MOODY'S
INVESTORS SERVICE

CREDIT OPINION
25 September 2017

Update

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RATINGS

Co-operative Bank Plc

Domicile	United Kingdom
Long Term Debt	Caa2
Type	Senior Unsecured - Dom Curr
Outlook	Positive
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 following the upgrade of the BCA to caa2

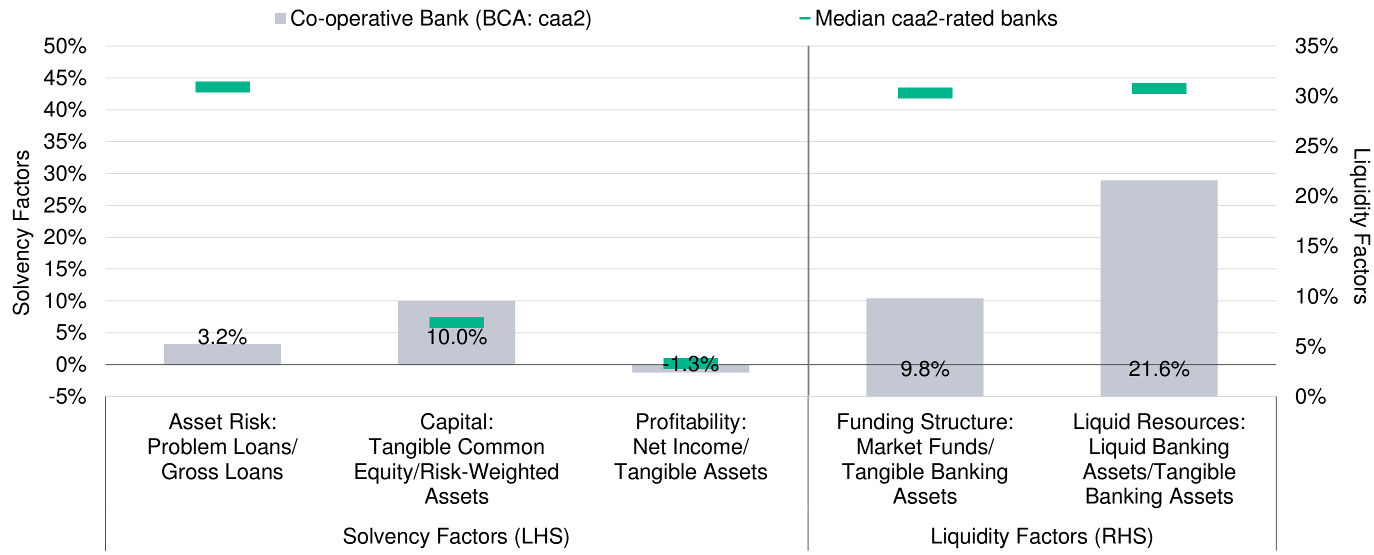
Summary Rating Rationale

On 7 September 2017 we upgraded Co-operative 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. The bank's long-term deposit ratings were affirmed at Caa2, and its short-term deposit ratings were affirmed at Not Prime. The action was driven 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 senior debt and deposits. The bank's long-term Counterparty Risk Assessment (CR Assessment) was upgraded to B3(cr), and it short-term CR Assessment was affirmed at Not Prime.

The upgrade of the bank's BCA to caa2 from ca reflects our view that the bank's standalone creditworthiness has improved with the completion of the recapitalisation plan and the injection of £250 million new equity in addition to the conversion of c.£443 million of Tier 2 bonds into common equity. The caa2 BCA also continues to incorporate: (1) a sizeable non-core portfolio weighing down the bank's asset quality; (2) our expectation of net losses continuing until at least 2018 and therefore limited capacity for the bank to achieve internal capital generation; (3) the bank's relatively stable funding position, despite some outflow of deposits due to negative publicity; and (4) 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



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

Credit Strengths

» Low reliance on wholesale funding;

» Sufficient liquidity levels.

Credit Challenges

» Sizeable non-core portfolio, although expected to materially reduce through the planned asset sale;

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

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

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 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.

