

The Co-operative Bank p.l.c.

Update

Key Rating Drivers

Compliant With Regulatory Buffers: The Co-Operative Bank p.l.c.'s Viability Rating (VR) is two notches below the 'bb+' implied VR because its business profile, which Fitch Ratings believes is vulnerable to competitive pressures, has a strong impact on its VR. The VR also reflects the bank's low-risk credit exposures, healthy impaired loans ratio, strengthened profitability, improved capitalisation as it now meets regulatory capital requirements, and reasonable funding and liquidity.

Resilient Franchise: The bank's ethical focus has helped it to attract and retain customers, building resilience in its franchise. However, the bank's limited scale, low market shares and lack of diversification weigh on its business model. Structural profitability has improved with effective cost management following the completion of the restructuring process in 2021, but costs remain high compared with peers.

Mortgage Lending Dominates Assets: The Co-operative Bank has tightened its underwriting standards and risk controls, which are in line with other UK mortgage lenders, and it primarily writes low-risk residential and buy-to-let mortgages, with a small share of unsecured retail and higher loan-to-value (LTV) lending. We expect mortgage lending growth to be muted in 2023, given higher interest rates and housing market uncertainty. The average mortgage LTV in the portfolio (end-1H23: 55.8%) provides a buffer against a moderate house price correction.

Healthy Asset Quality: Asset quality has remained healthy, with low arrears and an impaired loan ratio of 0.4% at end-1H23 (or 0.7% when including purchased originated credit impaired loans). We expect the impaired loans ratio to rise to around 0.5% of gross loans by end-2024, mainly due to higher interest rates, the expected recession in 2023, and affordability pressures. Nevertheless, The Co-operative Bank is well positioned due to the low risk nature of its loans and conservative underwriting standards.

Improved Capital Position: The Co-operative Bank's common equity Tier 1 (CET1) ratio of 20.1% at end-June 2023 reflects the low risk-weights assigned to mortgage loans under the bank's internal ratings-based approach. The bank is now fully compliant with regulatory requirements, and has resources in excess of end-state minimum requirements for own funds and eligible liabilities (MREL).

The leverage ratio incrementally improved to 4.1% at end-June 2023 (end-2022: 4%), and is expected to strengthen slightly, putting the bank in a better position to gradually expand its balance sheet.

Resilient Customer Funding: The bank is predominantly retail-funded, with a resilient core deposit base. Access to wholesale markets is limited and largely consists of MREL-eligible debt, Tier 2 debt and the Bank of England's Term Funding Scheme with additional incentives for SMEs (TFSME). The bank was able to place an additional GBP200 million MREL issuance in May. Liquidity is healthy, with large holdings of cash at the Bank of England boosted by TFSME drawings, which raised the liquidity coverage ratio to 224% at end-June 2023.

The Short-Term IDR of 'B' maps to the only available option for a Long-Term IDR of 'BB' under Fitch's rating criteria.

Rating Uplift to Opco: The Co-operative Bank's Long-Term IDR is one notch above its VR because we believe that there are sufficient resolution funds issued by The Co-operative Bank Finance plc, the bank's intermediate holding company, which afford additional protection to the bank's external senior creditors, in case of its failure.

Ratings

Foreign Currency

Long-Term IDR	BB
Short-Term IDR	B

Viability Rating	bb-
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Government Support Rating	ns
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Sovereign Risk (United Kingdom)

Long-Term Foreign-Currency IDR	AA-
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Long-Term Local-Currency IDR	AA-
Country Ceiling	AAA

Outlooks

Long-Term Foreign-Currency IDR	Stable
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Sovereign Long-Term Foreign-Currency IDR	Negative
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Sovereign Long-Term Local-Currency IDR	Negative
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Applicable Criteria

[Bank Rating Criteria \(September 2023\)](#)

Related Research

[Fitch Upgrades The Co-operative Bank to 'BB'; Outlook Stable \(February 2023\)](#)

[Fitch Affirms United Kingdom at 'AA-'; Outlook Negative \(June 2023\)](#)

[Global Banks Mid-Year Outlook 2023 \(June 2023\)](#)

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Rating Sensitivities

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

The ratings could be downgraded if The Co-operative Bank recorded weaker-than-expected profitability or faster-than-planned growth that eroded buffers against CET1 and leverage ratio requirements, with no clear actions to restore them.

