500 of the committed 2016 headcount reduction of 6,000.

Our downgrade in January of Credit Suisse's baseline credit assessment to baa2 from baa1 reflects our expectation that weaker profitability levels over the next two years, driven by higher restructuring charges and exit costs, as well as the execution risk associated with successfully implementing the firm's new strategy pose greater near-term risks for creditors. We also noted at the time that environmental factors beyond management's control could still derail or delay success; the bank's first quarter results highlight such risks. Should the strategic plan's 2018 earnings targets be achieved on a sustainable basis, we believe the improved profitability would be positive for creditors and could result in upward ratings pressure. Nonetheless, at present the near-term risks outweigh this potential future benefit.

The bank's Basel III common equity tier 1 (CET1) ratio on a look-through basis remained unchanged at 11.3%, based on the Swiss capital rules (11.4% on a BIS basis), for the quarter. The firm's stable CET1 ratio was a result of a 3% decrease in risk-weighted assets to CHF 280 billion relative to a similar decline in CET1 capital. CET1 capital was impacted by the balance of the quarter's loss, CET1 relevant taxes, currency impacts, accrued cash dividends and share-based compensation. The decline in RWAs during the quarter was primarily the balance of net declines from business exits, model and parameter updates, and changes in average risk weights in the Strategic Resolution Unit (SRU) and GM versus modest increases in SUB, where business growth and phase-in of the Swiss mortgage multipliers increased RWAs. While Credit Suisse's CET1 ratio remains at the lower-end of its peers, it is more in line with or even above peers with the inclusion of the considerable amount of high-trigger contingent capital instruments the bank has issued. Including high-trigger instruments, the bank had a look-through Swiss buffer capital ratio (CET1 plus high-trigger instruments) of 14.2%.

The bank reported a look-through Swiss CET1 leverage ratio of 3.3% for the quarter and a BIS Tier 1 leverage ratio (including CET1 plus additional Tier 1 securities) of 4.4%, little changed from the last quarter, and now more in line with peers. While the bank's Swiss total capital leverage ratio was higher at 5.1%, it includes dated contingent capital instruments in addition to CET1 and AT1 securities. Total leverage exposure declined 1.8% from the prior quarter to CHF 970 billion at quarter end, due largely to reductions in leverage exposure in IWM, SRU, IBCM and SUB, against increased leverage in GM and the Corporate Center.

Within the business segments, key operating and financial trends were as follows. Adjusted figures are as adjusted by the bank which exclude gains on sales of businesses and real estate, restructuring expenses and major litigation provisions.

Swiss Universal Bank ("SUB") reported adjusted pre-tax profits of CHF 466 million, up 12% from the quarter a year ago. On a reported basis, results are little changed. SUB Private Banking's adjusted pre-tax profits declined 3%, as the PB saw declines in transaction-based revenues and recurring commission and fee income, in comparison to the prior year period. The first quarter of 2015 included increased client activity following the Swiss National Bank's removal of the Swiss Franc floor in January 2015. These lower revenues were partly offset by increased net interest income, a result of improved loan margins. Reported pre-tax profits from SUB Corporate and Institutional Banking increased 26% (adjusted) versus the prior year as revenues increased due to higher net interest income on improved loan and deposit margins. The CIB also recorded a CHF 3 million release of provisions for credit losses against a provision of CHF 11 million in the prior year period. Average assets under management (AUM) in Private Banking decreased by CHF 4.7 billion over the quarter due to unfavorable market and FX-related movements. In Corporate and Institutional Banking, net new assets increased by CHF 2.3 billion, partially offsetting declines in AUM for similar reasons as Private Banking.

International Wealth Management ("IWM") reported adjusted pre-tax profits of CHF 279 million for the first quarter, up 10% from the quarter a year ago. On a reported basis, the division made profits of CHF 270 million, with adjustments due to restructuring expenses in the first quarter of 2016. Within IWM, Private Banking adjusted pre-tax income in the quarter was up 2% versus the prior year. Reported Private Banking income was improved largely due to growth in net interest income, while transaction based revenues declined due to the comparison with 1Q15 when client activity was driven by SNB actions. Adjusted operating expenses increased 7% from 1Q15 given higher compliance and risk management expenses. In Asset Management, reported pre-tax income was up 48% for the quarter versus the prior year. This was largely a result of lower operating expenses, as revenues were flat over the same period. In Private Banking, the quarter saw net new assets of CHF5.4 billion, a result of inflows from emerging markets and Europe. This inflow only partly mitigated market pressures and FX-related movements which brought AUM lower. In Asset Management, AUM declined CHF 20 billion to CHF 301.3 billion, as net new asset inflows of CHF 1.5 billion were dwarfed by downward adjustments on reporting of multi-asset class solutions in AUM as well as unfavorable market and FX-related moves.