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]

	6-17[2]	12-16[2]	12-15[2]	12-14[2]	12-13[2]	CAGR/Avg.[3]
Total Assets (GBP billion)	25	28	29	38	43	-14.6[4]
Total Assets (EUR billion)	28	32	39	48	52	-15.9[4]
Total Assets (USD billion)	32	34	43	59	72	-20.3[4]
Tangible Common Equity (GBP billion)	0.6	0.8	1.1	1.8	1.6	-23.6[4]
Tangible Common Equity (EUR billion)	0.7	0.9	1.5	2.3	2.0	-24.8[4]
Tangible Common Equity (USD billion)	0.8	0.9	1.7	2.8	2.7	-28.7[4]
Problem Loans / Gross Loans (%)	3.2	3.7	5.2	9.2	10.8	6.4[5]
Tangible Common Equity / Risk Weighted Assets (%)	10.0	11.4	15.2	14.2	10.8	12.3[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	84.5	81.2	74.6	103.5	131.1	95.0[5]
Net Interest Margin (%)	0.9	0.8	0.9	0.9	0.7	0.8[5]
PPI / Average RWA (%)	-4.8	-6.6	-3.6	-2.3	-1.7	-3.8[6]
Net Income / Tangible Assets (%)	-1.3	-1.3	-1.8	-0.4	-3.0	-1.6[5]
Cost / Income Ratio (%)	201.5	275.6	197.5	167.5	150.6	198.5[5]
Market Funds / Tangible Banking Assets (%)	9.8	11.9	12.6	12.6	17.7	12.9[5]
Liquid Banking Assets / Tangible Banking Assets (%)	21.6	26.5	27.4	25.5	22.6	24.7[5]
Gross Loans / Due to Customers (%)	91.0	87.2	87.4	87.8	94.7	89.6[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

Detailed Credit Considerations

Improving asset quality with expected material reduction in the non-core portfolio, but downside risks remain

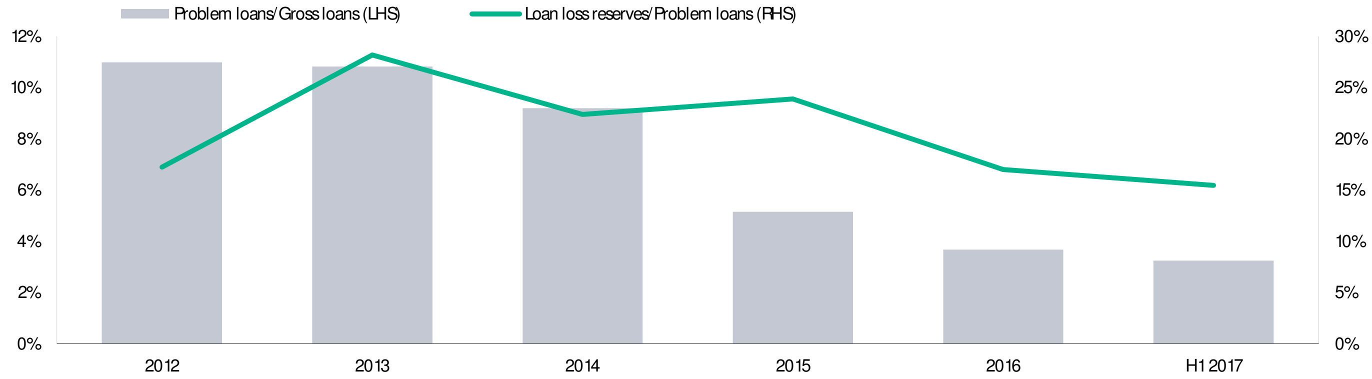
We note improving trends in asset quality of Co-operative Bank with a problem loan ratio at 3.2% at June 2017 (3.7% at end-2016). However, as the bank's core portfolio at £15 billion (appx. 80% of total lending) has been well performing, its non-core portfolio (appx. 20% of total lending) has higher concentration of nonperforming loans, albeit with improving trends. The latter includes corporate, Commercial Real Estate (CRE) and Optimum (residential mortgages) loans and is being run down. The non-core corporate book is concentrated with a relatively small number of borrowers and 14% of the portfolio is CRE loans. At June 2017, this segment of the loan book had a problem loan ratio of 8.6%, with 32% of impaired balances covered by provisions, which we consider as adequate. Optimum, a closed book of residential mortgages with 86% interest-only mortgages and an average LTV of 63% is more vulnerable to economic downturn compared to the core portfolio. At June 2017, 10.9% of Optimum loans were impaired. In contrast, the core residential mortgage book had 1.1% of loans impaired and an average LTV of 52% at the same date.

On 26 June 2017 the bank announced that it had updated the assumptions for its 2017-21 plan which now included a regulatory call of securities issued by Calico Finance Number One Limited (completed on 6 September 2017) and subsequent deleveraging of c.£2 billion of Optimum portfolio. The planned deleveraging would lead to legacy portfolio halving in size and we expect Co-operative Bank's asset quality to improve as a result.

