

21 JUL 2021

Fitch Upgrades The Co-operative Bank to 'B+'; Outlook Stable

Fitch Ratings - London - 21 Jul 2021: Fitch Ratings has upgraded The Co-operative Bank Plc's Long-Term Issuer Default Rating (IDR) to 'B+' from 'B'. The Outlook is Stable. The bank's Viability Rating (VR) has also been upgraded to 'b' from 'b-'.

The upgrade largely reflects improved profitability prospects, after several years of losses, aided by government-support measures and a buoyant housing market. This will benefit the bank's capitalisation and reduce downside risks to strategic execution. At the same time, the bank's risk appetite and asset quality have proved more resilient than expected.

Key Rating Drivers

IDRS and VR

The Co-operative Bank's VR is weighed down by weaker capitalisation than peers', particularly in light of the bank's limited ability to generate internal capital due to weak structural profitability, despite recent improvements. The VR also considers a low risk business model, which focuses on mortgage lending; healthy asset quality; sound liquidity; and a resilient deposit base, which provides the majority of funding.

The Co-operative Bank's franchise has been resilient through various stresses, utilising its ethical focus to attract and maintain customers but the business model continues to face uncertainty, particularly given its limited diversification and scale. Its weak competitive advantage than larger universal banking peers' stems from a high cost base, which we believe will continue to pose challenges over the longer term. The bank has been successful in achieving greater scale in 1Q21 with 5% growth in its loan book, as it increased exposure to SMEs via government-backed schemes and took advantage of wider asset margins in the mortgage space to increase low-risk exposure to these sectors.

Asset quality is a rating strength for The Co-operative Bank with its loan book clean-up largely complete. Government-support measures for the housing market and the furlough scheme have supported headline asset-quality metrics with the bank reporting an impaired loan ratio of 0.3% at end-1Q21 (0.8% when including purchased originated credit-impaired loans).

The bank's low-risk business model primarily underwriting owner-occupied mortgages, with limited SME and unsecured exposure should continue to hold up well once support measures expire with limited deterioration. We forecast the average four-year impaired loan ratio to rise but to remain

below 2% at end-2022, supporting an upward revision of the bank's asset-quality score to 'bbb+' from 'bbb-'.

The Co-operative Bank posted a profit in 1Q21 for the first time since 2011, albeit small at GBP4.9 million. This was largely supported by its restructuring, wider spreads in the mortgage market and a one-off refund for business rates. However, overall structural profitability remains weak and faces ongoing challenges such as an expected decrease in asset margins, which have been strong since 2H20, and pressure on interest income due to debt issuance to meet regulatory requirements in 2022.

Nevertheless, we believe the bank is now better positioned to remain structurally profitable over the medium term, supported by reduced operating costs and the completion of longstanding projects in recent years. All this supports our revised assessment of earnings and profitability to 'b-' from 'ccc+'. The positive trend on this factor highlights scope for further improvement as the bank benefits from the economic recovery in the UK and positions itself for further growth.

The Co-operative's Bank's common equity Tier 1 (CET 1) ratio of 19.9% at end-1Q21 reflects a low-risk business model and the low risk weights assigned to mortgage assets under the bank's internal ratings-based approach. Although the CET1 ratio is in line with peers', we view capitalisation as weaker than peers' as buffers above minimum regulatory capital requirements of 12.8% should be considered in light of improved but limited internal capital generation and growth plans. In our assessment of capitalisation, we also consider the bank's tighter leverage ratio of 3.9% which remains a constraint on growth. The Co-operative Bank currently meets interim minimum requirement for own funds and eligible liabilities (MREL) as set by the Bank of England (BoE).

The bank is predominantly retail-funded, with a resilient core deposit base through various stresses. Access to wholesale markets remains limited compared with peers' and is largely in the form of covered bonds, securitised funding and access to low-cost central-bank funding schemes. The BoE's Term Funding Scheme drawings for SMEs amounted to GBP1.75 billion at end-1Q21 and were staggered to reduce refinancing risks when funding matures. The bank's reliance on this funding is expected to materially increase asset encumbrance to the higher end versus mortgage lending peers'.

Liquidity is healthy with a large buffer of high-quality liquid assets (15% of total assets at end-1Q21). The bank's liquidity coverage ratio of 163% at end-1Q21 remained well above the regulatory requirement.

