MOODY'S
INVESTORS SERVICE

ISSUER COMMENT
5 February 2016

Rate this Research

Contacts

Michael Eberhardt, CFA 44-20-7772-8611
VP-Sr Credit Officer
michael.eberhardt@moodys.com

David Fanger 212-553-4342
Senior Vice President
david.fanger@moodys.com

Credit Suisse Group AG

Earnings Commentary - Fourth Quarter 2015

Credit Suisse Group AG reported a 6.4 billion pre-tax loss in the fourth quarter, driven in part by a CHF 3.8 billion goodwill impairment charge, reflecting a significant restructuring of the bank in line with management's strategic plan announced in October 2015, and a CHF 0.7 billion fair value loss on own debt. However, even excluding these items, quarterly results were still quite weak, reflecting losses in the bank's Strategic Resolution Unit, higher litigation and restructuring charges, and significant weakness in the bank's Global Markets division where volatile market conditions and wider credit spreads led to significant mark-to-market losses in the bank's still sizeable credit and securitized products businesses. Revenue declines across a number of other businesses also reflected reduced client activity in the face of a more challenged macroeconomic environment. On a Moody's adjusted basis pretax net income from continuing operations was a loss of CHF2.1 billion, excluding the goodwill impairment, fair value losses on own debt, and CHF 0.1 billion in gains on property sales and the sale of a business.

Our recent downgrade 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, and 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 fourth quarter results highlighted 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.

As a partial offset to the risks posed during the implementation of the new strategic plan, Credit Suisse issued CHF 6 billion in new common equity in December 2015, significantly boosting the bank's leverage ratio and capital position. The bank's Basel III common equity tier 1 (CET1) ratio on a look-through basis increased 120 basis points versus the previous quarter to 11.3%, based on the Swiss capital rules (11.4% on a BIS basis). While an improvement due to the capital raise, the ratio reflects the consumption of a net CHF2.4 billion in capital in the quarter. Risk-weighted assets increased 2% during the quarter to CHF 295 billion, primarily a result of internal methodology changes in treatment of operational risk and the balance of external methodology changes, model updates and increased market risk levels. 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 reported a look-through Swiss buffer capital ratio (CET1 plus high-trigger instruments) of 14.5%.

The bank reported a look-through Swiss CET1 leverage ratio of 3.3% for the quarter and a Tier 1 leverage ratio (including CET1 plus additional Tier 1 securities) of 4.5%, up 50 basis points and 60 basis points respectively from last quarter, and now more in line with peers. While the bank's Swiss total capital leverage ratio was higher at 5.2%, it includes dated contingent capital instruments in addition to CET1 and AT1 securities. These capital levels are now at or ahead of management targets set for end-2015. Total leverage exposure declined 5.4% from the prior quarter to CHF 993.5 billion at quarter end, due largely to reductions in leverage exposure in Global Markets, Strategic Resolution Unit and Corporate Center, against increased leverage in IBCM and International Wealth Management.

As part of management's strategy update, Credit Suisse reconfigured its reporting structure during the quarter from two core divisions (excluding Corporate Center) to five core divisions (excluding Corporate Center) and the addition of a Strategic Resolution Unit. Within the new business segments, key financial and operating trends were as follows –

Swiss Universal Bank ("SUB") reported adjusted pre-tax profits of CHF 336 million, up 25% from the quarter a year ago. On a reported basis, results are down 48%, largely reflecting CHF414 million of real estate gains in the fourth quarter of 2014, as well as restructuring and litigation expenses in the fourth quarter of 2015. SUB Private Banking's adjusted pre-tax profits improved 40%, a result of the Swisscard deconsolidation benefit as well as higher net interest income. Reported pre-tax profits from SUB Corporate and Institutional Banking increased 20% (adjusted +16%) versus the prior year as revenues increased due to higher net interest income and higher recurring commissions and fees. Assets under management (AUM) in Private Banking were increased by CHF 4 billion over the quarter largely due to reclassifications reflecting an updated AUM policy introduced in the prior quarter, as well as outflows associated with clients taking advantage of local tax amnesty programs ("regularization"). In Corporate and Institutional Banking, net new assets increased by CHF 4.2 billion, due to inflows from Swiss pension funds.

