

## ISSUER IN-DEPTH

10 November 2022



## RATINGS

## Credit Suisse Group AG

Domicile	Zurich, Switzerland
Long Term CRR	Not Assigned
Long Term Debt	Baa2
Type	Senior Unsecured - FgnCurr
Outlook	Negative
Long Term Deposit	Not Assigned

Source: Moody's Investors Service

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## Credit Suisse Group AG

2025 plan: breadth and complexity of restructuring entail significant execution risks

## Summary

On 27 October, Credit Suisse Group AG (CS, Baa2 negative<sup>1</sup>), the parent holding company of Credit Suisse AG (A3/A3 negative, ba1<sup>2</sup>), announced an updated business plan that will further reduce capital allocated to the Investment Bank but will entail significant execution risk because of the broad and complex repositioning of the group's business model. The capital increase and the planned divestment of the Securitised Products Group, while credit positive, will not fully mitigate these execution risks. In addition, the proposed restructuring will be more challenging in the deteriorating macro environment, and it will be some time before the bank returns to profit. These factors were key drivers in our [recent downgrade](#) of the operating company's Baseline Credit Assessment and ratings. The move follows the group's [previous exits](#) from the Prime brokerage business<sup>3</sup> as well as around 10 non-core markets. The plan, once completed, will be credit positive, enabling CS to move to a lower risk, more efficient and stable business model with greater focus on its core franchise strengths.

**Execution risk is high.** The plan will eventually lead to a substantially de-risked, more efficient and simplified bank, with materially lower leverage and reduced dependence on more volatile capital markets and investment banking earnings. However, the lengthy timeline to execute the group's broad and complex business repositioning will likely lead to high talent and client attrition risk.

**Profitability will be weak for a prolonged period.** We expect the plan will entail elevated restructuring and remediation costs, as well as reduce revenue streams, leading to large losses in 2022 and additional losses in 2023. The group should return to modest profitability in 2025, but at levels still significantly below its historical results. Executing this plan in a deteriorating markets and macroeconomic environment adds substantial downside risk.

**Liquidity has declined.** CS's historically ample liquidity deteriorated in October because of deposit outflows, and the firm disclosed that some material legal entities were in breach of regulatory liquidity requirements. Restoring stable deposit funding and swiftly improving its subsidiary and group-level liquidity profiles will be central to our credit view.

**Capitalization will help mitigate earnings volatility and preserve the franchise.** CS's solid capitalisation has been further strengthened in both quantity and quality by the group's announced CHF4 billion rights issue, bringing the pro forma Common Equity Tier 1 (CET1) ratio to 14%. This high buffer should enhance market confidence despite the group's eroded liquidity and the execution risk inherent in its lengthy restructuring.

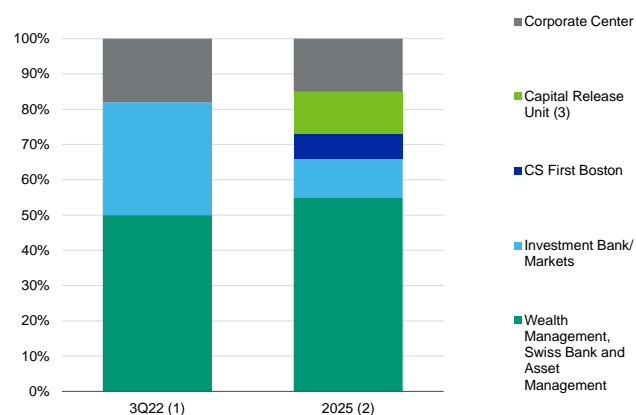
## Execution risk is high

CS's 2023-25 strategic plan is designed to eventually produce a substantially de-risked, more efficient and simplified bank, with materially lower dependence on more volatile capital markets and investment banking earnings. According to management, the Investment Bank's risk-weighted assets (RWAs) will decrease to below one fifth of group RWAs by 2025 versus around one third at end-September 2022 (Exhibit 1) because of a 40% reduction<sup>4</sup> in its capital allocation as the Non-Core Unit is wound down and capital is released from the transfer of the Securitized Products Group.

