

MOODY'S

RATINGS

Rating Action: Moody's Ratings downgrades the Coventry Building Society and upgrades The Co-operative Bank's ratings, stable outlook

18 Dec 2024

London, December 18, 2024 -- Moody's Ratings (Moody's) has today downgraded by a notch all ratings and assessments of Coventry Building Society ("Coventry BS"), with the exception of the Prime-1 short-term Counterparty Risk Ratings (CRR) and Prime-1(cr) short-term Counterparty Risk (CR) Assessment which have been affirmed. Previously, the ratings were on review for downgrade.

At the same time, we upgraded all ratings and assessments of The Co-operative Bank Holdings p.l.c. ("Co-operative Bank Holdings") and The Co-operative Bank plc (Co-operative Bank). Previously, the ratings were on review for upgrade. The rating action follows regulatory approval by the UK's Financial Conduct Authority (FCA) and Prudential regulatory Authority (PRA) of the acquisition of Co-operative Bank by Coventry BS for a total cash consideration of £780 million, with up to £125 million deferred for a period of 3 years subject to the future performance of Co-operative Bank. The acquisition is expected to complete on 1 January 2025.

This rating action concludes the review for upgrade initiated on 19 April 2024.

Today's rating action follows the announcement by Coventry BS and Co-operative Bank dated 28 November 2024, which confirms that the FCA and PRA have given their consent to the acquisition of the entire issued share capital of the Co-operative Bank Holdings by Coventry BS.

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

RATINGS RATIONALE

COVENTRY BUILDING SOCIETY

The downgrade of the Coventry BS's ratings and assessments was driven by the elevated operational challenges of integrating Co-operative Bank into Coventry BS, given its relatively large size, and the risks involved in delivering upgrades to and

integration of technology platforms, systems, risk appetites and governance. The negative one notch qualitative corporate behaviour adjustment reflects these heightened governance risks alongside the hurdles associated with the evolution of the merged group's business model as it expands into newer lending segments such as SME, Corporate and unsecured lending over time.

In line with current expectations, we expect a modest weakening in the Coventry BS's strong asset quality post integration with Co-operative Bank in line with sectoral trends. Against this, the society's moderate capitalization provides a solid loss absorbing cushion despite which the increased constraint due to the increase in our assessment of Tangible Common Equity (TCE) leverage. We expect the society's profitability to remain at a moderate level and market funding reliance to reduce, with society's funding base benefiting from greater diversification due to Co-operative Bank's non-interest-bearing current accounts. However, the positive impact on the combined liquidity profile will be moderated by the reduction in the level of liquid assets and the additional issuance of debt.

Given the similar nature of the two entities' loan books and product offerings, the BCA continues to incorporate a one notch negative qualitative adjustment to reflect lack of business diversification in line with current approach for our rated building societies.

The Group will continue to be primarily funded by retail deposits which continue to support the current 10% junior deposit assumption incorporated in the Advanced Loss Given Failure (LGF) analysis. The benefits of higher debt issuance are offset by growth in the tangible banking assets resulting in unchanged notching uplift for the society's liabilities.

ESG considerations are material to the outcome of the rating action. Coventry BS's Financial Strategy and Risk Management and Management Credibility and Track Record Governance Issuer Profile sub-factor scores will increase to 4 and 3 respectively, reflecting the evolving corporate structure due to the proposed acquisition which would result in a weakened leverage, high execution risk and an evolving business model, operational processes and infrastructure. As a result Coventry BS's ESG Credit Impact Score changes to CIS-4 from CIS-2, reflecting high credit impact from high governance risks.

CO-OPERATIVE BANK AND CO-OPERATIVE BANK HOLDINGS

The upgrade of Co-operative Bank's Baseline Credit Assessment (BCA) reflects its strong asset quality, improved stress capital resilience and internal capital generation capacity. Following the completion of its IT platform transition, we expect a material reduction in its cost base, which will improve its efficiency and core profitability while also likely leading to lower capital requirements. Being part of an enlarged group, would also provide Co-operative Bank with the opportunity to cross sell its loans and products to a far larger customer base, supporting growth and profitability.