The Long-Term IDR is also sensitive to the bank being able to meet its end-state regulatory resolution buffer requirements, which includes qualifying junior debt and internal subordinated debt. The Long-Term IDR could be downgraded to the same level as the VR if the bank is no longer required or able to meet end-state MREL regulatory requirements.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

An upgrade would require the bank to sustain a record of improved structural profitability, and to continue to demonstrate its ability to generate sufficient capital while maintaining healthy buffers above minimum capital and leverage requirements. In turn, stronger capital buffers that supported the bank's business growth, competitiveness and scale could support our business profile assessment and the bank's VR.

Significant Changes from Last Review

Operating Environment

Fitch's September [Global Economic Outlook](#) revised the UK growth forecast to 0.2% for 2023, from the negative 0.1% expected in June, reflecting the stronger-than-expected rise in GDP in 2Q23 (0.2% qoq). Fitch still expects the economy to fall into recession in 2H23, but there should be a recovery in 2024, as falling inflation eases the squeeze on real households' incomes. The recent increases in core inflation and wages point to one final 25bp rate rise, to 5.5%, and Fitch expects the first cut to come only in 2H24. Recently announced revisions to UK GDP data that will be made official later in September suggest the economy fared slightly better during the pandemic than previously estimated.

1H23 Results

The Co-operative Bank reported an operating profit of GBP62 million in 1H23 (2022: GBP133 million). The Fitch-calculated net interest margin (NIM) increased to 2.2% in 1H23 (FY22: 2%), benefitting from improved deposit margins following further rises in the Bank of England base rate. However, mortgage margins continued to be subdued in an environment of elevated swap rates and deteriorating housing market activity. The loan book incrementally expanded in 1H23, following a modest contraction in 2022, and the bank has announced the acquisition of the Sainsbury's Bank's mortgage portfolio, which will expand the loan book by around 2.3%. Loan impairment charges of GBP0.3 million (2022: GBP6.4 million) were driven by post-model adjustments and a refinement of IFRS9 modelling, with underlying credit quality remaining strong.

Ratings Navigator

The Co-operative Bank p.l.c.							ESG Relevance: 	Banks Ratings Navigator		
Operating Environment	Business Profile	Risk Profile	Financial Profile				Implied Viability Rating	Viability Rating	Government Support	Issuer Default Rating
			Asset Quality	Earnings & Profitability	Capitalisation & Leverage	Funding & Liquidity				
	20%	10%	20%	15%	25%	10%	aaa	aaa	aaa	AAA
							aa+	aa+	aa+	AA+
							aa	aa	aa	AA
							aa-	aa-	aa-	AA-
							a+	a+	a+	A+
							a	a	a	A
							a-	a-	a-	A-
							bbb+	bbb+	bbb+	BBB+
							bbb	bbb	bbb	BBB
							bbb-	bbb-	bbb-	BBB-
							bb+	bb+	bb+	BB+
							bb	bb	bb	BB Sta
							bb-	bb-	bb-	BB-
							b+	b+	b+	B+
							b	b	b	B
							b-	b-	b-	B-
							ccc+	ccc+	ccc+	CCC+
							ccc	ccc	ccc	CCC
							ccc-	ccc-	ccc-	CCC-
							cc	cc	cc	CC
							c	c	c	C
							f	f	ns	D or RD

The Key Rating Driver (KRD) weightings used to determine the implied VR are shown as percentages at the top. In cases where the implied VR is adjusted upwards or downwards to arrive at the VR, the KRD associated with the adjustment reason is highlighted in red. The shaded areas indicate the benchmark-implied scores for each KRD.

