

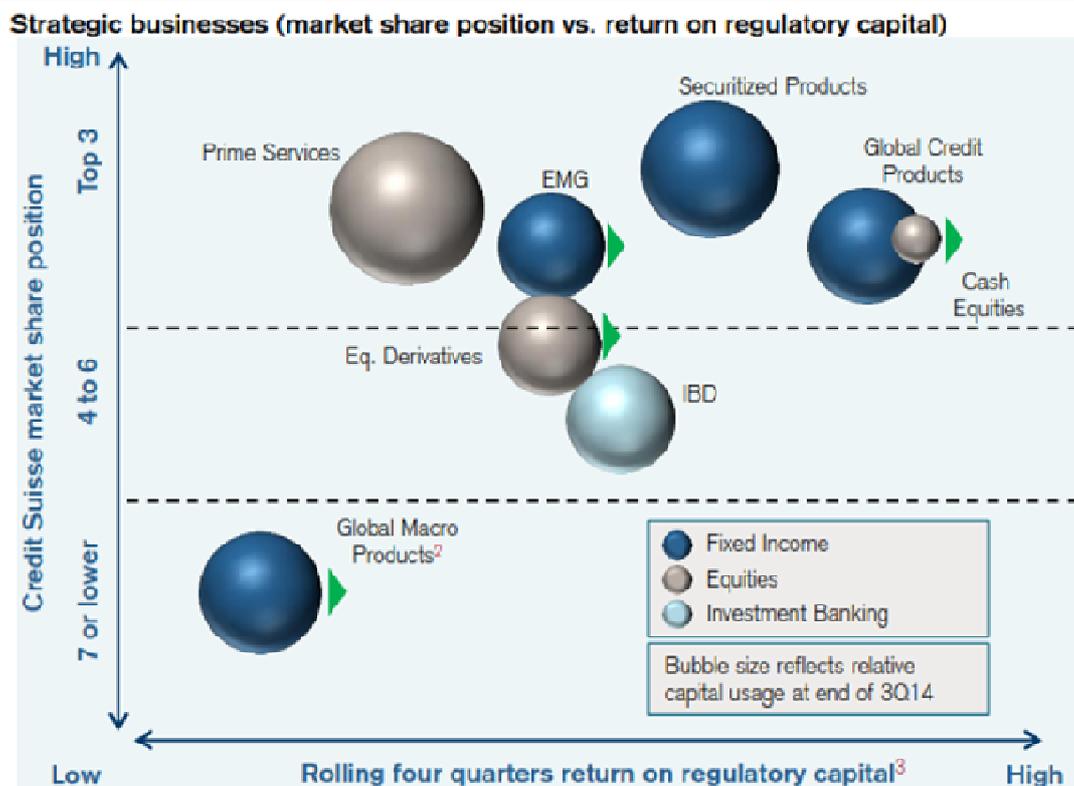
Credit Suisse: Prime Service, IB targets & achievements

- Credit Suisse is scaling down its Prime Services unit. The revenue impact may be minimal: the bank has a strong synthetic financing capability, which could be folded into equity derivatives.
- We disagree with the mainstream media's unflattering coverage. CS' cautious approach to restructuring is justified by the uncertain regulatory outlook, and the bank is, in fact, very close to achieving its key financial targets.

Credit Suisse's decision to scale down its Prime Services unit has merit ...

Yesterday, news emerged that Credit Suisse intends to scale down its Prime Services unit. This latest initiative is part of the bank's wider plan to reduce leverage and RWA, and is driven by regulatory changes (primarily Basel 3 and Dodd-Frank). The chart below illustrates the challenge that CS Prime Services faces: the unit has a very strong market position but accounts for \$18bn of Basel 3 RWA, equal to 43% of Strategic Equities RWA. The resultant return on regulatory capital (RoRE) is the second-worst among Investment Bank's products.

Credit Suisse IB Strategic businesses: market position, capital consumption and RoRE* (extract from 3Q14 Results presentation)



Source: Credit Suisse. Note: RoRE = return on regulatory capital.