Asia Pacific ("APAC") reported adjusted pre-tax profits of CHF 252 million in the first quarter, a 46% decline compared to the prior year. In APAC Private Banking, adjusted pre-tax income fell 6% due to increased operating expenses, a result of higher compensation expenses which reflects additions in relationship managers. This investment reflects management's emphasis on growth areas with recurring fee generation as part of achieving its 2018 profitability targets for the broader Group. APAC Investment Banking reported adjusted pre-tax profits for the quarter of CHF150million, a 58% decline relative to the prior year, largely reflecting revenue declines as lower equity sales and trading revenues (-40%) were not offset by higher fixed income sales and trading revenues (+3%). Private Banking AUM was flat versus the prior quarter as net new assets inflow of CHF 4.3 billion from Greater China and South East Asia markets offset unfavorable market and FX-related moves.

Global Markets ("GM") reported CHF 635 million pretax loss in the first quarter of 2016. This is an improvement on the prior quarter which faced a CHF 3.5 billion loss, largely due to a CHF2.7 billion goodwill impairment. On an adjusted basis, the bank posted a CHF 534 million loss for the first quarter of 2016 relative to a profit of CHF 842 million in the prior year period. The underlying results reflect difficult trading conditions where a significant market selloff in key markets exposed the business to continued losses in its global credit, corporate banking and securitized products portfolios, contributing to a sharp decline in fixed income sales and trading revenues during the quarter. While the prior quarter saw considerable deleveraging of GM (USD 40 billion during the quarter), the first quarter of 2016 saw an increase in leverage exposure of USD 25 billion to USD 342 billion, due to an increase in high quality liquid

assets and seasonal increase in prime services business activity. Fixed income sales and trading revenues declined 82% compared to 1Q15, a reflection of reduced client activity particular to Credit Suisse' securitized products and global credit products. The decline was also due to USD 403 million in mark-to-market losses taken in the leveraged finance and distressed, par and securitized products trading books. While future trading income is likely to suffer, we are encouraged with the de-risking of the distressed debt and CLO portfolios where distressed debt exposures have fallen from USD 1.9 billion (4Q15) to USD 598 million (1Q16). Equity sales and trading revenues declined 29% from the prior year period. Management highlighted its gross oil and gas lending exposures of approximately USD 11.5 billion, including USD 9.3 billion net exposure in its corporate banking book. Within this portfolio, nearly half of the portfolio consists of exposure to the higher risk Exploration & Production (35%) and Oilfield Services (11%) sectors. Although much of that exposure is secured, we believe an extended period of low oil prices could result in greater losses in that portfolio.

Investment Banking and Capital Markets ("IBCM") reported an adjusted pre-tax loss of CHF 76 million for the first quarter of 2016 due largely to an 8% revenue decline compared to 1Q15, as well as a CHF 53 million increase in the provision for credit losses on corporate lending to the energy sector. Continuing on from the fourth quarter 2015, a bright spot was in IBCM's advisory business where revenues increased 97% versus the prior year, although down 10% versus the fourth quarter. Relative to 1Q15, debt and equity underwriting declined 16% and 53% respectively, on the back of lower leveraged finance revenues and significant reductions in industry-wide IPO issuance activity. The division also took mark-to-market losses of USD 40 million on its corporate bank and leverage finance portfolios. Risk weighted assets in IBCM decreased USD 1.4 billion to USD 16.6 billion while leverage exposure declined USD 3.1 billion to USD 40.2 billion, as exposures to the debt underwriting portfolio decreased.

The Strategic Resolution Unit ("SRU") reported a narrower adjusted pre-tax loss of CHF 643 million in the quarter, relative to an adjusted pre-tax loss of CHF 714 million in the last quarter of 2015. This was due to lower general and administrative expenses, reflecting a 28% reduction in headcount in the quarter, as well as lower restructuring and credit expenses. These improvements offset an increase in loss on the legacy investment banking portfolio to CH207 million from CHF136 million and lower revenues from restructuring of select onshore businesses. Look-through risk-weighted assets reduced by CHF7 billion in the quarter to CHF54.6 billion, reflecting model updates and a smaller book size which more than offset negative quality movements. Look-through Leverage exposure declined CHF16 billion to CHF122.2 billion. Referring to the acceleration of the strategy announced in March, we understand that the SRU will take on a further USD 10 – 15 billion in RWAs from GM.

Corporate Center reported an adjusted pre-tax profit of CHF 83 million in the quarter, excluding the CHF52 million of losses relating to business disposals. The improvement from a loss of CHF381 million in the final quarter of last year related mainly to an improved Treasury result and beneficial movements in valuation of certain deferred compensation plans.

Endnotes

1 Please refer to Credit Suisse' Strategy Update Highlights Execution Challenges in Unsupportive Market Environment

REPORT NUMBER 1024752

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