VR - Adjustments to Key Rating Drivers

The VR of 'bb-' has been assigned below the 'bb+' implied VR due to the following adjustment reason: business profile (negative).

The operating environment score of 'aa-' has been assigned in line with the 'aa' category implied score. Sovereign rating was identified as a relevant negative factor in the assessment.

The business profile score of 'bb-' has been assigned below the 'bbb' category implied score due to the following adjustment reasons: business model (negative), market position (negative).

The asset quality score of 'bbb+' has been assigned below the 'aa' category implied score due to the following adjustment reason: concentrations (negative).

The earnings and profitability score of 'bb-' has been assigned above the 'b' category implied score due to the following adjustment reason: historical and future metrics (positive).

The capitalisation and leverage score of 'bb-' has been assigned below the 'aa' category implied score due to the following adjustment reasons: leverage and risk-weight calculation (negative), capital flexibility and ordinary support (negative).

The funding and liquidity score of 'bb+' has been assigned below the 'a' category implied score due to the following adjustment reason: non-deposit funding (negative).

Financials

Financial Statements

	30 Jun 23		31 Dec 22	31 Dec 21	31 Dec 20	31 Dec 19
	6 months - interim (USDm) Reviewed - unqualified	6 months - interim (GBPm) Reviewed - unqualified	Year end (GBPm) Audited - unqualified			
Summary income statement						
Net interest and dividend income	310	245.1	458.3	323.9	266.9	310.0
Net fees and commissions	24	18.8	31.8	25.2	23.5	20.7
Other operating income	5	4.0	21.6	29.2	24.9	55.9
Total operating income	339	267.9	511.7	378.3	315.3	386.6
Operating costs	260	205.8	372.7	346.1	395.4	478.7
Pre-impairment operating profit	79	62.1	139.0	32.2	-80.1	-92.1
Loan and other impairment charges	0	0.3	6.4	1.1	21.6	-2.5
Operating profit	78	61.8	132.6	31.1	-101.7	-89.6
Other non-operating items (net)	n.a.	n.a.	n.a.	n.a.	-2.0	-62.5
Tax	-52	-41.4	110.5	-166.2	-8.0	0.9
Net income	131	103.2	22.1	197.3	-95.7	-153.0
Other comprehensive income	-1	-0.8	-475.0	80.2	-41.8	14.8
Fitch comprehensive income	130	102.4	-452.9	277.5	-137.5	-138.2
Summary balance sheet						
Assets						
Gross loans	26,742	21,145.2	20,962.2	21,039.5	18,725.4	17,945.1
- Of which impaired	109	85.9	80.3	67.4	62.9	79.5
Loan loss allowances	49	38.8	40.3	37.4	42.9	26.7
Net loans	26,693	21,106.4	20,921.9	21,002.1	18,682.5	17,918.4
Interbank	587	463.9	387.1	191.5	536.2	474.3
Derivatives	153	121.0	89.4	158.0	324.0	285.9
Other securities and earning assets	1,888	1,492.8	955.9	1,226.1	1,172.5	1,651.9
Total earning assets	29,321	23,184.1	22,354.3	22,577.7	20,715.2	20,330.5
Cash and due from banks	4,938	3,904.8	5,270.4	5,696.9	3,877.8	2,153.5
Other assets	717	566.6	508.1	1,048.7	1,006.5	951.5
Total assets	34,976	27,655.5	28,132.8	29,323.3	25,599.5	23,435.5
Liabilities						
Customer deposits	24,727	19,551.4	20,107.4	21,135.9	20,365.8	18,996.9
Interbank and other short-term funding	763	603.3	483.4	327.6	2,066.4	1,143.7
Other long-term funding	7,490	5,922.4	6,028.8	5,805.4	1,137.0	1,071.7
Trading liabilities and derivatives	56	44.2	68.9	140.7	340.1	288.0
Total funding and derivatives	33,036	26,121.3	26,688.5	27,409.6	23,909.3	21,500.3
Other liabilities	168	132.8	145.3	161.8	215.8	323.4
Preference shares and hybrid capital	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Total equity	1,772	1,401.4	1,299.0	1,751.9	1,474.4	1,611.8
Total liabilities and equity	34,976	27,655.5	28,132.8	29,323.3	25,599.5	23,435.5
Exchange rate		USD1 = GBP0.790701	USD1 = GBP0.828638	USD1 = GBP0.74438	USD1 = GBP0.745156	USD1 = GBP0.76211

Source: Fitch Ratings, Fitch Solutions, The Co-operative Bank p.l.c.