Impairment write-backs decreased to £1.4 million in the first half of 2017 from £2.7 million in the same period of 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 15% at June 2017 was significantly below the level 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, but the bank's ability to meet its full capital requirements is dependent on a successful completion of deleveraging and issuance of Tier 2 instruments

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 9.8% at June, down from 11% at December 2016. Its fully loaded total capital ratio stood at 16.8% as of the same date (17.7% at December 2016). However, after the recapitalisation we estimate a pro-forma CET1 ratio of 20.7%.

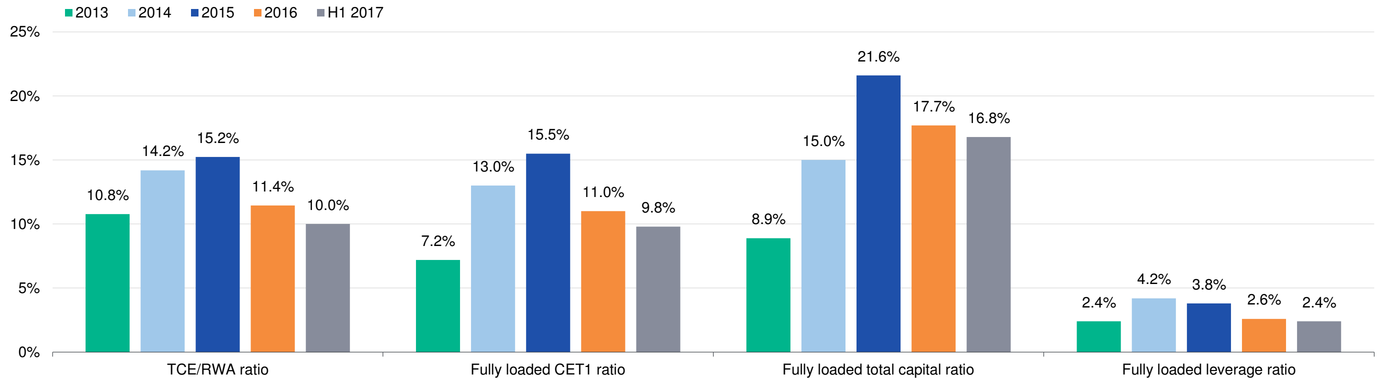
As a result of the restructuring, the bank will immediately meet the CET1 component of its Individual Capital Guidance (ICG) of 17.3%, but full ICG compliance (23%, or Pillar 1 + 2A requirements set by the Prudential Regulation Authority) depends upon the completion of Co-operative Bank's proposed issuance of Tier 2 capital in 2018.

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). This legacy loan book's share of the bank's total credit risk-weighted assets (RWA) was 32%, at £2 billion, as of end-June 2017. Following the recapitalisation, the bank has announced its intentions to deleverage £2 billion of the Optimum portfolio. The planned transaction will significantly reduce RWA, although the full impact on capital ratios is not yet known.

Nevertheless, Co-operative Bank continues to face challenges in its efforts to rebuild a sustainable business model. The bank is unable to generate capital organically due to ongoing restructuring costs, subdued income amid the low interest rate environment and potential further losses on asset sales.

Our assigned Capital score of caa1 incorporates Co-operative Bank's strengthened capital levels but also takes into account that despite the implementation of the restructuring plan, the bank remains in breach of its full ICG requirements and has limited capacity for internal capital generation. Full compliance remain dependant on successful Tier 2 issuance and further Optimum deleveraging.

Exhibit 4
Co-operative Bank's capital metrics



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

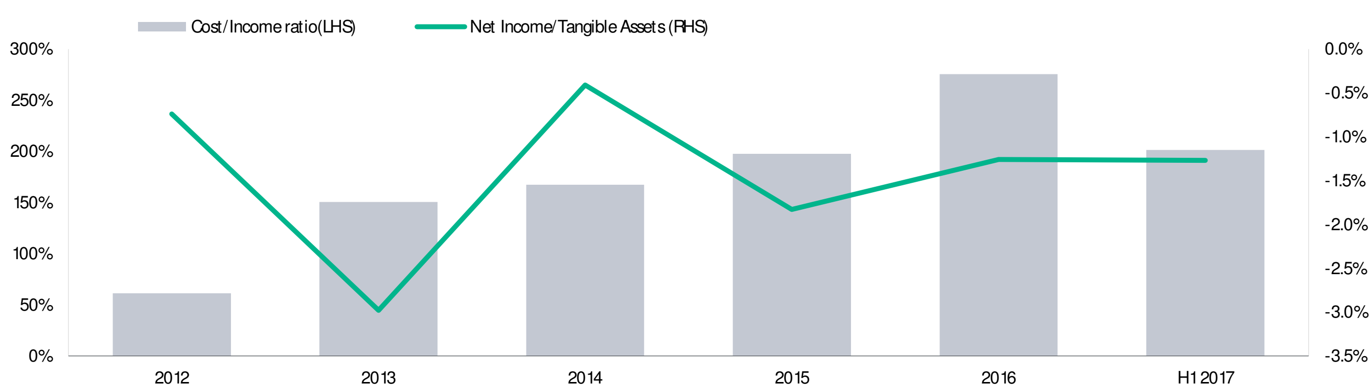
Profitability is negative and we expect the bank to remain loss-making over the outlook period