CS is currently organised along four divisions: Wealth Management, Swiss Bank, Asset Management and Investment Bank. The reduction of the Investment Bank's RWAs will result in a more stable and sustainable business mix for the group (Exhibits 1-2)

Exhibit 1

### Investment Bank RWAs will decline RWAs breakdown during the plan

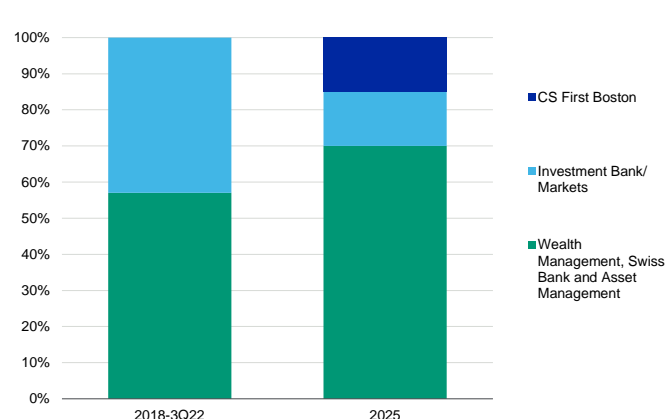


(1) Based on current structure pre-Global Trading Solutions and APAC Financing Group pay-away (2) Including Basel III reforms (3) Including Asset Resolution Unit and Securitized Products.

Source: CS

Exhibit 2

### Business mix will stabilize Adjusted revenue mix excluding Corporate Center and Capital Release Unit



Source: CS

However, the lengthy timeline to execute such a broad and complex repositioning of the group will likely result in high talent and client attrition. These transformation risks are amplified by the significant turnover at the group's board and senior executive levels, notwithstanding the recent appointment of an experienced new management team.

## The plan marks a more radical departure from capital markets activities

CS's 2023-25 plan will be more transformative, with higher execution risk, than its previous 2022-24 plan because it entails a more structural reduction of the Investment Bank activities, and will eventually lead to a less risky, more stable business model. Exhibit 3 provides a comparison of the key financial targets.

- » The 2025 plan targets a 40% reduction in RWAs and leverage exposure in the Investment Bank division, whereas the 2024 plan targeted a ~25% reduction in RWA via a \$3 billion reduction in capital over 2021-22.
- » The 2025 plan also targets a lower level of CET1 regulatory capital of at least 13% throughout the 2023-25 period, around 100 basis points below the 2024 plan guidance of above 14% during the 2022-24 period. Solid, though lower, capitalization will mitigate earnings volatility.
- » Further, the 2025 plan envisages more modest profitability, with a group target return on tangible equity of around 6% in 2025 versus the 2024 plan's target of 10% in 2024, despite larger cuts in operating costs of CHF2.5 billion over the 2022-25 period.

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Exhibit 3

**Financial aspirations: 2025 vs 2024 plan**

	2024 plan	2025 plan
<b>Profitability</b>		
Group RoTE (1), reported	>10%	~6%
Cost to income ratio/ Operating cost base target	~70% (2)	CHF ~14.5 billion
<b>Capital</b>		
CET1 ratio (3)	>14%	>13.5% (4)
Leverage ratio	~4.5%	na

(1) RoTE = return on tangible equity. (2) Excluding significant items, with additional investments of c.CHF1-1.5 billion p.a. by 2024. (3) Pre-Basel III reforms. (4) CS targets a CET1 ratio through transformation (2023-25) of at least 13.0% and a CET1 ratio >13.5% in 2025

Source: Company reports

To help achieve these financial targets, the 2025 plan includes the following main actions (Exhibit 4):

- » **Finalizing and executing the transfer of the majority of securitized products group assets** to investment vehicles managed by affiliates of Apollo and PIMCO. The disposal will free up significant capital and liquidity, as the unit currently consumes CHF22 billion of RWA and its leverage exposure is CHF85 billion and has large funding needs.
- » **Setting-up a Non-Core Unit (NCU)** with markets businesses, including prime services, equities, rates, fixed income trading, credit and emerging markets, with attached CHF25 billion of RWA and CHF116 billion leverage exposure, as well as some non-Investment Bank assets and assets previously held in the Asset Resolution Unit with attached CHF10 billion of RWA and CHF16 billion leverage exposure. We expect the Investment Bank business runoff to be slow because of the long tenor of some products (the average duration is around 4-5 years). CS estimates RWAs and leverage to only halve by 2025 to CHF17 billion and CHF61 billion, respectively. Further, the NCU will post large losses: the unit will report a CHF2.2 billion adjusted pretax loss in 2022, to decrease to a \$1.3 billion loss in 2025.
- » **Carving out and attracting new external capital for a simplified independent investment bank.** CS will create a separate independent investment bank, headquartered in New York and under the CS First Boston brand, which will house the equity capital markets, debt capital markets and advisory businesses. CS will seek partnerships or other capital investments over time; however, the current plan is to maintain a significant ownership stake. Carving out CS First Boston is positive for risk and performance measurement and management, but the complexity of this initiative will require a lengthy timeline with high risk of talent and client attrition.
- » **Align and streamline the group's remaining businesses,** focusing primarily on banking in its domestic Swiss market and global Wealth and Asset Management, while retaining a much smaller ancillary markets footprint.