Key Ratios

	30 Jun 23	31 Dec 22	31 Dec 21	31 Dec 20	31 Dec 19
Ratios (%; annualised as appropriate)					
Profitability					
Operating profit/risk-weighted assets	2.5	2.8	0.7	-2.2	-1.9
Net interest income/average earning assets	2.2	2.0	1.5	1.3	1.5
Non-interest expense/gross revenue	76.8	72.8	91.5	125.4	123.8
Net income/average equity	15.4	1.4	12.2	-6.1	-9.0
Asset quality					
Impaired loans ratio	0.4	0.4	0.3	0.3	0.4
Growth in gross loans	0.9	-0.4	12.4	4.4	0.9
Loan loss allowances/impaired loans	45.2	50.2	55.5	68.2	33.6
Loan impairment charges/average gross loans	0.0	0.0	0.0	0.1	0.0
Capitalisation					
Common equity Tier 1 ratio	20.1	19.8	20.7	19.2	19.6
Tangible common equity/tangible assets	4.0	3.7	5.1	5.5	6.4
Basel leverage ratio	4.1	3.3	3.1	3.4	3.9
Net impaired loans/common equity Tier 1	4.8	4.2	3.3	2.2	5.6
Funding and liquidity					
Gross loans/customer deposits	108.2	104.3	99.5	92.0	94.5
Gross loans/customer deposits + covered bonds	108.2	104.3	99.5	89.8	91.6
Liquidity coverage ratio	224.0	265.3	241.8	193.4	173.7
Customer deposits/total non-equity funding	75.0	75.5	77.5	86.4	89.6
Net stable funding ratio	n.a.	136.3	141.4	138.2	139.1

Source: Fitch Ratings, Fitch Solutions, The Co-operative Bank p.l.c.

Support Assessment

Commercial Banks: Government Support	
Typical D-SIB GSR for sovereign's rating level (assuming high propensity)	a or a-
Actual jurisdiction D-SIB GSR	ns
Government Support Rating	ns
Government ability to support D-SIBs	
Sovereign Rating	AA-/ Negative
Size of banking system	Negative
Structure of banking system	Negative
Sovereign financial flexibility (for rating level)	Positive
Government propensity to support D-SIBs	
Resolution legislation	Negative
Support stance	Negative
Government propensity to support bank	
Systemic importance	Negative
Liability structure	Neutral
Ownership	Neutral

The colours indicate the weighting of each KRD in the assessment.

■ Higher influence
 ■ Moderate influence
 ■ Lower influence

The GSR reflects Fitch's view that senior creditors cannot rely on extraordinary support from the UK authorities if The Co-operative Bank becomes non-viable. This is because of UK legislation and regulations that provide a framework that is likely to require senior creditors to participate in losses after a failure.

Environmental, Social and Governance Considerations

FitchRatings The Co-operative Bank p.l.c.

Banks
Ratings Navigator

Credit-Relevant ESG Derivation

The Co-operative Bank p.l.c. has 5 ESG potential rating drivers

- ➔ The Co-operative Bank p.l.c. has exposure to compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security) but this has very low impact on the rating.
- ➔ Governance is minimally relevant to the rating and is not currently a driver.