We believe the bank is unlikely to return to profitability until at least 2018 due to low interest margins, an exceptionally high cost base and potential further impairment losses and losses on asset sales. In the first six months of 2017 Co-operative Bank reported a statutory loss before tax of £135.2 million, compared to the £177 million pre-tax loss reported in the same period of 2016. A better result reflects reduced operating costs and project spend, lower conduct charges reduced fair value unwind charge related to the merger with the Britannia Building Society. At the same time, net interest income fell by 15% 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 -1.3% for the first half of 2017 (-1.3% in 2016).

Co-operative bank's net interest margin (NIM) decreased by 10 basis points to 1.32% in the first half 2017 from 1.42% in the first half of 2016, as reported by the bank. The reduction reflects mortgage margin pressures, lower returns on financial assets and customer deposit pricing. The bank's NIM remains significantly below the level of peers 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, negatively affected by industry-wide lower card interchange rates, and significantly lower Link commission income following the disposals in the ATM estate. Impairment write-backs, which were supporting the profitability in the past couple of years, fell to just £1.4 million in the first half of 2017, and are expected to reverse to impairments charges, driven by the anticipated weakening of the economic environment.

Operating and project expenses, although decreasing, remain elevated. Combined with subdued operating income, this resulted in the bank's cost to income ratio of 201% in the first half of 2017 (259% in the same period of 2016), according to our calculations.

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



Source: Moody's Banking Financial Metrics

In addition to heightened operating costs, the bank's profitability continues to be affected by the unwind of the fair value adjustments associated with the merger with Britannia Building Society with £58.3 million incurred in the first six months of 2017. Conduct charges totaled £4.7 million in the same period.

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 very limited access to wholesale markets

Customer deposits continue to be Co-operative Bank's primary source of funding - 90% of total funding as of June 2017. The bank's loan-to-deposit ratio remains broadly stable at around 91% at June 2017 (gross customer loans as a percentage of customer deposits).

The reliance on wholesale funding is relatively low, as reflected in the market funds over tangible banking assets ratio of 9.8% as at June 2017 (11.9% at December 2016), according to our calculations. This is expected to reduce with the repayment of the bank's £400 senior notes in September. However, given the ongoing underperformance, we believe Co-operative Bank has a very limited wholesale market access. We therefore assign a Funding Structure score of b2.

Co-operative Bank maintains a sufficient stock of liquid assets, which is a relative strength. The bank's liquid banking assets to tangible banking assets ratio was 21.6% at June 2017. We also see some liquidity risks, should there be any further negative publicity. In the first half of 2017 the bank experienced around 25k current account closures and outflows of instant access savings related to the uncertainty around the bank's future. 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:

85% or more of the loan book is made of residential mortgages;

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.

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 except for the £400 million of senior unsecured notes due to mature in late September. We do not account for these in the LGF analysis.

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.

Senior unsecured debt is also likely to face a moderate loss-given-failure rate according to our LGF analysis and its PRA of caa2 is at the same level as the adjusted BCA.

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), 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	5.3%	baa2	←→	caa1	Quality of assets	Operational risk
Capital						
TCE / RWA	10.0%	ba1	↑↑	caa1	Stress capital resilience	Expected trend
Profitability						
Net Income / Tangible Assets	-1.3%	caa3	←→	caa3	Return on assets	Earnings quality
Combined Solvency Score		ba2		caa1		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	11.9%	a2	←→	b2	Lack of market access	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	26.5%	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:				Aa1		
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	3,368	13.5%	4,831	19.4%
Deposits	20,902	83.9%	19,439	78.1%
Preferred deposits	18,812	75.5%	17,871	71.8%
Junior Deposits	2,090	8.4%	1,568	6.3%
Equity	634	2.5%	634	2.5%
Total Tangible Banking Assets	24,904	100%	24,904	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	8.8%	8.8%	8.8%	8.8%	2	2	2	2	0	b3 (cr)
Deposits	8.8%	2.5%	8.8%	2.5%	0	0	0	0	0	caa2
Senior unsecured bank debt	8.8%	2.5%	2.5%	2.5%	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	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 -Dom Curr	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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