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Neuberger Berman Fixed Income

Update on Credit Suisse Group — March 16, 2023

Summary

Credit Suisse has well known challenges and recent market volatility events suggest increased market impatience with the bank's three-year transformation plan. Earlier this week, NB Fixed Income posted views on the initial market volatility related to financials and recent events. The blogs can be found at [Blog | Neuberger Berman (nb.com)]. Below are our latest views related to the situation with Credit Suisse:

The past two days have seen some large movements in fixed income spreads of Credit Suisse. This is a fluid situation and we wanted to highlight some key views on the issuer.

- *The challenges for Credit Suisse (CS) are well known by financial markets. CS announced a CHF 4.0 billion equity capital raise on 27th October 2022, and new strategic plan to transform its operating model over 2023 to 2025 with a material reduction in the Investment Bank, group wide cost reduction effort, and focus on its core franchise of Global Wealth and Swiss Retail Banking. The bank closed the equity capital raise on 8th December 2022 and reported a regulatory capital ratio well above requirements at 31st December 2022.*
- *Due to various negative headlines about the company during the fourth quarter of last year, and negative social media rumors on its capital and liquidity position, substantial asset outflows in its Global Wealth franchise occurred as clients took precaution and withdrew funds. According to the CEO, the majority of clients, however, did not close their accounts. The outflows in Global Wealth were 15% of total assets under management in the fourth quarter of last year, and group wide outflows were 7% as Asset Management and Swiss Universal Banking outflows were substantially lower. With first quarter 2023 results, the bank noted outflows had moderated to a much slower pace, but did not completely reverse. CS also reaffirmed its plan to materially downsize the Investment Bank, noting progress on the sale of certain non-core assets, and that restructuring costs would be covered by the equity capital raise and non-core asset disposals. The CEO reaffirmed the target over the 2023 to 2025 business plan to keep the common equity Tier 1 ratio above 13.0%.*
- *At an equity conference earlier this week, the CEO confirmed the group's liquidity position continued to strengthen during 1Q23. The bank has maintained group wide liquidity requirements above supervisory expectations at all times during recent stress events. CS reported a high quality liquid asset portfolio of CHF 118.5 billion for 4Q22 with this portfolio hedged to interest rates, and comprising mainly of U.S. Treasuries, Swiss government bonds, and central bank cash at the Federal Reserve, Swiss National Bank and ECB. The CEO stated liquidity coverage was trending above 150% as of this week. By our calculations, the bank had excess liquidity of CHF 40 billion above group wide requirements. We believe the stress in CS spreads stems from a lack of patience by financial markets with the bank's turnaround plan, and concern that franchise erosion will be difficult to overcome.*
- *While concern about deposit outflows for all banks is in focus due to the events of last week, we are monitoring the situation and assessing options that CS is likely to take to shore up confidence. Liquidity is the main focus near term and the bank noted its liquidity coverage ratio had strengthened heading into this week. The bank also has access to pre-positioned eligible collateral to post for liquidity at various central banks, if required. That said, CS bonds are trading lower today, and the bank will need to find a confidence boosting measure as headlines continue to come in.*

Background of Current Issue

- *Credit Suisse challenges stem from past lapses in risk management and governance with the first quarter of 2021 in focus after the bank incurred a CHF 4.4 billion trading loss on a U.S. hedge fund client in its prime services unit. The third party independent* *report on this event identified short comings in risk management and culture, in particular at the Investment Bank unit. There was also a conflict of interest with the Supply Chain funds matter which spanned Investment Banking and Asset Management. Credit Suisse acknowledged the lapses, and committed to improve risk, governance and controls and did an equity capital raise in the third quarter of 2021. Eventually CS changed the Chair, CEO and CFO, and brought in senior specialists in key leadership positions across Legal, Compliance, and Risk. The bank exited prime services, and embarked on a new plan to focus on Wealth Management and Swiss Banking. The new head of legal also took a more proactive stance to resolve outstanding litigation matters.*

- *The economic events of 2022 resulted in sharply higher central bank policy rates, which heavily weighed on the bank's Investment Bank revenues, as CS is more focused on credit and advisory work. Also negatively impacted was fee income given that Global Wealth assets declined due to lower market values. The market's impatience with the announcement of the new strategy resulted in various social media rumors ahead of the strategy update on 27th October 2022. Due to limits on the bank's ability to communicate, the bank did not respond to market rumors. Franchise erosion occurred last quarter as large clients of the Wealth division withdrew funds and deposits and Investment Bank revenue were modest due to market volatility and CS-specific restructuring efforts.*

We note the statement from yesterday (15 March 2023) from the Swiss National Bank (SNB) on Credit Suisse and that it remains in close contact with the bank and will provide CS with liquidity, if required. The statement also noted that CS met all capital and liquidity requirements yesterday (15 March 2023) as a systemically important bank. CS has subsequently announced an intention to exercise its option to borrow from the SNB up to CHF 50Bn which materially strengthens Group liquidity. CS also announced a tender for up to CHF 3 billion of its operating company senior unsecured bonds.