Exhibit 4

**The Investment Bank division's breakup**

	Markets	CSFB	SPG	NCU	Total
Revenue	3	>2.5		0.2*	
RWA	22	21	22	25	90
Leverage	109	75	85	116	385

Moody's estimate on CS data

Source: Company data

## Profitability will be weak for a prolonged period

CS's 2025 plan aims to decrease the bank's earnings volatility and return it to sustainable profitability. However, there will be elevated restructuring costs and reduced revenue streams while the risk, compliance and cultural remediation efforts are underway. We forecast financial losses for CS of around CHF7 billion in 2022 and around CHF2 billion in 2023, before the prospective financial benefits of its strategic shift begin to materialize, with the group breaking even in 2024 and returning to modest profitability in 2025. CS targets a group return on tangible equity of around 6% in 2025, which would remain one of the lowest RoTE targets among large capital markets banks.

The forecast losses for 2023 and 2024 largely reflect restructuring charges, software and real estate impairments of CHF3.9 billion, and charges associated with the reduction of 9,000 full-time employees (FTE), or 17% of the FTE base by 2025 (2,700 or 5% of these reductions are already underway). We also expect regulatory remediation costs in 2023.

Because of the foregoing, we do not expect CS to generate operating capital for some time. Further, executing this plan in a deteriorating markets and macroeconomic environment adds substantial downside risk.

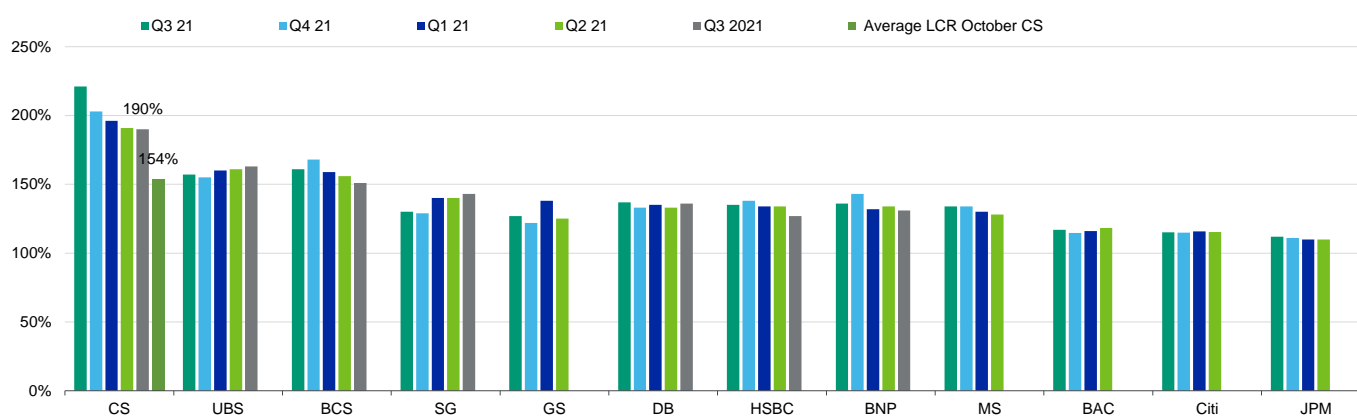
## Liquidity has declined

CS's liquidity deteriorated in October, following large institutional and corporate deposit funding outflows. The group average Liquidity Coverage ratio (LCR) decreased from 192% at end-September 2022 (broadly unchanged from 191% at end-June 2022) to 154% through October 25, a much lower level but still above regulatory requirements; we assume management will aim to reestablish previous liquidity levels. Further, the firm disclosed that during this period some of its material legal entities were in breach of regulatory liquidity requirements. The group's ability to swiftly improve liquidity and achieve compliance with regulatory liquidity requirements at its operating entities will be central to our credit view.

CS's liquidity level is no longer the highest among peers (Exhibit 5), which was previously a core credit strength and differentiating factor for the group. Maintaining solid liquidity while executing its restructuring is important to CS because of its sizable global wealth management and capital markets franchises, whose deposits and short-term market funding are typically more confidence-sensitive than retail deposits. Liquidity deterioration therefore has the potential to hinder the difficult and complex restructuring of CS's businesses.

