MOODY'S INVESTORS SERVICE

CREDIT OPINION
8 September 2016

Update

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RATINGS

Co-Operative Bank Plc

Domicile	United Kingdom
Long Term Debt	Caa2
Type	Senior Unsecured - Dom Curr
Outlook	Positive
Long Term Deposit	Caa2
Type	LT Bank Deposits - Fgn Curr
Outlook	Positive

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Co-operative Bank Plc

Post Rating Action Update

Summary Rating Rationale

On 18 August, we affirmed Co-operative Bank's long-term bank deposits and senior unsecured debt at Caa2. These ratings are underpinned by (1) the bank's caa2 baseline credit assessment (BCA); (2) the results of our Advanced Loss Given Failure (LGF) analysis which leads to a Preliminary Rating Assessment (PRA) for both deposits and senior unsecured debt at the same level as the BCA and; (3) a low probability of government support, resulting in no uplift from the PRA for both deposit and senior unsecured debt ratings. Co-operative Bank's short-term deposits and short-term debt are rated at Not Prime. The bank's Counterparty Risk Assessment (CR Assessment) is B2(cr)/NP(cr).

Despite the considerable challenges face by the bank, which are reflected in its current rating, the outlook on the Co-operative Bank's deposit and senior unsecured debt ratings remains positive reflecting our expectation that the bank will continue the gradual implementation of its restructuring plan leading to stronger credit fundamentals, subject to continued forebearance on the part of the UK Prudential Regulation Authority and the Financial Conduct Authority (FCA)..

Despite the positive outlook, as a UK bank, Co-operative faces increased headwinds due to the negative implications for UK medium term growth we now expect to result from the prolonged period of uncertainty following the outcome of the referendum on the UK membership to the EU. Weaker economic growth could in turn lead to: (1) weaker operating profitability due to slower domestic credit demand; (2) weaker credit quality due to a likely modest increase in unemployment and downward pressure on property prices in the UK; and 3) potentially higher and more volatile funding costs. These drivers will pressure revenues, asset quality and profitability metrics for all banks in the system, although some are more resilient to these strains. These factors led us to revise the outlooks on many UK banks and building societies ratings to negative from stable. We revised our outlook on the UK banking system itself to negative from stable at the same time.

Co-operative Bank's BCA at caa2 continues to reflects these challenges as well as (1) the significant progress the bank has made in reducing its low-quality non-core portfolio and, consequently, its downside risks; (2) improved asset quality metrics; and (3) the maintenance of solid funding and liquidity positions. The BCA also incorporates (1) the considerable execution risk to the transformation plan amid a more challenging operating environment in the UK; (2) the expectation of continued net losses through to 2017, eroding the bank's capital and leverage position; and (3) the bank's continuing reliance on regulatory forbearance with regards to its inability to consistently comply with its Individual Capital

Guidance (ICG) and PRA buffers and non-compliance with regulators' requirements in relation to credit risk modeling and certain IT standards.

Credit Strengths

» Reduced downside risk following reduction of its non-core portfolio

» Improved asset quality metrics

» Resilient deposit base despite significant challenges

» Low reliance on wholesale funding

» Sufficient liquidity levels

Credit Challenges

» Operating environment uncertainties following the outcome of the EU referendum

» Continued reliance on regulatory forbearance with regards to minimum capital requirements, internal credit risk modeling requirements and IT standards

» Low and further decreasing leverage ratio

» Negative profitability due to high cost base and legacy issues

Rating Outlook

The outlook on all ratings is positive, reflecting our expectation that despite the considerable challenges Co-operative Bank continues to face, which are exacerbated by the weakening operating environment, the bank will continue the gradual implementation of its business restructuring plan which will strengthen its credit fundamentals, subject to continued regulatory forbearance.