The upgrade of its BCA also reflects its stable retail funding model, as well as its improved market funding access as being part of a larger group. The bank also maintains a strong level of liquidity.

The upgrade of its Adjusted BCA reflects our view of a very high probability of support from its potential new parent, Coventry BS, in a situation of stress. Co-operative Bank will now be a wholly owned part of a larger and higher rated entity which leads to two notches of uplift to Co-operative Bank's baa3 BCA, to an Adjusted BCA of baa1. The upgrade of Co-Operative Bank's other ratings as well as the ratings of Co-operative Bank Holdings stems from the upgraded Adjusted BCA but also our application of the same assumptions under our Loss Given Failure (LGF) methodology as those applied to Coventry BS.

We expect that in case of failure, Coventry BS and Co-operative Bank will be resolved as a single unit, which would mean that the bank's depositors and senior bondholders would therefore also benefit from the loss absorbency of Coventry BS's bail-in-able debt and junior deposits. We now therefore assume the loss-given-failure of the debt and deposits of Co-operative Bank and Co-operative Bank Holdings to be in-line with that of Coventry BS's very low loss-given-failure for junior deposits, which results in a one-notch uplift from the baa1 Adjusted BCA, and moderate loss-given-failure Co-operative Bank Holdings' senior and subordinated bondholders, resulting in one notch negative differential from the Adjusted BCA.

Governance is also a key driver for the rating action. Although, we consider risks from governance related to the bank completing its IT simplification and improving its overall financial performance to have reduced, the risks related to the integration of the bank into Coventry BS have notably increased. As a result, we have moved the entity's governance score to G- 4. The credit impact score moves to CIS-2 from CIS-3 because of the extent of affiliate support for Co-operative bank's ratings.

OUTLOOKS

The outlooks on Coventry BS's long-term deposit and senior unsecured debt ratings are stable, reflecting our expectation that the society's capitalisation, liquidity, and funding metrics will remain in line with its current standalone assessment and the economies of scale and completion of the integration will be achieved beyond the outlook period.

The outlooks on Co-operative Bank Holdings' long-term issuer and senior unsecured debt ratings and Co-operative Bank's long-term deposit rating are stable and reflects the stable outlook on Coventry BS's long-term deposit and senior unsecured ratings.

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

COVENTRY BUILDING SOCIETY

Coventry BS's long-term ratings and assessments could be upgraded following a successful integration of Co-operative Bank, resulting in removal of one notch corporate behaviour adjustment and thus an upgrade of the society's BCA. Furthermore, deposit and debt ratings could be upgraded following a significant increase in the stock of more junior bail-in-able liabilities.

Coventry BS's long-term ratings and assessments could be downgraded following a downgrade of the BCA due to deterioration in the society's solvency and liquidity, material cost or time overruns in the phased integration plans or following a significant reduction in the stock of bail-in-able liabilities.

CO-OPERATIVE BANK HOLDINGS AND CO-OPERATIVE BANK

Co-operative Bank's BCA could be further upgraded following a combination of a greater than expected improvement in profitability driven by improved efficiency and stronger income generation, combined with strong asset quality and capitalisation levels.

The Adjusted BCA, debt and deposit ratings of Co-operative Bank and Co-operative Bank Holdings, where applicable, could be upgraded following an upgrade of Coventry BS's BCA or if there were a material increase in the aggregate stock of bail-in-able debt of the combined group.

Co-operative Bank's BCA could be downgraded if there is a material weakening in its asset risk, lower capitalisation and a significant fall in core profitability. The Adjusted BCA, debt and deposit ratings of Co-Operative Bank and Co-Operative Bank Holdings, where applicable, could be downgraded following a downgrade of Coventry BS's BCA or if there were a material decrease in the aggregate stock of bail-in-able debt of the combined group.