International Wealth Management ("IWM") reported adjusted pre-tax profits of CHF 230 million for the fourth quarter, down 35% from the quarter a year ago. On a reported basis, the division made losses of CHF 20 million, with adjustments due to significant litigation provisions and restructuring in the fourth quarter of 2015. Within IWM, Private Banking adjusted pre-tax income in the quarter was up 4% versus the prior year. Reported Private Banking income was lower largely due to charges for litigation brought by clients who have claimed their former relationship manager in Switzerland exceeded his investment authority. We believe this reflects a weakness in internal controls, a factor we have previously cited as a risk for creditors at Credit Suisse. In Asset Management, reported pre-tax income was down 79% for the quarter versus the prior year. This was largely a result of lower revenues following the sale of an Italian business and change in fund management in Brazil where the firm's Hedging-Griffo Asset Management unit launched as a new firm in the fourth quarter of 2014, but also reflects a more challenging environment for alternative investment products in which the business is concentrated. In Private Banking, net new asset outflows of CHF4.2 billion occurred in the quarter, of which CHF 2.3 billion were related to outflows associated with clients taking advantage of local tax amnesty programs ("regularization"). In Asset Management, net new asset inflows of CHF 3.6 billion brought total net new assets to CHF 26.5 billion for 2015, primarily in to Alternatives and Credit Suisse's JV in China and index products.

Asia Pacific ("APAC") reported adjusted pre-tax profits of CHF 148 million in the fourth quarter, a 21% increase compared to the prior year. On a reported basis, APAC made losses of CHF 617 million, largely due to a CHF 756 million goodwill impairment in the APAC Investment Banking sub-segment. In APAC Private Banking, adjusted pre-tax income fell 18% as increased net interest income was offset by lower transaction based revenues and increased operating expenses, which reflect the hiring of new relationship managers. This is a key area of investment by Credit Suisse towards achieving its 2018 profitability targets for APAC and the broader Group. APAC Investment Banking reported pre-tax losses for the quarter of USD675 million largely reflecting the aforementioned goodwill impairment. On an adjusted basis, pre-tax income of USD 92 million was up 56% for the quarter versus the prior year, reflecting improved revenues in fixed income and equity sales. Private Banking net new assets inflow of CHF 3.0 billion reflected inflows primarily from Greater China and South East Asia markets.

Global Markets ("GM") reported a USD 3.5 billion pretax loss in the fourth quarter of 2015. Excluding a USD2.7 billion goodwill impairment, restructuring expenses of USD105 million and USD 51 million of litigation charges, the division would have reported an

adjusted pre-tax loss of USD 664 million. The underlying results reflect difficult trading conditions where a significant market selloff in key markets exposed the business to substantial 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. Management indicated considerable deleveraging of the capital markets portfolio, resulting in a reduction in leverage exposure of CHF 35 billion during the quarter. Equity sales and trading declined 28% in the quarter versus the prior year. Management highlighted its oil and gas exposures of approximately USD 11 billion, including $9.1 billion net exposure in its corporate banking book where, although only 22% is funded. Nearly half of the portfolio consists of exposure to the higher risk Exploration & Production and Oilfield Services 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 a USD 503 million loss for the fourth quarter of 2015 due largely to goodwill and restructuring charges. On an adjusted basis, IBCM generated a USD 97 million loss, as net revenues were down 22% for the fourth quarter versus the prior year. This was largely due to declines in debt (-22%) and equity underwriting revenues (-33%) reflecting generally lower market volumes, and mark-downs in the underwriting and corporate bank portfolios. One bright spot was advisory revenues, which were up 29% in the fourth quarter versus the prior year and exceeded any other quarter in at least the past three years. Risk-weighted assets in IBCM increased USD 4 billion to USD 18 billion, a result of increased underwriting commitments in investment grade and speculative grade transactions.

The newly created Strategic Resolution Unit ("SRU"), which largely consists of investment banking activities which were deemed non-core during the October 2015 strategy review, reported a pre-tax loss of CHF 1,122 million in the quarter, slightly larger than the prior year. This loss is due to restructuring charges from the transfer of the U.S. Private Bank and higher provisions for credit losses on positions in the Private Banking and Asset Management portfolio.

Corporate Center reported adjusted pre-tax losses of CHF 381 million in the quarter, excluding the CHF697 million of fair value losses on own debt. This widening of loss relative to the loss of CHF 70 million in the fourth quarter a year ago largely reflects increased operating expenses.

REPORT NUMBER 1016038

MOODY'S
INVESTORS SERVICE