MOODY'S
INVESTORS SERVICE

CREDIT OPINION
26 March 2018

Update

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RATINGS

Co-operative Bank Plc

Domicile	United Kingdom
Long Term Debt	(P)Caa2
Type	Senior Unsecured MTN - Dom Curr
Outlook	Not Assigned
Long Term Deposit	Caa2
Type	LT Bank Deposits - Fgn Curr
Outlook	Positive

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Co-Operative Bank Plc

Update to annual results, year-end 2017

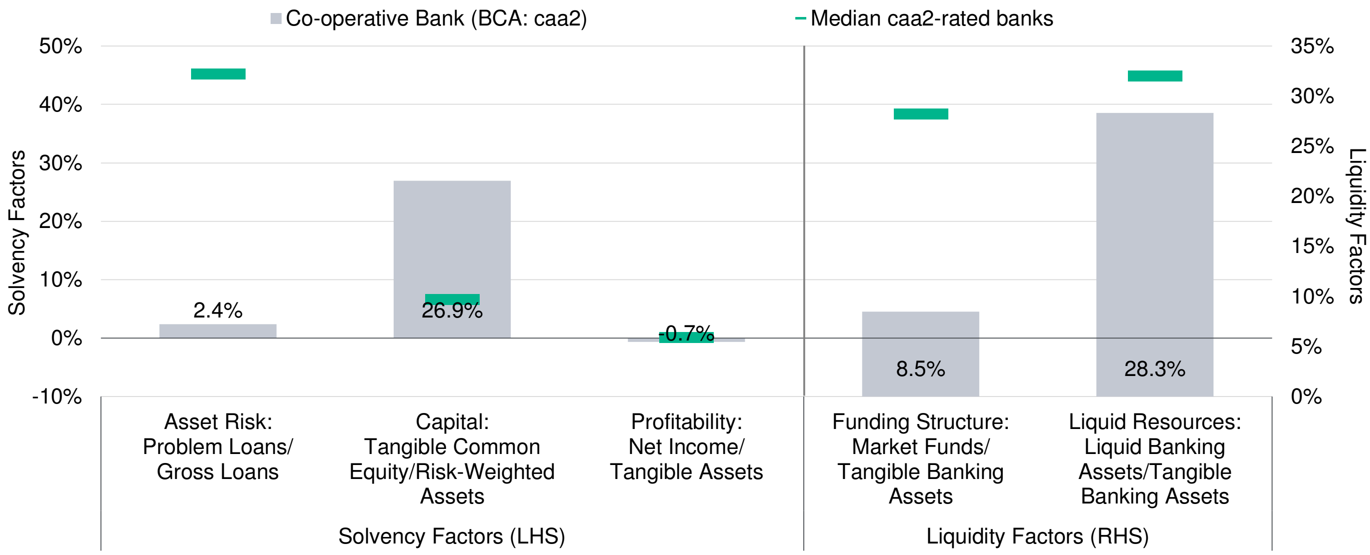
Summary

We rate Co-operative Bank's long-term deposit and senior unsecured debt ratings at Caa2, following the completion of the bank's capital raising plan without the imposition of any losses on this class of creditors. These ratings are underpinned by (1) the upgrade of the bank's standalone baseline credit assessment (BCA) to caa2 from ca and (2) the results of our Advanced Loss Given Failure (LGF) analysis, resulting in no additional uplift for the bank's deposits. The bank's long-term Counterparty Risk Assessment (CR Assessment) is at B3(cr)/ Not Prime.

Co-Operative Bank's BCA at caa2 continues to reflect (1) our expectation of the bank not returning to profitability until at least 2019 and therefore limited capacity for the bank to achieve internal capital generation; (2) the bank's relatively stable funding position, despite some outflow of deposits in 2017; and (3) sufficient liquid resources.

The outlook on Co-operative Bank's long-term ratings is positive, reflecting our expectation that the completion of the bank's recapitalisation will enable it to focus on improving its profitability and low efficiency.

Exhibit 1
Key financial ratios



December 2017 ratios for Co-operative Bank
Source: Moody's Banking Financial Metrics

Credit strengths

» Low reliance on wholesale funding;

» Sufficient liquidity levels.

Credit challenges

» Negative profitability due to high cost base and legacy issues;

» Uncertainty around the bank's ability to generate capital organically in the medium-term;

Rating outlook

The outlook on Co-operative Bank's long-term debt and deposit ratings is positive, reflecting our expectation that the completion of the bank's recapitalisation will enable it to focus on improving its profitability and low efficiency.