LIST OF AFFECTED RATINGS

..Issuer: Coventry Building Society

Outlook Actions:

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

Downgrades:

.... Adjusted Baseline Credit Assessment, Downgraded to baa1 from a3

.... Baseline Credit Assessment, Downgraded to baa1 from a3

.... LT Counterparty Risk Assessment, Downgraded to A1(cr) from Aa3(cr)

.... LT Counterparty Risk Rating (Foreign Currency), Downgraded to A1 from Aa3

- LT Counterparty Risk Rating (Local Currency), Downgraded to A1 from Aa3
- ST Bank Deposits (Foreign Currency), Downgraded to P-2 from P-1
- ST Bank Deposits (Local Currency), Downgraded to P-2 from P-1
- Junior Senior Unsecured (Local Currency), Downgraded to Baa2 from Baa1
- Subordinate Medium-Term Note Program (Local Currency), Downgraded to (P)Baa2 from (P)Baa1
- Senior Unsecured Medium-Term Note Program (Local Currency), Downgraded to (P)A3 from (P)A2
- Junior Senior Unsecured Medium-Term Note Program (Local Currency), Downgraded to (P)Baa2 from (P)Baa1
- Preferred Stock Non-cumulative (Local Currency), Downgraded to Ba1 (hyb) from Baa3 (hyb)
- Senior Unsecured (Local Currency), Downgraded to A3 STA from A2 RUR
- Senior Unsecured (Foreign Currency), Downgraded to A3 STA from A2 RUR
- LT Bank Deposits (Foreign Currency), Downgraded to A3 STA from A2 RUR
- LT Bank Deposits (Local Currency), Downgraded to A3 STA from A2 RUR

Affirmations:

- ST Counterparty Risk Assessment, Affirmed P-1(cr)
- ST Counterparty Risk Rating (Foreign Currency), Affirmed P-1
- ST Counterparty Risk Rating (Local Currency), Affirmed P-1

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

Outlook Actions:

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

Upgrades:

- ST Issuer Rating (Foreign Currency), Upgraded to P-2 from NP
- ST Issuer Rating (Local Currency), Upgraded to P-2 from NP

... LT Issuer Rating (Foreign Currency), Upgraded to Baa2 STA from Ba2 RUR
... LT Issuer Rating (Local Currency), Upgraded to Baa2 STA from Ba2 RUR
... Subordinate (Local Currency), Upgraded to Baa2 from Ba2
... Senior Unsecured (Local Currency), Upgraded to Baa2 STA from Ba2 RUR
..Issuer: The Co-operative Bank plc

Outlook Actions:

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

Upgrades:

... Adjusted Baseline Credit Assessment, Upgraded to baa1 from ba1
... Baseline Credit Assessment, Upgraded to baa3 from ba1
... LT Counterparty Risk Assessment, Upgraded to A1(cr) from Baa1(cr)
... ST Counterparty Risk Assessment, Upgraded to P-1(cr) from P-2(cr)
... LT Counterparty Risk Rating (Foreign Currency), Upgraded to A1 from Baa2
... LT Counterparty Risk Rating (Local Currency), Upgraded to A1 from Baa2
... ST Counterparty Risk Rating (Foreign Currency), Upgraded to P-1 from P-3
... ST Counterparty Risk Rating (Local Currency), Upgraded to P-1 from P-3
... ST Bank Deposits (Foreign Currency), Upgraded to P-2 from P-3
... ST Bank Deposits (Local Currency), Upgraded to P-2 from P-3
... LT Bank Deposits (Foreign Currency), Upgraded to A3 STA from Baa3 RUR
... LT Bank Deposits (Local Currency), Upgraded to A3 STA from Baa3 RUR

PRINCIPAL METHODOLOGY

The principal methodology used in these ratings was Banks published in November 2024 and available at <https://ratings.moodys.com/rmc-documents/432741>. Alternatively, please see the Rating Methodologies page on <https://ratings.moodys.com> for a copy of this methodology.

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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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