Credit Suisse, of course, is not the only bank reviewing its prime services franchise: Goldman Sachs, for example, is reducing flows with less RoAuM-profitable hedge funds and increasing fees for others, and pulling money out of internal funds¹.

Credit Suisse's downsizing of the Prime Services unit may only have a minimal impact on the Investment Bank's revenue line. The unit is very strong in synthetic financing, which is a relatively RWA-light segment. It is possible that the bank could fold this section into its successful equity derivatives business, alongside other equity swap capabilities that predominantly serve the hedge fund client base. In this way, the capital intensive securities lending/financing parts of Prime Services may be removed while preserving those with a higher RoE. We cannot at this stage confirm that this is Credit Suisse's intention, but it would be entirely consistent with the bank's focus on RoRWA and RoE.

¹ We recently completed a study of how regulations may impact specific prime brokers' capital (e.g. for equity/sovereign bond loaned vs cash collateral in the same country/currency) or liquidity (e.g. liquid equity shares collateralised by a liquid share/sovereign bond).

... and supports the progress the bank already made in restructuring and meeting its financial targets

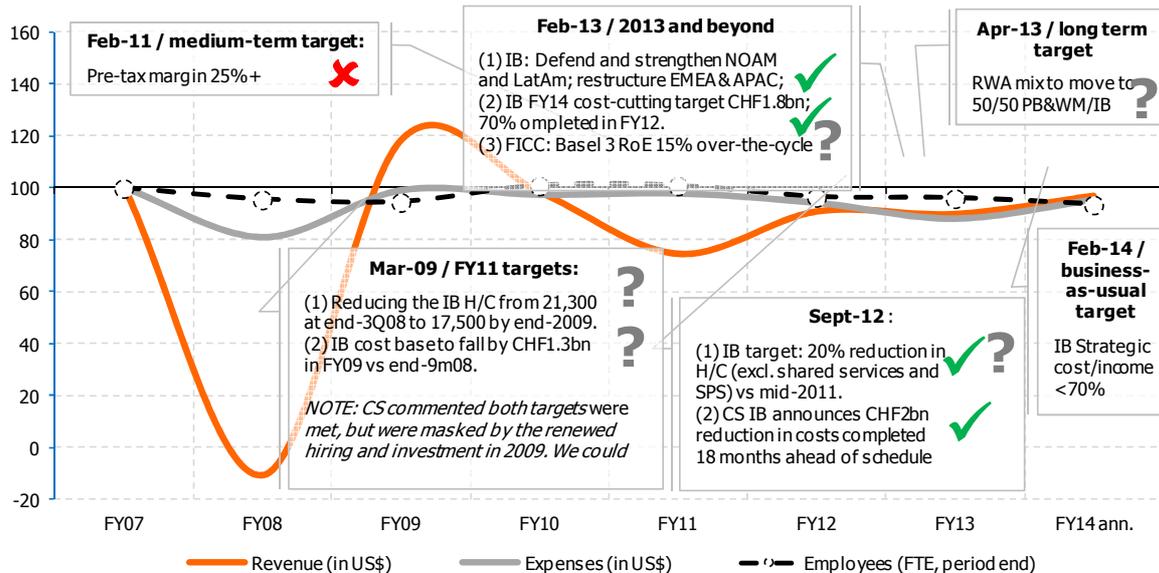
The media, however, focused on Credit Suisse’s staggered cutbacks to its capital markets units (government bond trading and commodities unit were downsized over the past year, too) and the bank’s alleged failure to meet their financial targets. A piecemeal approach to downsizing may not be the most appropriate course of action, especially as these businesses are not interdependent; but we see no evidence that Credit Suisse’s staggered scaling down damaged the wider franchise more than the wholesale closure (a tricky decision to make, in view of the ever-shifting regulation) may have.

More importantly, it is by no means clear that Investment Bank is missing its financial targets – at least in recent times. The chart below updates the dataset we originally compiled in 2013²; it highlights CS Investment Bank Strategic division’s publicly-stated financial targets and, to put those in the context, also plots indexed operating³ revenue, expenses and headcounts.