Factors that could lead to an upgrade

The BCA could be upgraded if the bank improves its currently weak profitability and meets its capital targets. An upgrade in the BCA would likely lead to an upgrade in all long-term debt and deposit ratings.

Factors that could lead to a downgrade

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 CET1 requirement, reduced liquidity or further deposit outflows, or any other factor leading to an increased probability of regulatory intervention.

Key indicators

Exhibit 2

Co-operative Bank Plc (Consolidated Financials) [1]

	12-17[2]	12-16[2]	12-15[2]	12-14[2]	12-13[2]	CAGR/Avg.[3]
Total Assets (GBP billion)	24	27	29	38	43	-13.3[4]
Total Assets (EUR billion)	28	32	39	48	52	-14.7[4]
Total Assets (USD billion)	33	34	43	59	72	-17.6[4]
Tangible Common Equity (GBP billion)	1.4	0.8	1.1	1.8	1.6	-4.2[4]
Tangible Common Equity (EUR billion)	1.5	0.9	1.5	2.3	2.0	-5.7[4]
Tangible Common Equity (USD billion)	1.9	0.9	1.7	2.8	2.7	-8.9[4]
Problem Loans / Gross Loans (%)	2.4	3.6	5.2	9.2	10.8	6.2[5]
Tangible Common Equity / Risk Weighted Assets (%)	26.9	11.4	15.2	14.2	10.8	15.7[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	27.4	79.4	74.6	103.5	131.1	83.2[5]
Net Interest Margin (%)	1.0	0.8	0.9	0.9	0.7	0.9[5]
PPI / Average RWA (%)	-3.4	-5.9	-3.6	-2.3	-1.7	-3.4[6]
Net Income / Tangible Assets (%)	-0.7	-1.3	-1.8	-0.4	-3.0	-1.4[5]
Cost / Income Ratio (%)	167.4	254.9	197.5	167.5	150.6	187.6[5]
Market Funds / Tangible Banking Assets (%)	8.5	11.3	12.6	12.6	17.7	12.5[5]
Liquid Banking Assets / Tangible Banking Assets (%)	28.4	26.0	27.4	25.5	22.6	25.9[5]
Gross Loans / Due to Customers (%)	81.5	87.2	87.4	87.8	94.7	87.7[5]

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel III - fully-loaded or transitional phase-in; IFRS [3] May include rounding differences due to scale of reported amounts [4] Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime [5] Simple average of periods presented for the latest accounting regime. [6] Simple average of Basel III periods presented

Source: Moody's Financial Metrics

Profile

Co-operative Bank is a commercial bank based in the UK that provides banking and related financial products and services to retail and corporate customers in the UK. Its products and services include mortgages and loans, clearing services, current accounts, credit cards, internet banking, and savings and investment products.

Co-operative Bank was established in 1872 as the Loan and Deposit Department of the Cooperative Wholesale Society. In January 2009, the bank announced a merger with Britannia Building Society (Britannia), the second-largest building society in the UK at the time.

Co-operative Bank's ownership structure changed substantially as a result of the LME, while shareholdings were altered by the capital-raising exercise conducted in September 2017.

Detailed credit considerations

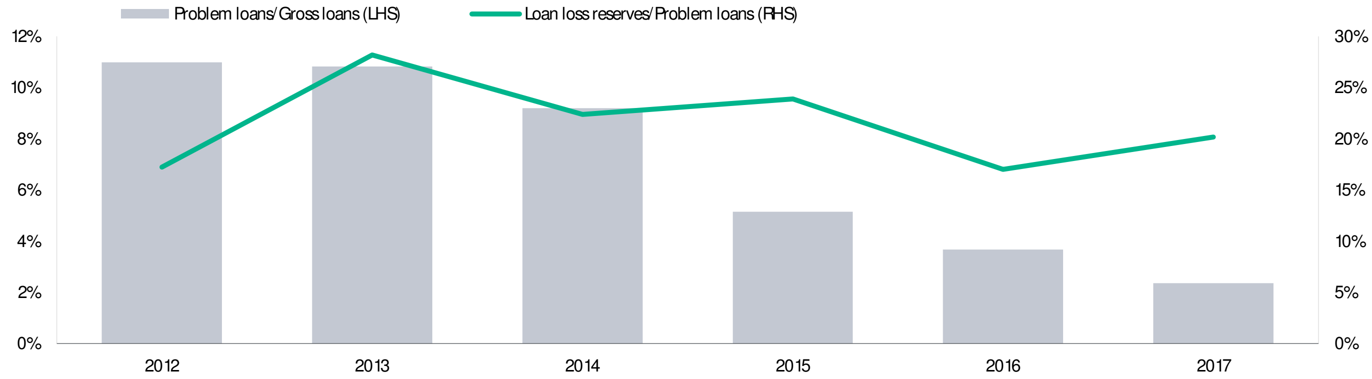
Improving asset quality, but downside risks remain