Factors that Could Lead to an Upgrade

The Co-operative Bank's BCA could be upgraded if the bank demonstrates further progress in (1) complying with the regulator's requirements in relation to credit risk modelling and certain IT standards, (2) further reducing the size of its non-core portfolio and (3) implementing cost-saving initiatives; while (4) maintaining satisfactory capital ratios. A positive change in the BCA would likely lead to an upgrade in all ratings.

Factors that Could Lead to a Downgrade

The Bank's BCA could be downgraded as a result of (1) a change in the regulator's approach towards the restructuring plan, resulting in calls to increase capital in order to remain as a going concern institution; (2) further delays in progress on cost saving and restructuring plans; and (3) significantly higher than expected impairment or conduct charges. A negative movement in the bank's BCA would likely lead to the downgrade of all ratings.

Key Indicators

Exhibit 1

Co-Operative Bank Plc (Consolidated Financials) [1]

	6-16[2]	12-15[2]	12-14[2]	12-13[2]	12-12[3]	Avg.
Total Assets (GBP million)	28195.9	29028.3	37582.9	43383.8	49772.8	-13.2[4]
Total Assets (EUR million)	33927.7	39386.1	48428.9	52146.5	61366.5	-13.8[4]
Total Assets (USD million)	37692.0	42784.9	58601.5	71854.8	80905.1	-17.4[4]
Tangible Common Equity (GBP million)	1060.9	1130.3	1792.7	1625.2	1444.6	-7.4[4]
Tangible Common Equity (EUR million)	1276.6	1533.6	2310.1	1953.5	1781.1	-8.0[4]
Tangible Common Equity (USD million)	1418.2	1666.0	2795.3	2691.8	2348.2	-11.8[4]
Problem Loans / Gross Loans (%)	4.4	4.8	9.2	10.8	11.0	8.0[5]
Tangible Common Equity / Risk Weighted Assets (%)	14.7	15.2	14.2	10.8	8.1	13.7[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	68.6	69.9	103.5	131.1	178.7	110.4[5]
Net Interest Margin (%)	0.7	0.9	0.9	0.7	1.2	0.9[5]
PPI / Average RWA (%)	-6.1	-3.6	-2.3	-1.7	1.6	-3.4[6]
Net Income / Tangible Assets (%)	-1.3	-1.8	-0.4	-3.0	-0.7	-1.4[5]
Cost / Income Ratio (%)	259.4	197.5	167.5	150.6	61.2	167.2[5]
Market Funds / Tangible Banking Assets (%)	13.4	12.6	12.6	17.7	19.2	15.1[5]
Liquid Banking Assets / Tangible Banking Assets (%)	25.4	27.4	25.5	22.6	25.0	25.2[5]
Gross loans / Due to customers (%)	89.6	87.4	87.8	94.7	92.4	90.4[5]

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel III - fully-loaded or transitional phase-in; IFRS [3] Basel II; IFRS [4] Compound Annual Growth Rate based on IFRS reporting periods [5] IFRS reporting periods have been used for average calculation [6] Basel III - fully-loaded or transitional phase-in & IFRS reporting periods have been used for average calculation

