

Rating Action: Moody's upgrades Co-operative Bank's long-term debt rating to Caa2 and confirms deposit rating at Caa2 with a positive outlook

Global Credit Research - 07 Sep 2017

Action follows completion of the capital raising plan

London, 07 September 2017 -- Moody's Investors Service has today upgraded the standalone baseline credit assessment (BCA) of the Co-operative Bank Plc (the Co-op Bank) to caa2 from ca in light of its improved credit profile and capital position given the implementation of the bank's capital increase.

Moody's upgraded the bank's long-term senior unsecured debt rating to Caa2 from Ca, reflecting the completion of the bank's capital raising plan without the imposition of any losses on this class of creditors.

Moody's confirmed the long-term deposit ratings at Caa2, at the same level as its standalone BCA, given the reduced amount of subordination benefiting this class of liabilities due to the cancellation of Tier 2 capital as part of the restructuring. The short-term deposit ratings were affirmed at Not Prime.

The outlook on the long-term debt and deposit ratings is positive, driven by Moody's expectation that the completion of the bank's recapitalization will enable it to focus on the reduction of its non-core portfolio, improving its profitability and low efficiency.

The rating action follows the bank's announcement on 1 September, 2017 that the bank had raised approximately GBP700 million of additional common equity tier 1 (CET1) capital, before expenses, through the conversion of subordinated debt into equity and the issuance of new equity.

This rating action concludes the review initiated on 30 June, 2017.

The full list of affected ratings is at the end of this press release.

RATINGS RATIONALE

---RATIONALE FOR THE BCA

The upgrade of the bank's BCA to caa2 from ca reflects Moody's view that the bank's standalone creditworthiness has improved with the completion of the recapitalization plan and the injection of GBP250 million new equity by certain shareholders and bondholders in addition to the conversion of GBP443 million of Tier 2 bonds into common equity. The agency expects that the bank's outstanding GBP400 million senior unsecured bonds will be fully repaid upon their maturity in late September 2017 without materially affecting the bank's liquidity position.

As a result of the restructuring, the bank will immediately meet the CET1 component of its Individual Capital Guidance (ICG), but full ICG compliance (i.e. Pillar 1 + 2A requirements set by the Prudential Regulation Authority) depends upon the completion of the Co-op Bank's proposed issuance of Tier 2 capital in 2018. The recapitalization has also improved the bank's risk-absorption capacity which has been weighed down by a sizeable legacy portfolio of corporate and commercial real estate loans and residential mortgages (the Optimum book). This legacy loan book's share of the bank's total credit risk-weighted assets was 32%, at GBP2 billion, as of end-June 2017. Following the recapitalization, the bank has announced its intentions to deleverage GBP2 billion of the Optimum portfolio and reduce its RWAs, although the full impact on capital ratios is not yet known.

The relatively low BCA is constrained by the fact that despite the implementation of the restructuring plan, the bank remains in breach of its full ICG requirements and due to ongoing losses has limited capacity for internal capital generation until 2019, in Moody's view. This makes the bank dependent on a Tier 2 issue to comply, but of which the success is far from certain. Moody's also notes the outflow of deposits during the first half of 2017 which, if continued, may erode the bank's available liquid assets. However, the agency notes that these outflows subsequently stabilised and expects this trend to prevail following the recapitalization.

---RATIONALE FOR SENIOR DEBT

The upgrade of the bank's long-term senior unsecured debt ratings to Caa2 from Ca reflects the fact that the plan was carried out without any impairment of this debt class and instead relied on the conversion of Tier 2 subordinated debt into equity. It also reflects the upgrade of the bank's standalone BCA to caa2, offset by the lack of protection from more subordinated debt liabilities. The senior unsecured debt will mature in late September 2017, leaving the bank with no outstanding senior unsecured bonds.

---RATIONALE FOR DEPOSITS

Moody's confirmation of the bank's long-term deposit ratings at Caa2 reflects the upgrade of the bank's BCA to caa2 and the agency's Loss Given Failure analysis for the bank's wholesale uninsured deposits. With the expected repayment of the senior debt and conversion of the Tier 2 instruments into equity, these deposits are exposed to any loss exceeding the bank's equity.

RATIONALE FOR POSITIVE OUTLOOK

The positive outlook on the bank's long-term ratings is driven by the potential benefit to the bank's standalone BCA from the continued improvement in asset risk as its non-core loan book shrinks, cost-cutting measures are implemented, and profitability improved. Nevertheless, Moody's expects these improvements to be gradual, given a more uncertain macroeconomic context and a subdued UK mortgage market.

WHAT COULD CHANGE THE RATINGS UP/DOWN

A downgrade of the bank's standalone BCA, and correspondingly its long-term debt and deposit ratings, could occur in the event of losses resulting in a breach of the bank's Pillar 1 CET1 requirement, reduced liquidity or further deposit outflows, or any other factor leading to an increased probability of regulatory intervention.

The BCA could be upgraded if the bank meets its profitability and capital targets while completing its reduction in non-core lending. An upgrade in the BCA would likely lead to an upgrade in all long-term debt and deposit ratings.

The principal methodology used in these ratings was Banks published in January 2016. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

LIST OF AFFECTED RATINGS

Issuer: Co-operative Bank Plc

Upgrades:

- Senior Unsecured Regular Bond/Debenture, Upgraded to Caa2 Positive from Ca Rating Under Review
- Senior Unsecured MTN Program, Upgraded to (P)Caa2 from (P)Ca
- Adjusted Baseline Credit Assessment, Upgraded to caa2 from ca
- Baseline Credit Assessment, Upgraded to caa2 from ca
- LT Counterparty Risk Assessment, Upgraded to B3(cr) from Caa1(cr)

Confirmation:

- LT Bank Deposits (Local & Foreign Currency), Confirmed at Caa2 Positive from Rating Under Review

Affirmations:

- ST Bank Deposits (Local & Foreign Currency), Affirmed NP
- ST Counterparty Risk Assessment, Affirmed NP(cr)
- Other Short Term, Affirmed (P)NP
- Commercial Paper, Affirmed NP

Outlook Actions:

...Outlook, Changed To Positive from Rating Under Review

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