We note improving trends in asset quality of Co-operative Bank with a problem loan ratio at 2.4% at end-2017 (3.6% at end-2016). However, as the bank's secured residential portfolio at £14.1 billion (appx. 85% of total lending) has been well performing, its corporate and optimum portfolio (appx. 15% of total lending) has a higher concentration of nonperforming loans, albeit with improving trends. The Corporate portfolio includes SME Business, Commercial and CRE loans of £0.3Bn and a Legacy portfolio of £1.3Bn which was run down over the past few years. We note significant decrease in Optimum portfolio balances to £0.6 billion from £2.6 billion in 2016 driven by deleveraging and a securitization deal. At end-2017, 18.4% of Optimum loans were impaired. In contrast, the retail secured residential mortgage book had 1% of loans impaired and an average LTV of 53%. The retail secured portfolio has material geographic concentration to London and South East measured at 43.4% which would expose the bank to downside risk in the event of a sharp downturn in property prices in the region.

Impairment expenses were £1.9 million in 2017 compared to £6.2 million gains in 2016 owing primarily to lower levels of deleveraging. We expect the bank's impairment charges to pick up amid the more challenging operating environment in the UK which we anticipate as the country negotiates its exit from the EU. Co-operative Bank's total coverage ratio at 20% in 2017 was below the average of its UK peers.

Exhibit 3

The bank's asset quality is weighed down by the non-core assets; provision coverage remains below that of peers



Source: Moody's Banking Financial Metrics

We assign an Asset Risk score of caa1 to reflect: (1) the downside risks in the remaining non-core portfolio; (2) pressures from the weakening operating environment; and (3) execution risks inherent in the bank's currently ongoing transformation plan.

Successful execution of the recapitalisation plan strengthened capital ratios and contributed to meeting individual capital guidance compliance

On 1 September 2017 Co-operative Bank announced successful completion of recapitalisation plan including the injection of £250 million new equity by certain shareholders and bondholders and the conversion of c.£443 million of Tier 2 bonds into common equity.

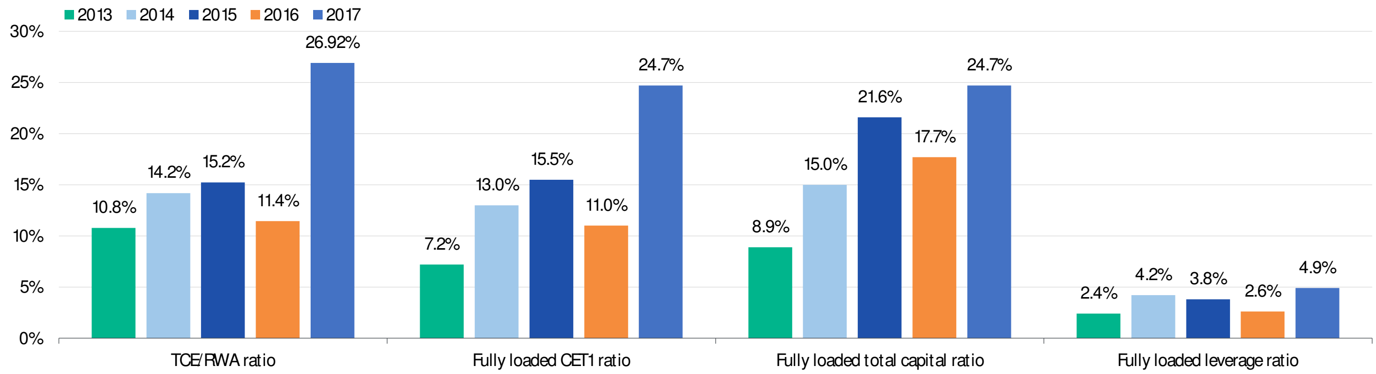
The bank reported a fully loaded common equity tier 1 (CET1) ratio of 24.7% in 2017, up from 11% at December 2016. Its fully loaded total capital ratio stood at 24.7% as of the same date (17.7% at December 2016). As a result of the restructuring, the bank now fully meets its 18% of RWA ICG requirement with CET1 as of year end 2017, no longer holding Tier 2 resources.