Source: Moody's Financial Metrics

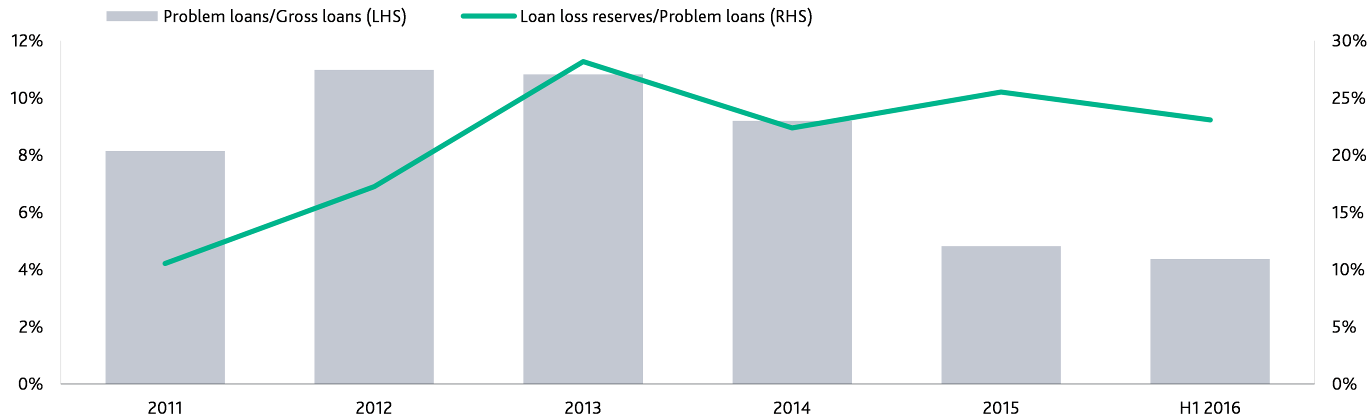
Detailed Rating Considerations

Although asset quality has improved, it remains weaker compared to peers due to Co-operative Bank's large non-core portfolio

The bank's problem loan ratio declined to 4.4% as of June 2016 from a peak of 11% as of December 2012. The improvement has been mainly driven by the deleveraging process of its non-core portfolio. However, Co-operative Bank's non-core portfolio, which we still consider to be a relatively low quality loan portfolio compared to its core business, still accounts for about 21% of gross lending as of June 2016 according to our calculations. This portfolio includes corporate, Commercial Real Estate (CRE) and Optimum (residential mortgages) loans and is being run down. The non-core corporate book is concentrated with a relatively small number of borrowers and it includes PFI, housing association and CRE loans. As of June 2016, the book had a problem loan ratio of 15.6%, with 36% of impaired balances covered by provisions. Optimum, a closed book of residential mortgages, is highly vulnerable to economic downturn with 85% interest-only mortgages and an average LTV of 65.2%. As of June 2016, 11.2% of Optimum loans were impaired. In contrast, the core residential mortgage book had 1.3% of loans impaired and an average LTV of 49.8% at end of June 2016.

Impairment write-backs decreased to £4.6 million during the first half of 2016 from £44.6 million in 2015. The bank's coverage ratio declined slightly to 23.1% as of end of June 2016 from 25.5% as of December 2015 given the increased weighting of the secured retail book. However, the level remains significantly below that of its UK peers.

Exhibit 2
Problem loan ratio improved on the back of non-core asset sales; coverage remains relatively low



Source: Moody's Banking Financial Metrics

We now expect a material slow-down in the bank's asset quality improvements. Co-operative Bank announced in April that in response to unfavorable market conditions it had agreed an updated turnaround plan with the Prudential Regulation Authority (PRA), which includes suspending its plans to deleverage the remaining Optimum assets. While the bank is committed to seek opportunities for asset sales subject to improved market conditions, attempts to execute the sales in the near term will be further hampered by the more challenging operating environment in the UK.