The last time the bank clearly missed its target was in 2011: struggling to contain costs (its historical challenge), Investment Bank missed its pre-tax profit margin target of 25%. Thereafter, however, the bank has been making steady progress:

- In Feb-13, FICC after-tax RoE target was set at 15% ‘over the cycle’. Reported figures are not helpful, but our profitability analysis suggests that the target may have been reached in recent quarters. Meanwhile, Strategic IB reported RoRE of 19% in 9m14 (down 1% versus a prior year period), significantly above the Group’s 15% target. This is an impressive improvement on 8% from FY12 and 7% from FY13.
- In Apr-13, CS announced that it will – in the long term’ - move the Basel 3 RWA business mix towards 50/50 split between PB&WM and Investment Bank. The bank has not reached that target yet, but it has made steady progress: at end FY12, Investment Bank (Strategic and Non-Strategic divisions) accounted for 65% of the Group’s RWA; this ratio then declined to 64% in FY13 and to 61% at end-3Q14 (57% excluding the Non-Strategic unit).
- In Feb-14, the new IB Strategic cost/income target was <70%. The bank failed to achieve this target (in fact, since FY07, it reached that target only once, in FY09, when it reported 60%), but has reduced cost/income from 94% in FY11 and 74% in FY12 to 71% in FY13 and 69% in 9m14. Investment Bank (including the Non-Strategic unit) is well on target to achieve \$2.1bn reduction in direct costs (\$3bn in fully-loaded costs) by end-FY15.

Credit Suisse IB Strategic businesses (FY07-FY14, indexed to FY07)



Source: Credit Suisse, Tricumen analysis. Note: expenses exclude commission expenses and provision for credit losses.

² In Apr-13, we published conclusions of a study that assesses eight major investment banks’ track record in meeting their stated financial targets. This note is available on our website: <http://www.tricumen.com/theme-capital-markets-planning/>

³ We only excluded commission expenses, DVA/equivalents and items that occurred outside the regular course of business. We include litigation-related items, severance payments, losses on disposal of assets and similar, as they all occurred in the course of ‘regular’ business.

About Tricumen

Tricumen was founded in 2008. It quickly became a strong provider of diversified market intelligence across the capital markets and has since expanded into transaction and corporate banking coverage. Tricumen's data has been used by many of the world's leading investment banks as well as strategy consulting firms, investment managers and 'blue chip' corporations.

Situated near Cambridge in the UK, Tricumen is almost exclusively staffed with senior individuals with an extensive track record of either working for or analysing banks; and boasts what we believe is the largest capital markets-focused research network of its peer group.

Caveats

No part of this document may be reproduced or transmitted in any form by any means without written permission of Tricumen Limited. Such consent is often given, provided that the information released is sourced to Tricumen and that it does not prejudice Tricumen Limited's business or compromise the company's ability to analyse the financial markets. Full acknowledgement of Tricumen Limited must be given.

Tricumen Limited has used all reasonable care in writing, editing and presenting the information found in this report. All reasonable effort has been made to ensure the information supplied is accurate and not misleading. For the purposes of cross-market comparison, all numerical data is normalised in accordance to Tricumen Limited's proprietary product classification. Fully-researched dataset may contain margin of error of 10%; for modelled datasets, this margin may be wider.

The information and commentary provided in this report has been compiled for informational purposes only. We recommend that independent advice and enquiries should be sought before acting upon it. Readers should not rely on this information for legal, accounting, investment, or similar purposes. No part of this report constitutes investment advice, any form of recommendation, or a solicitation to buy or sell any instrument or to engage in any trading or investment activity or strategy. Tricumen Limited does not provide investment advice or personal recommendation nor will it be deemed to have done so.

Tricumen Limited makes no representation, guarantee or warranty as to the suitability, accuracy or completeness of the report or the information therein. Tricumen Limited assumes no responsibility for information contained in this report and disclaims all liability arising from negligence or otherwise in respect of such information.

Tricumen Limited is not liable for any damages arising in contract, tort or otherwise from the use of or inability to use this report or any material contained in it, or from any action or decision taken as a result of using the report.

© Tricumen Limited 2014. All rights reserved.