The recapitalisation 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), before the deleveraging. Total credit risk RWA decreased by approximately 31% driven by deleveraging of Legacy and Optimum portfolio as well as decrease of Treasury RWA balances.

Nevertheless, despite improved capital position Co-operative Bank continues to face challenges in its efforts to rebuild a sustainable business model. So far the bank has been unable to generate capital organically due to ongoing restructuring costs and subdued income amid the low interest rate environment.

Our assigned Capital score of b1 incorporates Co-operative Bank's strengthened capital levels but has limited capacity for internal capital generation.

Exhibit 4
Co-operative Bank's capital metrics



Source: Moody's Banking Financial Metrics and the bank's financial reports

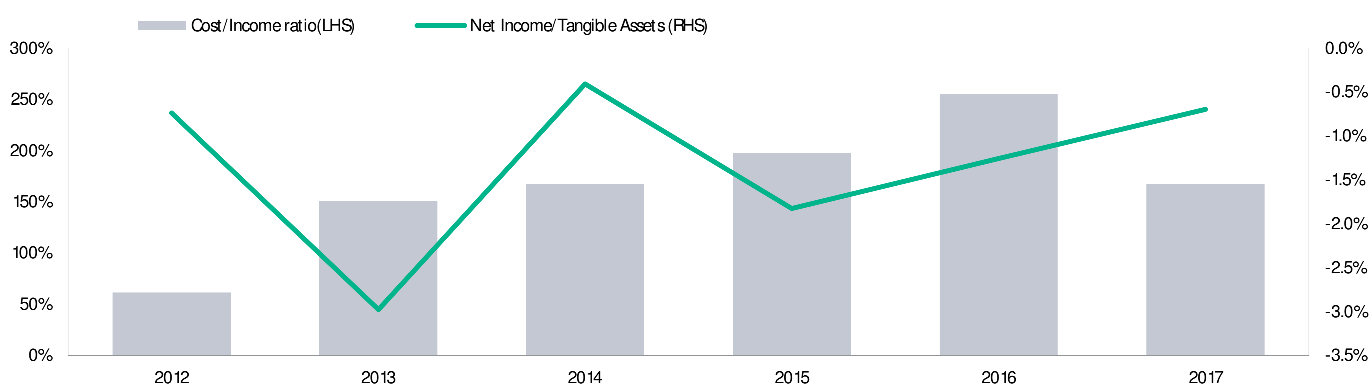
Profitability is negative and we expect the bank to remain loss-making over the outlook period

We believe the bank is unlikely to return to profitability until at least 2019 due to low interest margins, an exceptionally high cost base and potential further impairment losses and losses on asset sales. In 2017 Co-operative Bank reported a statutory loss before tax of £174 million, compared to the £477 million pre-tax loss reported in 2016. A better result reflects reduced operating costs and project expenditures. The bank also completed its fair value write-down in 2017 and this item will not affect profitability in future. At the same time, net interest income fell by 20% and the bank saw a decrease in write-backs of loan loss provisions as deleveraging activity winds down. We calculate a net income to tangible assets ratio of -0.65% for 2017 which is an improvement from -1.53% in 2016.

Co-operative bank's net interest margin (NIM) decreased by 18 basis points to 1.22% in the 2017 from 1.40% in 2016, as reported by the bank. The reduction reflects mortgage margin pressures, lower returns on financial assets (albeit the quality has improved after the reduction in the legacy portfolio) and customer deposit pricing. The bank's NIM remains under pressure and is expected to face further margin pressures following the UK's decision to leave the EU with rates now likely to stay low for an extended period of time. Amid weak interest income the bank will also continue to see impediments to fee and commissions income down by 18.5% in 2017, negatively affected by industry-wide lower card interchange rates, and significantly lower commission income following the disposals in the ATM estate. Impairment write-backs, which were supporting the profitability in the past couple of years, reversed to £1.9 million expenses in 2017.

