FitchRatings

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Fitch Upgrades The Co-operative Bank to 'BBB+'; Off Rating Watch Positive

Fitch Ratings - London - 08 Jan 2025: Fitch Ratings has upgraded The Co-operative Bank p.l.c.'s Long- and Short-Term Issuer Default Ratings (IDR) to 'BBB+' from 'BB+' and to 'F1' from 'B', respectively, and removed them from Rating Watch Positive (RWP). The Outlook on the Long-Term IDR is Negative.

These actions follow the completed acquisition by Coventry Building Society's (A-/Negative) of The Co-operative Bank. The Negative Outlook mirrors the Outlook on Coventry.

The Co-operative Bank's Viability Rating (VR) has also been upgraded to 'bbb-' from 'bb' to reflect its continued record of structural profitability and improved cost efficiency, due largely to its transformation programme and extensive restructuring in recent years.

A full list of rating actions is below.

Fitch has withdrawn The Co-operative Bank's Government Support Rating (GSR) of 'no support' as we believe Coventry has now become the primary source of extraordinary support.

Key Rating Drivers

Shareholder Support Drives IDRs: Following its acquisition by Coventry, The Co-operative Bank's IDRs are driven by Fitch's assessment of a high likelihood of support from the bank's new, higher-rated owner. We have reflected this likelihood of support by assigning The Co-operative Bank a Shareholder Support Rating (SSR) of 'bbb+'.

The SSR is one notch below Coventry's Long-Term IDR. This reflects The Co-operative Bank's strategic importance for its new owner as it adds scale and business diversification to Coventry's franchise, but also Fitch's expectation that The Co-operative Bank's integration into Coventry will remain limited for several years. The SSR also reflects The Co-operative Bank's large size relative to Coventry and the implications thereof for Coventry's ability to support The Co-operative Bank.

High Propensity to Support: The Co-operative Bank's IDRs and SSR reflect Fitch's view that a default of the bank would create high reputational risk for Coventry, and that the UK authorities would favour support for The Co-operative Bank from Coventry. In addition, the combined group's resolution plan will make support for the subsidiary likely, as the group will ultimately operate under a single-point-of-entry model, with Coventry acting as the resolution entity.

Role in Group; Slow Integration: Our support assessment considers The Co-operative Bank's strategic importance, but not core, to Coventry, given a planned gradual integration, as well as its high operational and management independence.

Transformation Supports Business Model: The Co-operative Bank's mortgage and savings transformation project is complete, which will support cost efficiency. Its focus on low-risk mortgage lending underpins the stability of its business model, but its franchise will remain modest and its business fairly undiversified.

Conservative Risk Profile: The Co-operative Bank primarily underwrites low-risk owner-occupied and buy-to-let residential mortgages, with a small share of unsecured retail and higher loan-to-value (LTV) lending. The average mortgage LTV in the mortgage portfolio remains low and provides a buffer against moderate house price falls.

Resilient Asset Quality: The Co-operative Bank's low impaired loan ratio (end-2023: 0.8%) is supported by low-risk mortgage loans and conservative underwriting standards. We expect the ratio to rise to around 1% by end-2026, due mainly to the seasoning of loans originated in recent years during the phase of higher interest rates.

Cost Control to Support Profitability: The Co-operative Bank's operating profitability softened in 2023 from a very strong level in 2022, but remains well above its four-year average. We forecast stronger operating profitability in 2025-2026, due to cost savings from transformation and restructuring as well as structural hedge income.

Strong Capitalisation: We expect the common equity Tier 1 ratio (end-2023: 20.1%) to be supported by improved profitability. Until the final resolution model is reached in May 2027, The Co-operative Bank's externally held eligible debt and Tier 2 instruments will be eligible to meet the consolidated minimum required eligible liabilities (MREL) requirements applicable to Coventry. Fitch expects this will allow the gradual migration of The Co-operative Bank's MREL debt to Coventry, where over time new MREL debt will be issued and down-streamed to The Co-operative Bank in a subordinated manner.

Stable Retail Funding: The bank is mainly funded by retail deposits, sourced from a fairly resilient core deposit base. Liquidity is healthy, and the bank has improved its access to wholesale markets with a covered bond issue in 2024.

Deposit Rating Assigned: Fitch has assigned The Co-operative Bank's deposit ratings of 'A-'/'F1'. The long-term deposit rating is one notch above the Long-Term IDR. This reflects the additional protection of creditors arising from the requirement for Coventry to raise and downstream a large buffer of senior non-preferred and junior debt to The Co-operative subgroup over time. The Short-Term IDR is the higher of two options that map to an 'A-' long-term rating and reflects the propensity of shareholder support.

Rating Sensitivities

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

A downgrade of The Co-operative Bank's IDRs and SSR could stem from a downgrade of Coventry's

Long-Term IDR as well as a diminished propensity or ability of Coventry to support. The ability to provide support could weaken, for example, due to substantially higher integration costs than currently expected by the society. Fitch's view of Coventry's propensity to provide support could be negatively affected if The Co-operative Bank is no longer deemed to be strategically important to Coventry. This may be due, for example, to a change in strategy that leads to a discontinuation of integration efforts.

The VR could be downgraded following materially weaker-than-expected profitability or faster-than-planned growth that erode capital buffers, with no clear actions to swiftly restore them. Weak strategic execution exacerbated by intense competition could also put the VR under pressure.

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

The Co-operative Bank's IDRs and SSR could be upgraded if Coventry's Long-Term IDR is upgraded or if we revise up our assessment of Coventry's ability and propensity to support The Co-operative Bank.

An upgrade to the VR is unlikely, given The Co-operative Bank's narrow franchise. However, over the longer term, and with a successful integration into Coventry, The Co-operative Bank's VR could be upgraded if its operating profitability is sustained at strong levels without a loosening in risk appetite, while maintaining strong capital and liquidity buffers.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

The Short-Term IDR has been upgraded to 'F1', which is the higher of the two options that map to its Long-Term IDR. This is because Fitch generally views the propensity of the shareholder support as more certain in the near term.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

The Co-operative Bank's deposit ratings are sensitive to changes to its Long-Term IDR and the protection provided to its depositors from MREL raised and down-streamed by Coventry.

VR ADJUSTMENTS

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

The capitalisation and leverage score of 'bbb-' is below the 'aa' category implied score, due to the following adjustment reason: leverage and risk-weight calculation (negative).

The funding and liquidity score of 'bbb-' is below the 'a' category implied score, due to the following adjustment reason: deposit structure (negative).

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

Public Ratings with Credit Linkage to other ratings

The Co-operative Bank's ratings are driven by Coventry's Long-Term IDR.

ESG Considerations

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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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
The Co-operative Bank p.l.c.	LT IDR	BBB+	Upgrade		BB+
	ST IDR	F1	Upgrade		B
	Viability	bbb-	Upgrade		bb
	Government Support	ns	Affirmed		ns
	Government Support	WD	Withdrawn		
	Shareholder Support	bbb+	New Rating		
• long-term deposits	LT	A-	New Rating		
• short-term deposits	ST	F1	New Rating		

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

Bank Rating Criteria (pub.15 Mar 2024) (including rating assumption sensitivity)

Additional Disclosures

Solicitation Status

Endorsement Status

The Co-operative Bank p.l.c.	UK Issued, EU Endorsed

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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. For more details on sector-specific best- and worst-case scenario credit ratings, please see Best- and Worst-Case Measures under the Rating Performance page on Fitch’s website.

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