

FITCH AFFIRMS CO-OP BANK AT 'B'; OUTLOOK NEGATIVE

Fitch Ratings-London-20 December 2013: Fitch Ratings has affirmed The Co-operative Bank Plc's (Co-op Bank) Issuer Default Rating (IDRs) and senior debt ratings at 'B'. The Rating Watch Negative (RWN) has been removed following the successful completion of the liability management exercise (LME) which has recapitalised the bank. Court approval for the debt exchange was received on 18 December 2013, following a vote in favour of the LME by bondholders and was settled on 20 December 2013.

Fitch has placed the Long-term IDR on Negative Outlook due to the on-going challenges the bank faces in returning to sustainable profitability, risks of strategic drift and potential damage to Co-op Bank's customer funding franchise.

Fitch has also downgraded the bank's VR to 'f' and immediately upgraded it to 'b'. The downgrade acknowledges the losses incurred by the junior bondholders on successful completion of the LME which represent a failure by the bank according to Fitch's definitions. The subsequent upgrade reflects Fitch's view that the bank has returned to viability following the recapitalisation. The Recovery Rating of the bank's senior debt has been affirmed at 'RR4'.

A full list of rating actions is at the end of this rating action commentary.

KEY RATING DRIVERS - IDRS, VR AND SENIOR DEBT

Co-op Bank's VR has been realigned with its IDR and the ratings are driven by Co-op's standalone creditworthiness. The bank's IDRs, VR and senior debt ratings reflect Fitch's view that the bank's capitalisation remains weak, despite the LME and that it is expected to remain weak in the foreseeable future given its revised strategy. Persistent losses are expected over the medium-term as the bank invests heavily in IT and as it de-risks its balance sheet through the disposal of its non-core loan portfolios. Non-core, non-prime and commercial loan portfolios (44% of gross loans at end-1H13) show fair values well below their carrying values, which is likely to hinder the pace of deleveraging, leaving material tail risk in the portfolio for several years. This could cause a large spike in credit impairment charges.

Potential significant conduct redress could also be a risk to the bank's capital base.

The Negative Outlook on the Long-term IDR reflects the considerable challenges that the bank will face during its restructuring, corporate governance challenges as well as the risks of strategic drift in the control of new shareholders. The Negative Outlook also captures the potential negative impact the change in shareholding and recent media attention could have on Co-op Bank's previously stable and loyal customer base.

RATING SENSITIVITIES - IDRS, VR AND SENIOR DEBT

The Outlook on the Long-term IDR is Negative. The bank's IDRs, VR and senior debt ratings are sensitive to the extent of losses incurred from restructuring and credit impairment charges as well as strategic drift or a weakening of its funding franchise. Fitch considers that the current strategy leaves little margin for error and downside risk still exists for the IDR if the combined weak operating performance and asset quality impairments become significantly destructive to capital ratios.

The ratings are also sensitive to a further revision of strategy following the change in ownership structure. Upside potential is limited until the bank becomes capital generative.

The senior debt's Recovery Rating of 'RR4' reflects Fitch's expectation that in the event of a default, recoveries on unsecured senior debt would be in the range of 31% to 50%, due to the bank's considerable share of encumbered assets (about 29% at end- 1H13), potential additional stress for the loan book and a reduced Tier 2 buffer after the LME.

KEY RATING DRIVERS AND SENSITIVITIES - SUPPORT RATING AND SUPPORT RATING FLOOR

The bank's Support Rating of '5' and Support Rating Floor of 'NF' have been affirmed and are consistent with Fitch's view of a clear political intention to ultimately reduce implicit support for banks in the UK. Fitch does not expect any change to these ratings.

KEY RATING DRIVERS - SUBORDINATED DEBT AND OTHER HYBRID SECURITIES

Fitch has withdrawn the subordinated debt's ratings as these instruments have been written down and no longer exist.

The rating actions are as follows:

Long-term IDR: affirmed at 'B'; RWN removed; placed on Negative Outlook

Short-term IDR: affirmed at 'B'; RWN removed

Viability Rating: downgraded to 'f' from 'c' and immediately upgraded to 'b'

Support Rating: affirmed at '5'

Support Rating Floor: affirmed at 'NF'

Senior unsecured notes' Long-term rating: affirmed at 'B'/RR4'; RWN removed

Senior unsecured notes' Short-term rating: affirmed at 'B'; RWN removed

5.5555% Upper Tier 2 securities GB00B3VMBW45: ratings withdrawn

13% Upper Tier 2 securities GB00B3VH4201: ratings withdrawn

Lower Tier 2 subordinated notes: ratings withdrawn

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Additional information is available on www.fitchratings.com.

Applicable criteria, 'Global Financial Institutions Rating Criteria', dated 15 August 2012, 'Evaluating Corporate Governance', dated 12 December 2012, 'Distressed Debt Exchange', dated 2 August 2013, 'Assessing and Rating Bank Subordinated and Hybrid Securities', dated 5 December 2012 and 'Recovery Ratings for Financial Institutions' dated 24 September 2013 are available on www.fitchratings.com.

Applicable Criteria and Related Research:

Global Financial Institutions Rating Criteria

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=686181

Evaluating Corporate Governance

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=694649

Distressed Debt Exchange

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=715005

Assessing and Rating Bank Subordinated and Hybrid Securities

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=695542

Recovery Ratings for Financial Institutions

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=717538

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