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24 March 2014

Co-operative Bank 2013 Reporting and Capital update

Summary:

- Signs of stabilisation in the Co-operative Bank's credit book, but continuing root and branch reviews of processes, procedures and documentation have yielded further conduct and legal issues
- Additional CET1 capital raising of around £400 million proposed
- Year end loss before tax and the impact of the profit generated by the 2013 Liability Management Exercise expected to be between £1.2 and £1.3 billion
- 2013 year end CET1 ratio expected to be around 7.2% versus previous guidance of towards the upper end of a range of below 9% but above the regulatory minimum requirement of 7%
- Annual Report and Accounts will be published on or before 8 April 2014
- Business plan in early stages of execution but as at the end of 2013 Non-core assets expected to be reduced by a total of £2.0 billion and the number of employees has reduced by around 1,000 (14%) in 2013
- The Co-operative Bank's objectives remain unchanged, namely to restore the capital position of the Bank, focus on our retail and SME customers and exit from our non-core activity

Chief Executive Niall Booker said: "The new executive team brought in just 9 months ago is continuing to review aspects of the Co-operative Bank's legacy operations, assets and liabilities.

"As a result of this continuing review we are unearthing a range of issues which the new executive team is having to address. Whilst these risks were identified in the Liability Management Exercise prospectus the review means we are now quantifying the financial impact of some of those risks.

"The result of providing for these items together with the cost of separation from the Co-operative Group is that the starting capital position of the bank for the 4-5 year recovery period is weaker than in the plan announced last year. The proposed capital raise would enable us to reset this starting point and continue with the execution of our original business plan.

"The objectives of this plan remain unchanged and there are some early indications of progress. We have started to simplify the business, reduce costs and de-risk assets as we drive the change needed to return to our roots as a Bank focused on our retail and SME customers. However, there remain significant challenges ahead."

Reporting and capital update

The Co-operative Bank is making this announcement ahead of the publication of its Annual Report and Accounts originally intended for 26 March 2014.

We expect to report a 2013 year end loss before tax and the impact of the Liability Management Exercise (LME) of between £1.2 and £1.3 billion. This is prior to an exceptional profit of £688 million generated on the Bank's 2013 LME which strengthened its capital position. The accounts finalisation process requires the completion of work relating to a technical breach of the Consumer Credit Act, corporation tax and deferred tax.

The Bank's underlying performance in the second half of 2013 was in line with management's expectations and the Bank's liquidity position remains stable. However as the new team moved to implementation of the reshaping of the business, reviewing and remediating legacy issues after a period of focusing on the LME, additional issues have resulted in further provisions.

The Bank expects to report full year charges relating to conduct and legal documentation issues amounting, in aggregate, to approximately £400 million in 2013. These conduct and legal documentation issues include legacy PPI business, mortgage product first payments, interest rate swaps, third party insurance and technical breaches of the Consumer Credit Act. In addition, one off costs and processes associated with the separation of the Co-operative Bank from the Co-operative Group have proved more costly, more time consuming and more complex than anticipated. Provisions for the estimated separation costs from the Co-operative Group are expected to be approximately £40 million in 2013. These factors have led to an expected 2013 year end CET1 ratio of around 7.2%. This is lower than our previous guidance of towards the upper end of a range of below 9% but above the regulatory minimum requirement of 7%.

As a result of these additional costs and in order to restore the capital buffer that the new executive and Board feel is responsible and appropriate for the Bank, we intend to raise around £400 million of additional CET1 capital, subject to the finalisation of the 2013 Annual Report and Accounts, in the form of new ordinary shares in the coming months.

This capital raising, in addition to the balance of the 2014 Contribution of £263 million contractually committed to come from the Co-operative Group, will strengthen the capital base of the Bank for the benefit of all stakeholders and will enable the Bank to further implement its turnaround plan.

The details of the proposed capital raising have yet to be finalised and are subject to a number of uncertainties including final transaction structure, shareholder approvals, execution of definitive documentation and market conditions.

The Co-operative Bank's strategic priorities:

The Co-operative Bank's Annual Report and Accounts are also expected to contain an update against the progress of the business plan. While there will be more detail in the Annual Report and Accounts, highlights are expected to include:

Back to community banking - Our focus is on our millions of individual customers and not on big business. Our core retail banking franchise remains resilient and we expect Core retail net interest income to be up 7% to £428.1 million and Core retail deposit balances to be broadly unchanged at £27.9 billion from £28.1 billion in 2012 (a decline of less than 1%). Whilst the Core franchise has remained resilient, there is no doubt that our financial difficulties and other issues have impacted the 2013 performance of the Core business.

Supporting small business - We will make use of our position in the community to rebuild our SME business as these businesses are important to the well-being of the UK economy. We intend to simplify our product range for both Retail and SME customers.

Doing fewer things better - We will stop doing things that distract from our focus on individuals and small businesses. We are actively managing the exit from our Non-core businesses. We are reducing non-core assets and expect to announce that the Bank has made progress towards our target to reduce Non-core assets to less than £11.5 billion by the end of 2014. It is anticipated that Non-core assets were reduced by a total of £2.0 billion in 2013 through a combination of formal trade sales, proactive re-banking of our Corporate clients and the natural run off of the Corporate book.

Fixing the fundamentals - This means investing in IT systems that deliver digital banking in a way that meets our customers' expectations. Behind the scenes we are improving and consolidating the systems that lie behind our products making them more resilient, faster and more efficient. We are exiting from international operations with the previously announced closure of branches in Guernsey and the Isle of Man. Our branch network has been consolidated, reduced by 9% and is on track to achieve the target of a 15% reduction in 2014 and our employee numbers have reduced by 14% in the course of 2013.

Values and ethics are at the heart of the Co-operative Bank – The Bank's constitution, in the form of its Articles of Association, for the first time now includes a commitment to act in line with the principles and values associated with the co-operative movement and we have established a Values and Ethics Committee to ensure that we adhere to them.

UBS Investment Bank has been engaged by the Co-operative Bank to assist in the proposed capital raising.

ENDS.

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Notes:

The Co-operative Bank is a member of the Financial Services Compensation Scheme which guarantees deposits and savings up to £85,000 for customers of authorised financial services firms.

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