			Overall ESG Scale	
key driver	0	issues	5	
driver	0	issues	4	
potential driver	5	issues	3	
not a rating driver	4	issues	2	
	5	issues	1	

Environmental (E)

General Issues	E Score	Sector-Specific Issues	Reference	E Scale
GHG Emissions & Air Quality	1	n.a.	n.a.	5
Energy Management	1	n.a.	n.a.	4
Water & Wastewater Management	1	n.a.	n.a.	3
Waste & Hazardous Materials Management; Ecological Impacts	1	n.a.	n.a.	2
Exposure to Environmental Impacts	2	Impact of extreme weather events on assets and/or operations and corresponding risk appetite & management; catastrophe risk; credit concentrations	Business Profile (incl. Management & governance); Risk Profile; Asset Quality	1

How to Read This Page
ESG scores range from 1 to 5 based on a 15-level color gradation. Red (5) is most relevant and green (1) is least relevant.

The Environmental (E), Social (S) and Governance (G) tables break out the individual components of the scale. The right-hand box shows the aggregate E, S, or G score. General Issues are relevant across all markets with Sector-Specific Issues unique to a particular industry group. Scores are assigned to each sector-specific issue. These scores signify the credit-relevance of the sector-specific issues to the issuing entity's overall credit rating. The Reference box highlights the factor(s) within which the corresponding ESG issues are captured in Fitch's credit analysis.

The Credit-Relevant ESG Derivation table shows the overall ESG score. This score signifies the credit relevance of combined E, S and G issues to the entity's credit rating. The three columns to the left of the overall ESG score summarize the issuing entity's sub-component ESG scores. The box on the far left identifies some of the main ESG issues that are drivers or potential drivers of the issuing entity's credit rating (corresponding with scores of 3, 4 or 5) and provides a brief explanation for the score.

Social (S)

General Issues	S Score	Sector-Specific Issues	Reference	S Scale
Human Rights, Community Relations, Access & Affordability	2	Services for underbanked and underserved communities; SME and community development programs; financial literacy programs	Business Profile (incl. Management & governance); Risk Profile	5
Customer Welfare - Fair Messaging, Privacy & Data Security	3	Compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security)	Operating Environment; Business Profile (incl. Management & governance); Risk Profile	4
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Business Profile (incl. Management & governance)	3
Employee Wellbeing	1	n.a.	n.a.	2
Exposure to Social Impacts	2	Shift in social or consumer preferences as a result of an institution's social positions, or social and/or political disapproval of core banking practices	Business Profile (incl. Management & governance); Financial Profile	1

Classification of ESG issues has been developed from Fitch's sector ratings criteria. The General Issues and Sector-Specific Issues draw on the classification standards published by the United Nations' Principles for Responsible Investing (PRI) and the Sustainability Accounting Standards Board (SASB).

Sector references in the scale definitions below refer to Sector as displayed in the Sector Details box on page 1 of the navigator.

Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference	G Scale	CREDIT-RELEVANT ESG SCALE
Management Strategy	3	Operational implementation of strategy	Business Profile (incl. Management & governance)	5	5 Highly relevant, a key rating driver that has a significant impact on the rating on an individual basis. Equivalent to "higher" relative importance within Navigator.
Governance Structure	3	Board independence and effectiveness; ownership concentration; protection of creditor/stakeholder rights; legal/compliance risks; business continuity; key person risk; related party transactions	Business Profile (incl. Management & governance); Earnings & Profitability; Capitalisation & Leverage	4	4 Relevant to rating, not a key rating driver but has an impact on the rating in combination with other factors. Equivalent to "moderate" relative importance within Navigator.
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Business Profile (incl. Management & governance)	3	3 Minimally relevant to rating, either very low impact or actively managed in a way that results in no impact on the entity rating. Equivalent to "lower" relative importance within Navigator.
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Business Profile (incl. Management & governance)	2	2 Irrelevant to the entity rating but relevant to the sector.
				1	1 Irrelevant to the entity rating and irrelevant to the sector.

CREDIT-RELEVANT ESG SCALE
How relevant are E, S and G issues to the overall credit rating?

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit <https://www.fitchratings.com/topics/esg/products#esg-relevance-scores>.

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