Fitch assigns a one-notch uplift to The Co-operative Bank's 'B+' Long-Term IDR to reflect the presence of resolution debt buffers, which provide protection to the bank's third-party senior creditors in case of failure. We calculate that these debt buffers, composed of Tier 2 debt as well as senior non-preferred debt issued by The Co-operative Bank Finance Plc, totalled 9.3% at 1Q21. We expect further MREL-eligible debt issuance to meet end-state MREL set by the BoE on a sustained basis.

The Short-Term IDR of The Co-operative Bank 'B' is the only short-term option mapping to the Long-Term IDR.

SUPPORT RATING (SR) AND SUPPORT RATING FLOOR (SRF)

The Co-operative Bank's SR of '5' and SRF of 'No Floor' reflect Fitch's view that senior creditors cannot rely on extraordinary support from the UK authorities in the event the bank becomes non-viable, because in our opinion the legislation and regulation implemented in the UK is likely to require senior creditors to participate in losses in resolving the bank.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

An upgrade would require the bank to sustain a longer record of improved structural profitability, which could manifest in a stable positive operating profit/risk-weighted assets ratio, while maintaining healthy buffers above capitalisation requirements.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

The ratings could be downgraded if The Co-operative Bank's CET1 ratio falls towards 14% with no discernible actions to reverse the trend or if pressure increases on the UK leverage ratio.

The Long-Term IDR is also sensitive to the bank remaining subject to the regulatory resolution buffer requirements as communicated by the BoE and maintaining a sustainable buffer amount, which includes qualifying junior debt and internal subordinated debt down-streamed from The Co-operative Bank Finance Plc. The Long-Term IDR could be downgraded to the same level as the VR if the bank is no longer required or able to meet end-state regulatory resolution requirements.

SR AND SRF

Fitch does not expect any changes to the SR and the SRF due to legislation requiring senior creditors to participate in losses in resolving The Co-operative Bank.

Best/Worst Case Rating Scenario

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit <https://www.fitchratings.com/site/re/10111579>

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

Fitch Ratings Analysts

Claudia Nelson

Senior Director
Primary Rating Analyst
International
+44 20 3530 1191
Fitch Ratings Ltd 30 North Colonnade, Canary Wharf London E14 5GN

Christopher Ogunleye

Senior Analyst
Secondary Rating Analyst
International
+44 20 3530 1192

Cristina Torrella Fajas

Senior Director
Committee Chairperson
+34 93 323 8405

Media Contacts

Louisa Williams

London
+44 20 3530 2452
louisa.williams@thefitchgroup.com

Rating Actions

ENTITY/DEBT	RATING	RECOVERY	PRIOR
The Co-	LT IDR	B+ ●	Upgrade
			B ●

ENTITY/DEBT	RATING		RECOVERY	PRIOR
operative Bank p.l.c.				
	ST IDR	B	Affirmed	B
	Viability	b	Upgrade	b-
	Support	5	Affirmed	5
	Support Floor	NF	Affirmed	NF

RATINGS KEY OUTLOOK WATCH

POSITIVE	⊕	◊
NEGATIVE	⊖	◊
EVOLVING	◊	◆
STABLE	◐	

Applicable Criteria

[Bank Rating Criteria \(pub.28 Feb 2020\) \(including rating assumption sensitivity\)](#)

Additional Disclosures

[Solicitation Status](#)

[Endorsement Status](#)

Disclaimer

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](https://www.fitchratings.com/understandingcreditratings). IN ADDITION, THE FOLLOWING [HTTPS://WWW.FITCHRATINGS.COM/RATING-DEFINITIONS-DOCUMENT](https://www.fitchratings.com/rating-definitions-document) DETAILS FITCH'S RATING DEFINITIONS FOR EACH RATING SCALE AND RATING CATEGORIES, INCLUDING

DEFINITIONS RELATING TO DEFAULT. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT [HTTPS://WWW.FITCHRATINGS.COM/SITE/REGULATORY](https://www.fitchratings.com/site/regulatory). FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR WHICH THE LEAD ANALYST IS BASED IN AN ESMA- OR FCA-REGISTERED FITCH RATINGS COMPANY (OR BRANCH OF SUCH A COMPANY) CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH RATINGS WEBSITE.

Copyright

Copyright © 2021 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind,

and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001

Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see <https://www.fitchratings.com/site/regulatory>), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

Endorsement policy

Fitch's international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes,

pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch's approach to endorsement in the EU and the UK can be found on Fitch's [Regulatory Affairs](#) page on Fitch's website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.