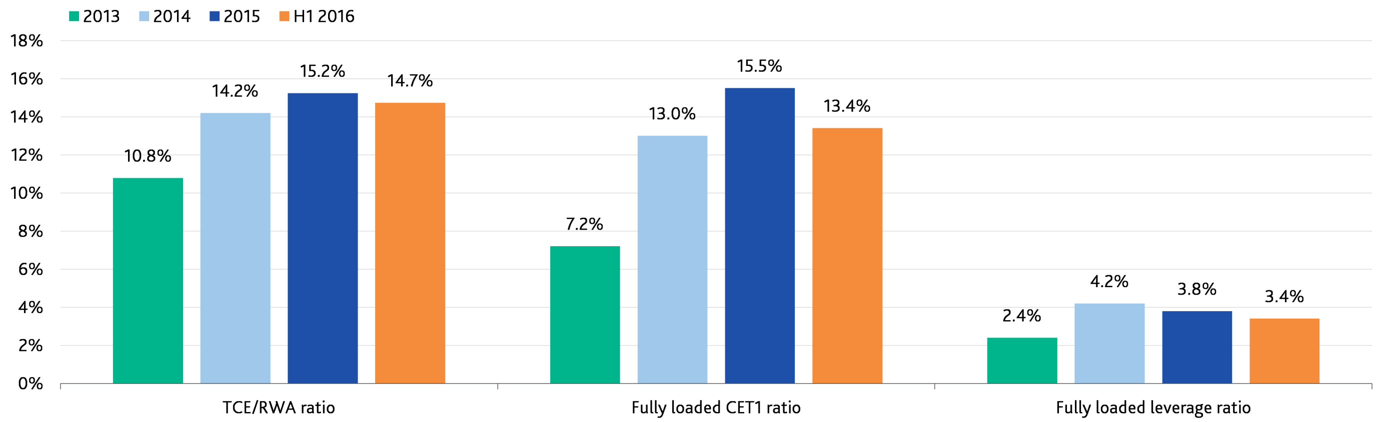
We assign an Asset Risk score of caa1 to reflect the downside risks to asset quality stemming from the remaining non-core portfolio and the weakening economic environment as well as the execution risks inherent in the bank's transformation plan.

Negative pressure on capital

We calculate Co-operative Bank's Tangible Common Equity over Risk Weighted Assets at 14.7% as of June 2016, a significant decline from 15.2% at end-2015. The main drivers for the decline were the losses reported by the bank during the first half of 2016. In parallel, the bank's fully loaded common equity tier 1 (CET1) ratio declined to 13.4% as of June 2016 from 15.5% as of December 2015. Given the uncertainty around the timing of further disposals from the Optimum portfolio and the expected material slowdown in deleveraging, the bank is now unlikely to achieve further considerable reductions in risk-weighted assets/exposures to mitigate against the impact of ongoing losses on its capital resources. Uncertainty also remains as to when the bank will start generating capital organically through earnings retention. In the current economic environment, further non-core portfolio disposals will likely generate losses, negatively impacting its capital ratios net of any offsetting reduction in the bank's RWAs. Given sizable investments in IT infrastructure and the cost of ongoing restructuring, the bank is unlikely to return to profit in the near future. We therefore expect Co-operative Bank's capital ratios to decrease further over the outlook period.

Exhibit 3

Co-operative Bank's capital metrics are declining and remain susceptible to stress



Source: Moody's Banking Financial Metrics and bank's financial reports

The bank is reliant on regulatory forbearance for a sustained period of time particularly relating to its inability to consistently comply with its ICG and PRA buffer requirements, non-compliance with internal credit risk modeling requirements and the need to upgrade IT infrastructure to comply with applicable standards. As of June 2016, the bank had a total capital requirement of 20.6%, the highest among UK banks, which was composed of a Pillar 1 requirement of 8% and a Pillar 2A requirement of 12% plus a combined CET1 buffer of 0.6%, . Co-operative Bank extended the timeline for its capital strategic plan, which includes meeting the minimum required 7% CET1 ratio throughout the planning period (2016-2020), sustainably meeting its ICG by 2020, complying with the PRA buffer and achieving a leverage ratio above 3.0% by the end of 2020. As of June 2016, the bank does not now meet its ICG and Combined Buffer requirements.

