



Rating Action: Moody's upgrades The Co-operative Bank's long-term deposit ratings to Ba1, outlook changed to positive

02 Dec 2022

London, December 02, 2022 – Moody's Investors Service ("Moody's") today upgraded the long-term deposit ratings of The Co-operative Bank plc (The Co-operative Bank) to Ba1 from Ba2, as well as its standalone Baseline Credit Assessment (BCA) to ba2 from ba3. The bank's long- and short-term Counterparty Risk Ratings were upgraded to Baa3 and Prime-3 from Ba1 and Not Prime and the long-term Counterparty Risk Assessment was also upgraded to Baa2(cr) from Baa3(cr). The bank's other short term ratings were affirmed. The senior unsecured debt rating of The Co-operative Bank Finance p.l.c. (The Co-operative Bank Finance), the holding company of The Co-operative Bank, was upgraded to Ba3 from B1.

The outlook on the senior unsecured debt rating of The Co-operative Bank Finance and on the long-term deposit ratings of The Co-operative Bank has been changed to positive from stable.

A full list of affected ratings can be found at the end of this press release.

RATINGS RATIONALE

Moody's said the upgrade of The Co-operative Bank's long-term deposit ratings and the upgrade of its BCA reflect the bank's improving profitability driven by higher interest rates which has enabled the bank to become compliant with all regulatory buffer requirements. The bank is now able to meet its Prudential Regulatory Authority buffer requirement, as its improved profitability offsets capital erosion under the regulatory stress test. Together, these are clear signals of the bank's progress towards a sustainable capital generative business model.

The rating agency said that significantly higher base rates in the UK with an expectation of further increases to come along with the secured and high quality nature of the bank's lending operations will support core profitability and hence further internal capital generation. While loan and asset growth will be moderate over the next 12-18 months, the bank will be able to reprice its mortgage loans at higher rates which along with robust deposit margins will lead to growth in net interest income. As of June 2022, the bank's capitalization, as measured by Moody's ratio of Tangible Common Equity to risk weighted assets, was a very high 34.2%, and the bank's improved profitability means that the bank would be able to restore its capital to levels in line with its requirements in a stress, supporting the rating agency's improved view of its capital strength.

The bank's asset risk is expected to remain low, despite downward pressures from the current operating environment, with cost of risk normalising and with coverage levels remaining adequate particularly in light of the highly secured nature of its loan book.

Despite improvements, the bank's efficiency and its leverage remain weak particularly compared to peers. The Co-operative Bank's earnings will still be constrained by its still high cost to income ratio. The bank is currently in the process of transitioning its mortgage operations onto one

technology platform which, once completed, will reduce the bank's overheads over the next two to three years. Moody's also notes that the bank's 2021 net income was heavily reliant on the use of deferred tax assets which will likely continue to be a key factor in net income levels over the coming years.

The Co-operative Bank's cost of funding benefits from its large share of low cost deposits, which account for around 75% of total funding and of which 40% are current accounts which bear no interest. Moody's also notes that the The Co-operative Bank's Finance's senior unsecured debt of £250 million issued in April 2022 will also add some pressure to interest expense.

Governance is highly relevant for The Co-operative Bank, as it is to all firms operating in the financial services industry, particularly in light of its loss making past and historic asset risk issues. Moody's notes that the bank has been on a de-risking and recovery plan since 2017 with an explicit aim to become profitable and return to a sustainable business model. Now that the bank has become fully capital buffer compliant including on a stress basis, the rating agency recognises this important achievement as a sign of reduced governance risks and supportive of the ratings upgrade.

The Co-operative Bank Finance's minimum requirements for own funds and eligible liabilities (MREL) compliant £250 million issuance in 2022 coupled with Moody's expectation that the bank's balance sheet will only moderately grow over the outlook horizon, provides protection to The Co-operative Bank's junior depositors. This results in an unchanged notching under Moody's Loss Given Failure analysis to the bank's long-term deposit rating and the holding company's senior unsecured debt rating which are one notch above and one notch below the bank's ba2 BCA, respectively.

OUTLOOK

The outlook on The Co-operative Bank Finance's senior unsecured debt rating and The Co-operative Bank's long-term deposit ratings has been changed to positive. The outlooks reflect further potential improvements in The Co-operative Bank's core profitability, supporting capitalisation, which would be more commensurate with a higher rating,

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

The Co-operative Bank's BCA could be upgraded following a combination of further improvement in profitability, implying durable and sustainable internal capital generation, and a reduction in its cost base driven by a successful IT platform transition. A lower regulatory pillar 2A capital requirement in recognition of the reduction in execution risk from completion of the mortgage platform migration could also lead to a ratings upgrade. An upgrade of the BCA would lead to an upgrade of the long-term deposit ratings of The Co-operative Bank and the senior unsecured debt rating for The Co-operative Bank Finance. The Co-operative Bank Finance's senior unsecured debt rating and The Co-operative Bank's long-term deposit ratings could also be upgraded following a material increase in the stock of bail-in-able liabilities issued by The Co-operative Bank Finance or by The Co-operative Bank.

Given the positive outlook there is limited downward pressure on the bank's ratings.

LIST OF AFFECTED RATINGS

Issuer: The Co-operative Bank Finance p.l.c.

..Upgrades:

....Long-term Issuer Ratings, upgraded to Ba3 from B1, outlook changed to Positive from Stable

....Senior Unsecured Regular Bond/Debenture, upgraded to Ba3 from B1, outlook changed to Positive from Stable

..Affirmations:

....Short-term Issuer Ratings, affirmed NP

..Outlook Action:

....Outlook changed to Positive from Stable

Issuer: The Co-operative Bank plc

..Upgrades:

....Long-term Counterparty Risk Ratings, upgraded to Baa3 from Ba1

....Short-term Counterparty Risk Ratings, upgraded to P-3 from NP

....Long-term Bank Deposits, upgraded to Ba1 from Ba2, outlook changed to Positive from Stable

....Long-term Counterparty Risk Assessment, upgraded to Baa2(cr) from Baa3(cr)

....Baseline Credit Assessment, upgraded to ba2 from ba3

....Adjusted Baseline Credit Assessment, upgraded to ba2 from ba3

..Affirmations:

....Short-term Bank Deposits, affirmed NP

....Short-term Counterparty Risk Assessment, affirmed P-3(cr)

..Outlook Action:

....Outlook changed to Positive from Stable

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks Methodology published in July 2021 and available at <https://ratings.moodys.com/api/rmc-documents/71997>. Alternatively, please see the Rating Methodologies page on <https://ratings.moodys.com> for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on <https://ratings.moodys.com/rating-definitions>.

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At least one ESG consideration was material to the credit rating action(s) announced and described above.

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