Operating and project expenses, although decreasing, remain elevated. Combined with subdued operating income, this resulted in the bank's reported cost to income ratio of 108.1% in 2017 (103.6% in 2016)

Exhibit 5
High cost base impedes Co-operative Bank's profitability



Source: Moody's Banking Financial Metrics

Conduct charges totaled £27.4 million for the period which is £2.5 million increase from 2016 driven by additional provision of £38.5 million recognized due to PPI mis-selling.

Given our expectation of a more challenging operating environment as the UK negotiates its exit from the EU and some unresolved legacy issues, we think that profitability metrics will see little improvement in the near term. We therefore assign a Profitability score of caa3.

Reliance on market funding will remain low and current liquidity levels are sufficient, but the bank has had limited access to unsecured wholesale markets

Customer deposits continue to be Co-operative Bank's primary source of funding comprising 90% of total funding as of December 2017. The bank's loan-to-deposit ratio remains broadly stable at around 81% at end-2017 (gross customer loans as a percentage of customer deposits). We note the bank's solid liquidity position with liquidity coverage ratio at 213% and encumbrance ratio at 15.1%.

The reliance on wholesale funding is relatively low, as reflected in the market funds over tangible banking assets ratio of 8.5% as at end-2017 (11.9% at end-2016), according to our calculations. However, given the past underperformance, Co-operative Bank has had limited access to unsecured wholesale markets. We therefore assign a Funding Structure score of b2.

Co-operative Bank maintains a sufficient stock of liquid assets, which is a relative strength. Sources of primary liquidity include cash and central bank balances, gilts and high quality government bonds measured at £4.6 billion. Total liquidity balances which include unencumbered liquid investment securities and other form of contingent liquidity comprise around £10 billion. The bank's liquid banking assets to tangible banking assets ratio was 28.4% at December 2017. We also see some liquidity risks, should there be any further negative publicity. During the course of 2017 the bank experienced net customer deposit outflows related to the uncertainty around the bank's future. However, this trend stabilised in Q4 2017.

We reflect these consideration in the assigned Liquid Resources score of baa2.

Increased focus on mortgage lending and past control failures drive our qualitative adjustments

Co-operative Bank's resulting financial profile score is b2.

We apply a negative qualitative adjustment reflecting expected lack of business diversification since Co-operative Bank has announced that going forward it will primarily focus on its retail franchise. We believe that on a forward looking basis, as the bank disposes of its corporate and commercial assets, its business model will be characterized by the following mono-line characteristics: (1) 85% or more of the loan book is made of residential mortgages; (2) 80% or more of revenues comes from one source.

We also apply a two-notch negative adjustment for Corporate Behaviour, given the bank's past control failures and the need to restore its business model. The investigation by the Prudential Regulation Authority and the Financial Conduct Authority into the bank's management activities over the period from mid-2009 to end-2013 identified that during this period the bank was in breach of Principle Three of the Principles for Businesses which requires a firm to have an adequate and effective risk management framework. Co-operative Bank failed to design, maintain and oversee appropriately its three lines of defense risk management model. In addition to risk management and control failures, the bank failed to act in a transparent and co-operative manner with the regulator and did not provide timely disclosures on important changes in the bank's senior management. We, however, acknowledge the new management has made significant progress in remediating the legacy issues as part of the bank's restructuring plan. This is evidenced by the removal of the Model Risk add-on component of the Bank's Pillar 2a capital requirement due to improvements in the bank's management of Model Risk.

The scorecard-calculated BCA range is caa1-caa3. We assign a BCA of caa2 to the bank.

Support and structural considerations

Loss given failure (LGF)

Co-operative Bank is subject to the UK implementation of the EU Bank Resolution and Recovery Directive (BRRD), which we consider to be an Operational Resolution Regime. We assume residual tangible common equity of 3% and losses post-failure of 8% of tangible banking assets, a 25% run-off in "junior" wholesale deposits, and a 5% run-off in preferred deposits. These are in line with our standard assumptions. Particular to Co-operative Bank and other retail funded banks in the UK, we assume the proportion of deposits considered junior at 10%, relative to our standard assumption of 26%, due to largely retail-oriented depositor base of the bank.

Post recapitalisation Co-operative Bank has no debt instruments outstanding.

Our LGF analysis indicates that the bank's deposits are likely to face a moderate loss-given-failure rate driven by (1) declining deposit volume and (2) no subordinated debt in the liability structure that would otherwise provide a loss absorbing cushion for deposits. This results in the Preliminary Rating Assessment (PRA) for the deposits in line with the adjusted BCA at caa2.