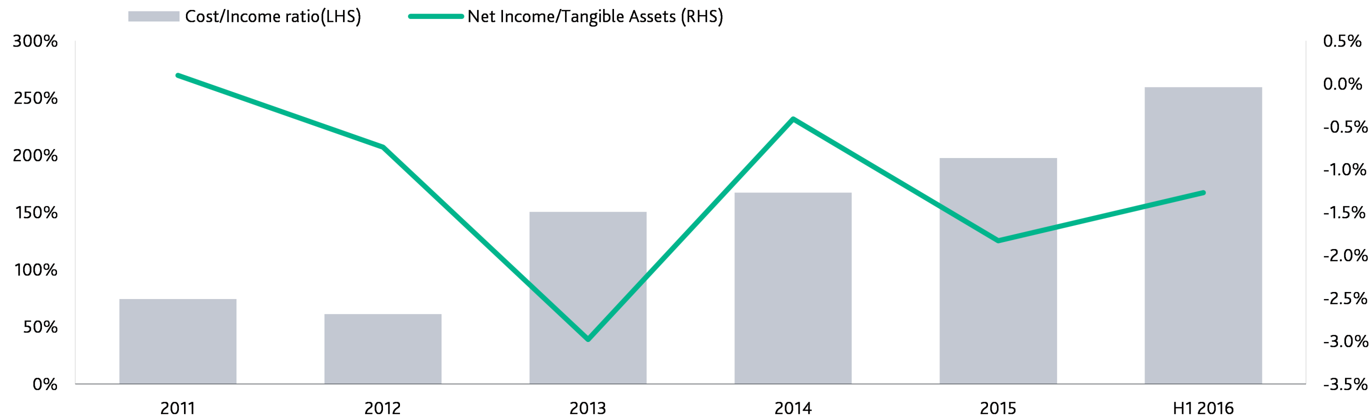
Having issued £250 million of MREL-eligible Tier 2 notes in 2015, Co-operative Bank does not currently believe it will be able to undertake any further issuance of MREL-qualifying instruments before 2018 due to the expected impact on its cost of funding. The regulator, has however, expressed a preference for an earlier MREL issuance in order to enhance the volume of the bank's loss absorbing liabilities. Should the Co-operative Bank's management find an opportunity to undertake an earlier MREL issuance, the negative financial impact will likely result in further delay in achieving full compliance with its ICG and the PRA buffer requirements.

For the reasons discussed above, we continue to believe Co-operative Bank's capital position is extremely vulnerable, as reflected in the assigned Capital score of caa3. The bank has limited room to absorb unexpected losses, including conduct-remediation costs and potential additional impairments caused by more adverse economic and market conditions.

Profitability is negative and will likely remain subdued in the near term

We believe the bank is unlikely to return to profitability in 2016 and 2017 due to low interest margins, an exceptionally high cost base and potential further impairment losses and conduct remediation charges. During the first half of 2016, Co-operative Bank reported a loss before tax of £177 million, compared to the £204 million pre-tax loss reported during the same period in 2015, reflecting lower operating expenses and provisions for customer redress along with a one-off gain from the sale of the bank's stake in Visa Europe. The results also lead to a slight improvement in the bank's Net Income to Tangible Asset ratio to -1.3% in the first half of 2016 from -1.8% in 2015.

Exhibit 4
High cost base continues to impede Co-operative Bank's profitability



Source: Moody's Banking Financial Metrics

The Co-operative Bank's net interest margin (NIM) as calculated by the bank was 1.42% for the period ending June 2016. The ratio is still significantly below that of peers. Co-operative Bank, in line with other UK banks, is expected to face further margin pressures following the Bank of England's recent decision to cut its base rate by 25 basis points to 0.25%, to the extent that this impact is not mitigated through access to cheap funding under the Bank of England Term Funding Scheme. In addition, lower credit demand could adversely affect business volumes. Impairment reversals, which supported profitability in the past couple of years, show a decreasing trend, and will likely fall further as impairments pick up driven by weakening economic environment.

The bank is making a significant effort to offset the decline in revenues through a reduction in operating expenses, which fell by 13% to £491.9 million in 2015. A further 19% year-on-year decrease was achieved in the first six months of 2016. Despite these improvements, the bank's cost-income ratio increased to 259% during the first half of 2016 from 198% in 2015, according to our calculations. In addition to the transitory project costs, the bank's profitability continues to be affected by the unwind of the fair value adjustments associated with the merger with Britannia Building Society with £81.3 million incurred during the first half of 2016.

