

Rating Action: Moody's upgrades long-term deposit ratings of The Cooperative Bank, stable outlook

31 May 2022

London, May 31, 2022 -- Moody's Investors Service ("Moody's") today upgraded the long-term deposit ratings of The Co-operative Bank plc (The Co-operative Bank) to Ba2 from Ba3, as well as its standalone Baseline Credit Assessment (BCA) to ba3 from b1. The bank's long-term Counterparty Risk Ratings were upgraded to Ba1 from Ba2 and the long- and short-term Counterparty Risk Assessments were also upgraded to Baa3(cr) and Prime-3(cr) from Ba1(cr) and Not Prime(cr). The bank's other short term ratings and the senior unsecured debt rating of The Co-operative Bank Finance p.l.c. (The Co-operative Bank Finance), the holding company of The Co-operative Bank, were affirmed.

The outlook on the senior unsecured debt rating of The Co-operative Bank Finance and on the long-term deposit ratings of The Co-operative Bank has been changed to stable from positive.

A full list of affected ratings can be found at the end of this press release.

RATINGS RATIONALE

Moody's said the upgrade of The Co-operative Bank's long-term deposit ratings and the upgrade of its BCA reflect the bank's improving profitability, supported by rising interest rates and robust volumes, which is a sign of progress towards a sustainable capital generative business model. Never the less, the bank still suffers from weak efficiency and susceptibility to capital erosion in a stress due to still weak core profitability. The affirmation of The Co-operative Bank Finance's senior unsecured debt rating reflects relatively higher loss-given-failure which now results in no uplift under Moody's advanced Loss Given Failure analysis.

The rating agency said that higher base rates in the UK which will also likely rise further over the next 12-18 months coupled with lower charges for extraordinary items will mean that the bank's recent return to profitability will continue and it will begin generating capital internally. While loan growth will be moderate over the next 12-18 months, the bank will be able to reprice its mortgage loans at higher rates which will lead to growth in net interest income given that the bank is predominantly deposit funded. As of December 2021, the bank's capitalization was 38%, and recovering profitability will make the bank's capital less susceptible to stress. However, the bank still does not meet its regulatory stress capital buffer due to its still relatively weak profitability which constrains the rating agency's view of its capital strength. The bank's asset risk is expected to remain low but to tick up from current low levels, and remain well covered by provisions particularly in light of the highly secured nature of its loan book.

At the same time, despite a return to positive profitability in 2021, The Co-operative Bank's internal capital generation will remain relatively weak given its still high cost to income ratio. Moody's also notes that the bank's 2021 net income was heavily reliant on tax loss carry forwards. The Co-operative Bank's cost of funding will also increase as a result of the need to issue additional capital instruments to meet with its minimum requirements for own funds and eligible liabilities (MREL) which led the bank to issue senior unsecured debt of £250 million in April 2022. As such, despite improvements, the rating agency continues to see challenges remaining for the bank as it looks to achieve stable and reliable earnings and a sustainable business model, a key governance consideration and a key rating constraint.

In line with a regulatory need to issue MREL-compliant debt by the end of 2022, the bank's recent £250 million issuance coupled with Moody's expectation that the bank's balance sheet will only moderately grow over the outlook horizon, provides additional protection to The Co-operative Bank's junior depositors. This results in an unchanged notching under Moody's Loss Given Failure analysis to the bank's long-term deposit rating but the holding company's senior unsecured debt rating remains at B1, now one notch below the bank's BCA.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

The Co-operative Bank's BCA could be upgraded following a stronger than expected improvement in profitability, leading to durable and sustainable internal capital generation through earnings. An upgrade of the

BCA would lead to an upgrade of the long-term deposit ratings of The Co-operative Bank and the senior unsecured debt rating for The Co-operative Bank Finance. The Co-operative Bank Finance's senior unsecured debt rating and The Co-operative Bank's long-term deposit ratings could also be upgraded following a material increase in the stock of bail-in-able liabilities issued by The Co-operative Bank Finance or by The Co-operative Bank.

The Co-operative Bank's BCA could be downgraded following evidence that the bank will not return to a sustainable level of net profitability beyond 2022 or if asset risk began to show strong signs of weakness. A downgrade of The Co-operative Bank's BCA would lead to a downgrade of all long-term ratings of The Co-operative Bank and The Co-operative Bank Finance.

LIST OF AFFECTED RATINGS

Issuer: The Co-operative Bank Finance p.l.c.

..Affirmation:

....Long-term Issuer Ratings, affirmed B1, outlook changed to Stable from Positive

....Short-term Issuer Ratings, affirmed NP

....Senior Unsecured Regular Bond/Debenture, affirmed B1, outlook changed to Stable from Positive

..Outlook Action:

....Outlook changed to Stable from Positive

Issuer: The Co-operative Bank plc

..Upgrades:

....Long-term Counterparty Risk Ratings, upgraded to Ba1 from Ba2

....Long-term Bank Deposits, upgraded to Ba2 from Ba3, outlook changed to Stable from Positive

....Long-term Counterparty Risk Assessment, upgraded to Baa3(cr) from Ba1(cr)

....Short-term Counterparty Risk Assessment, upgraded to P-3(cr) from NP(cr)

....Baseline Credit Assessment, upgraded to ba3 from b1

....Adjusted Baseline Credit Assessment, upgraded to ba3 from b1

..Affirmations:

....Short-term Counterparty Risk Ratings, affirmed NP

....Short-term Bank Deposits, affirmed NP

..Outlook Action:

....Outlook changed to Stable from Positive

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks Methodology published in July 2021 and available at <https://ratings.moodys.com/api/rmc-documents/71997>. Alternatively, please see the Rating Methodologies page on <https://ratings.moodys.com> for a copy of this methodology.

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For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on <https://ratings.moodys.com/rating-definitions>.

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