Government support

The implementation of the BRRD has caused us to reconsider the potential for government support to benefit certain creditors. In the case of the Co-operative Bank, whose systemic importance has reduced, we now expect a low probability of support for deposits and senior unsecured, resulting in no uplift from the PRA.

Counterparty risk assessment

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than both the likelihood of default and the expected financial loss suffered in the event of default and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (e.g., swaps), letters of credit, guarantees and liquidity facilities.

The Co-operative Bank's CR Assessment is positioned at B3(cr)/NP(cr).

The Co-operative Bank's CR Assessment is positioned at B3(cr)/NP(cr), two notches above the Adjusted BCA of caa2, based on the cushion against default provided to the senior obligations represented by the CR Assessment by more subordinated instruments - junior deposits. The main difference with our Advanced LGF approach used to determine instrument ratings is that the CR Assessment captures the probability of default on certain senior obligations, rather than expected loss, therefore we focus purely on subordination and take no account of the volume of the instrument class.

The CR Assessment does not benefit from any additional notches of uplift due to government support, in line with our assumptions of a low probability of UK Government support for Co-Operative Bank's senior obligations in the event of failure.

About Moody's Scorecard

Our Scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our Scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The Scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating methodology and scorecard factors

Exhibit 6

Co-operative Bank Plc

Macro Factors		
Weighted Macro Profile	**Strong +**	**100%**

Factor	**Historic Ratio**	**Macro Adjusted Score**	**Credit Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	3.7%	a3	↓	caa1	Quality of assets	Operational risk
Capital						
TCE / RWA	26.9%	aa1	←→	b1	Stress capital resilience	Expected trend
Profitability						
Net Income / Tangible Assets	-1.3%	caa3	↓	caa3	Return on assets	Earnings quality
Combined Solvency Score		baa1		b3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	8.5%	a1	←→	b2	Lack of market access	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	28.4%	a3	←→	baa2	Stock of liquid assets	
Combined Liquidity Score		a2		ba2		
Financial Profile				b2		
Business Diversification				-1		
Opacity and Complexity				0		
Corporate Behavior				-2		
Total Qualitative Adjustments				-3		
Sovereign or Affiliate constraint:				Aa2		
Scorecard Calculated BCA range				caa1-caa3		
Assigned BCA				caa2		
Affiliate Support notching				0		
Adjusted BCA				caa2		

Balance Sheet	**in-scope (GBP million)**	**% in-scope**	**at-failure (GBP million)**	**% at-failure**
Other liabilities	3,042	12.5%	4,486	18.4%
Deposits	20,635	84.5%	19,191	78.6%
Preferred deposits	18,572	76.1%	17,643	72.3%
Junior Deposits	2,064	8.5%	1,548	6.3%
Equity	732	3.0%	732	3.0%
Total Tangible Banking Assets	24,409	100%	24,409	100%

Debt class	De Jure waterfall		De Facto waterfall		Notching		LGF Notching Guidance vs. Adjusted BCA	Assigned LGF notching	Additional notching	Preliminary Rating Assessment
	Instrument volume + subordination	Sub-ordination	Instrument volume + subordination	Sub-ordination	De Jure	De Facto				
Counterparty Risk Assessment	9.3%	9.3%	9.3%	9.3%	2	2	2	2	0	b3 (cr)
Deposits	9.3%	3.0%	9.3%	3.0%	0	0	0	0	0	caa2
Senior unsecured bank debt	9.3%	3.0%	3.0%	3.0%	0	-1	0	0	0	caa2

Instrument class	Loss Given Failure notching	Additional Notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Assessment	2	0	b3 (cr)	0	B3 (cr)	--
Deposits	0	0	caa2	0	Caa2	Caa2
Senior unsecured bank debt	0	0	caa2	0	(P)Caa2	--

Source: Moody's Financial Metrics

Ratings

Exhibit 7

Category	Moody's Rating
CO-OPERATIVE BANK PLC	
Outlook	Positive
Bank Deposits	Caa2/NP
Baseline Credit Assessment	caa2
Adjusted Baseline Credit Assessment	caa2
Counterparty Risk Assessment	B3(cr)/NP(cr)
Senior Unsecured MTN -Dom Curr	(P)Caa2
Commercial Paper -Dom Curr	NP
Other Short Term -Dom Curr	(P)NP

Source: Moody's Investors Service

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CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

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