Exhibit 5

### Liquidity Coverage Ratios for major capital markets banks



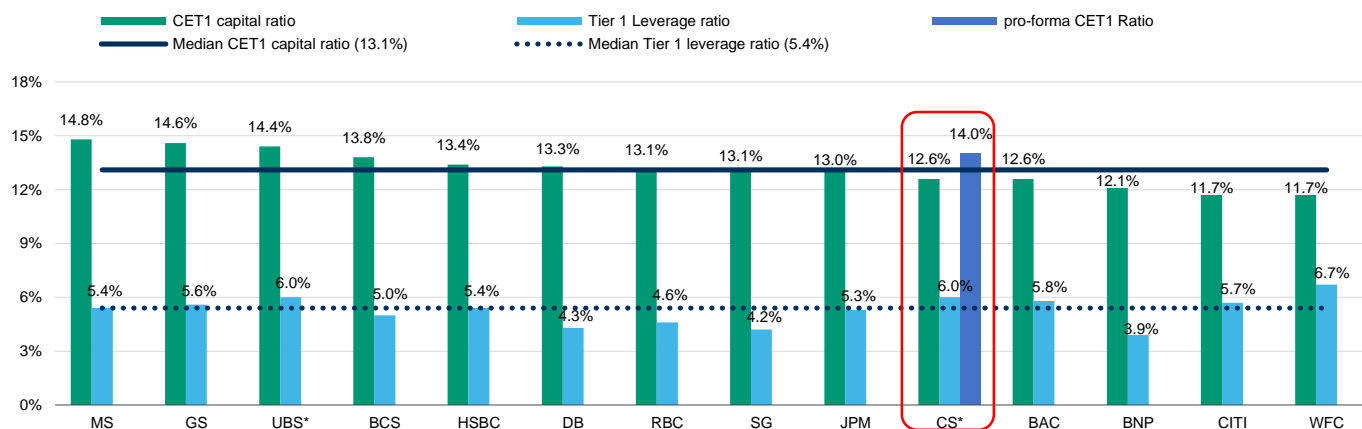
Source: Company reports

## Capitalization will mitigate earnings volatility and help preserve the franchise

CS's strong and enhanced capital position will provide much-needed capacity to buffer the negative financial impact and execution risk of its restructuring plan, including the complex carve-out of an independent investment bank. Incorporating the announced CHF 4 billion rights issue, the group's pro forma CET1 capital ratio is 14.0%, which is in line with peers (Exhibit 6).

Exhibit 6

### Common Equity Tier 1 ratios for major capital markets banks



\*UBS and CS leverage ratios reflect group-level Common Equity Tier plus Low Trigger Additional Tier 1 and High-Trigger Additional Tier 1 securities. \*\* Barclays leverage is the CRR leverage ratio excluding the IFRS9 transitional arrangements. \*\*\* pro forma to include CS's announced CHF4 billion capital raise

Source: company reports

CS targets a CET1 ratio of at least 13.0% through the transformation (2023-25), providing a buffer against earnings volatility and losses, and a CET1 ratio >13.5% in 2025 (pre-Basel III reforms), benefiting from the CHF4 billion fully subscribed rights issue (around 140 basis points of CET1 capital) and from the Securitised Products exposure reduction (around 50 basis points of CET1 capital, according to our estimates). The group estimates a 70-basis-point CET1 reduction because of the Basel III reform, before any mitigating actions, which will exert pressure on its capital position.

## Moody's related publications

- » [Credit Suisse Group AG - Credit Opinion - Update following rating action](#), November 2022
- » [Credit Suisse Group AG - Immediate risks outweigh prospective benefits of still unfolding strategic shift](#), September 2022
- » [Credit Suisse Group AG - 2024 plan: reduced risk appetite and greater shift to wealth management will lower risks and earnings volatility](#), November 2021
- » [Global Investment Banks – UK and Europe: Q3 2022 Update: Profit down on rising loan loss charges and weaker investment banking revenue](#), November 2022
- » [Global Investment Banks – US: Large US banks' third-quarter investment banking fees will reflect low issuance volumes](#), October 2022

## Rating actions

- » [Moody's affirms Credit Suisse Group's AG senior unsecured debt at Baa2 and downgrades Credit Suisse AG's senior unsecured debt to A3 and deposits to A3/Prime-2; outlook negative](#), November 2022

## Rating Methodology

- » [Banks Methodology](#), July 2021

## 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 and senior unsecured debt ratings and corresponding outlook(s), as well as its Baseline Credit Assessment.
- 3** Excluding Index Access and APAC Delta One
- 4** Based on RWAs excluding Basel III reforms

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