MOODY'S
INVESTORS SERVICE

Rating Action: Moody's reviews Co-Operative Bank ratings

Global Credit Research - 30 Jun 2017

Action follows announcement of capital raising plan

London, 30 June 2017 -- Moody's Investors Service has today placed on review for upgrade Co-Operative Bank Plc's Ca long-term senior unsecured debt rating, reflecting Moody's expectation that the bank's recently announced capital raising plan does not include a liability management exercise on senior unsecured bonds, reduces the probability of the bank being placed in resolution, and lowers the risk of loss on these instruments. These developments are also reflected in Moody's review for upgrade on the bank's ca standalone baseline credit assessment (BCA), given the rating agency's expectations that the bank's credit profile and risk-absorption capacity will improve if the capital raising plan is implemented as announced. Moody's has placed on review direction uncertain the Caa2 long-term deposit ratings, reflecting a different balance of risks for junior deposit holders, who would benefit from the recapitalisation but would be at risk of loss in a resolution, should the plan fail. The short-term deposit ratings were unaffected by this action and remain at Not Prime.

Similarly, the bank's long-term Caa1(cr) Counterparty Risk Assessment (CR Assessment) was placed on review direction uncertain. The short-term CR Assessment was unaffected at Not Prime(cr).

The rating action follows the bank's announcement on 28 June, 2017 that it plans to raise approximately GBP 700m of additional CET1 capital through conversion of subordinated debt to equity and further issuance of new equity, enabling the bank to meet its regulatory capital requirements in the medium-term. The bank has obtained support from 47% of Tier 2 noteholders and 52% of shareholders for the recapitalisation and the Prudential Regulation Authority (PRA) has accepted the plan. However, uncertainty around the plan's execution remains while the remaining shareholders and noteholders decide whether they will also support the proposals. To become effective, the scheme requires, amongst other things, the approval of 75% of each relevant creditor class and that of the court.

The review will focus on the likelihood of the plan being agreed and whether the proposed capital injection will be sufficient to recapitalise the bank on a sustainable basis over the medium-term, given that the bank remains loss-making.

The full list of affected ratings is at the end of this press release.

RATINGS RATIONALE

---RATIONALE FOR THE BCA

The review for upgrade of the bank's BCA of ca reflects Moody's view that the bank's standalone creditworthiness will improve if the announced recapitalisation plan is successful. Moody's estimates that, if the plan is carried out, the bank's common equity tier 1 (CET1) component of its Individual Capital Guidance (ICG) would be met immediately and full ICG compliance (i.e. Pillar 1 + 2A requirements set by the PRA) is expected from 2018 onwards following the proposed issuance of Tier 2 capital in 2018. The proposed recapitalisation will also improve the bank's risk-absorption capacity which has been weighed down by a sizeable non-core portfolio of corporate and commercial real estate loans and residential mortgages (the Optimum book). This non-core book's share of the bank's total credit risk-weighted assets was around 30% of the total, at GBP 2 billion, as of December 2016.

At the same time, Moody's expects the bank to remain loss-making until 2018 and it therefore has little capacity for internal capital generation. The review will focus on the sustainability of the bank's capital position in the context of these continued losses and its evolving regulatory capital requirements.

-- RATIONALE FOR SENIOR DEBT

The review for upgrade on the bank's long-term senior unsecured debt ratings reflects the fact that the plan does not anticipate a liability management exercise on its outstanding senior unsecured debt and instead relies on the conversion of Tier 2 subordinated debt. If successful, the recapitalization diminishes the probability of the bank being placed into resolution and the risk of the bank's bonds will improve relative to the current Ca rating, which was positioned in the rating agency's expectation of a 35-60% loss rate under a liability management exercise or resolution.

If the recapitalisation plan were to fail, Moody's believes that the bank would likely be placed into resolution, which would likely result in losses on senior debt consistent with the current rating.

The review will focus on the likelihood of the plan succeeding.

-- RATIONALE FOR DEPOSITS

Moody's review with direction uncertain on the bank's long-term deposit ratings of Caa2 reflect the different balance of risks for the bank's wholesale uninsured deposits and will likewise focus on the probability of the capital increase being accepted. If it is successful, the risk of loss for these deposits would likely diminish thanks to an increased capital cushion and the rating agency could therefore upgrade them.

If on the other hand the proposed plan is rejected, Moody's believes that bank would likely be placed in resolution. In this scenario, the rating agency considers that junior depositors would likely incur losses alongside the senior debt holders, and would lower the long-term deposit rating accordingly.

RATIONALE FOR THE CR ASSESSMENT

As part of today's action, Moody's also placed on review direction uncertain the bank's long-term CR Assessment of Caa1(cr). The short-term CR Assessment was unaffected at Not Prime(cr).

The review on the CR Assessment is driven by the same considerations as that on the bank's junior deposits. If the plan succeeds, the bank's senior operating obligations will be better protected from loss thanks to a greater capital cushion. If it fails and the bank enters resolution, they will be exposed to a higher risk of loss. The review will focus on the success of the plan and degree to which operating obligations are shielded from loss by other liabilities.

WHAT COULD CHANGE THE RATINGS UP/DOWN

Given the low standalone BCA of ca, scope for further downgrade is limited, but would be likely in the event that the bank were placed in liquidation. This or a resolution would increase the prospect of losses on outstanding senior unsecured debt and deposit instruments, leading to lower ratings.

The BCA could be upgraded if the bank demonstrates that it has been successful in improving its capitalisation on a sustainable basis. A positive change in the BCA would likely lead to an upgrade in all long-term debt and deposit ratings.

LIST OF AFFECTED RATINGS

Issuer: Co-Operative Bank Plc

Placed On Review for Upgrade:

....Senior Unsecured Regular Bond/Debenture, currently Ca, Outlook Changed To Rating Under Review From Developing

....Senior Unsecured MTN Program, currently (P)Ca

....Adjusted Baseline Credit Assessment, currently ca

....Baseline Credit Assessment, currently ca

Placed On Review Direction Uncertain:

....LT Bank Deposits (Local & Foreign Currency), currently Caa2, Outlook Changed To Rating Under Review From Developing

....LT Counterparty Risk Assessment, currently Caa1(cr)

Outlook Actions:

....Outlook, Changed To Rating Under Review From Developing

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks published in January 2016. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

For any affected securities or rated entities receiving direct credit support from the primary entity(ies) of this credit rating action, and whose ratings may change as a result of this credit rating action, the associated regulatory disclosures will be those of the guarantor entity. Exceptions to this approach exist for the following disclosures, if applicable to jurisdiction: Ancillary Services, Disclosure to rated entity, Disclosure from rated entity.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Please see www.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

Please see the ratings tab on the issuer/entity page on www.moodys.com for additional regulatory disclosures for each credit rating.

Irakli Pipia
VP - Senior Credit Officer
Financial Institutions Group
Moody's Investors Service Ltd.
One Canada Square
Canary Wharf
London E14 5FA
United Kingdom
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Nicholas Hill
MD - Banking
Financial Institutions Group
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Releasing Office:
Moody's Investors Service Ltd.
One Canada Square
Canary Wharf
London E14 5FA
United Kingdom
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454