Despite the more challenging operating environment, we think that profitability metrics will show a gradual improvement, albeit remaining very weak, as legacy issues and conduct costs are resolved. We assign a Profitability score of caa1 to reflect these expected improvements and the reduction in losses.

The bank's reliance on wholesale funding is low and current liquidity levels are sufficient

Co-operative Bank's funding profile remains a relative strength and customer deposits continue to be its primary source of funding as the bank reported a loan-to-deposit ratio of 89% as of June 2016, up from 86% at end-2015. Total customer deposits decreased by approximately £700 million to £22 billion during the first half of 2016.

The reliance on wholesale funding is low. As of June 2016, Co-operative Bank had £3.8 billion of market funds and its Market Funds as a proportion of Tangible Banking Assets ratio stood at 13.4%, according to our calculations. At the beginning of 2016 the bank repaid the remaining balance on the Funding for Lending Scheme (FLS) facility. Co-operative Bank issued £250 million of 10 year callable subordinated Tier 2 notes on 1 July 2015, reinstating its market access. In our opinion, despite the return to market, obtaining wholesale funding on favourable terms currently remains a challenge for the bank.

We assign a Funding Structure score of baa3. The score reflects the improvements in the metric and the bank's return to market access, as well as recognising the still limited opportunities for the bank to achieve a varied mix of wholesale funding.

Co-operative Bank maintains an ample stock of liquid assets reflected in a Liquid Banking Assets-to-Tangible Banking Assets ratio of 25.4% at June 2016 leading to the assigned Liquid Resources score of a2. The bank's primary liquidity has been managed down over the past couple of years, consistent with its deleveraging. As of 30 June 2016 primary liquid assets as a proportion of total assets reached a normalised level of around 13%.

Co-operative Bank's BCA is supported by its Very Strong- Macro Profile

As a retail domestic bank, Co-operative Bank's operating environment is heavily influenced by the United Kingdom and its Macro Profile is thus aligned with that of the UK at Very Strong-.

UK banks benefit from operating in a wealthy and developed country with a very high degree of economic, institutional and government financial strength as well as low susceptibility to event risk. The main risks to the system now stem from the economic uncertainty resulting from the UK's decision to leave the European Union (EU) and the high level of indebtedness of UK households, which are thus sensitive to changes in interest rates. UK banks are largely funded by deposits and banks' funding structures have remained relatively stable in the past few years, with both capital and liquidity having strengthened and a reduced reliance on short-term wholesale funding. On balance sheet liquidity is further bolstered by contingent liquidity arrangements put in place by the Bank of England and by the firms themselves. The UK banking sector is relatively concentrated but the price-setting dominance of large banks is somewhat challenged by competition from the shadow and challenger banking market.

Co-operative Bank's resulting financial profile score is b2.

We apply a negative qualitative adjustment reflecting expected lack of business diversification since Co-operative Bank has announced that going forward it aims to focus on UK retail and SME businesses. We believe that on a forward looking basis, as the bank disposes of its corporate and commercial assets, its business model will be characterized by the following mono-line characteristics:

85% of the loan book is made of residential mortgages;

80% of revenues comes from one source.

We also apply a two-notch negative adjustment for Corporate Behaviour. Although we believe that the current management team has developed a realistic de-risking and restructuring plan in order to eventually achieve a sustainable business model, the institution continues to face a number of challenges given past control failures. This is evident from the results of the investigation by the Prudential Regulation Authority and the Financial Conduct Authority into the bank's management activities over the period from mid-2009 to end-2013, released on 11 August 2015. The regulator identified that during this period the bank was in breach of Principle Three of the Principles for Businesses which requires a firm to have an adequate and effective risk management framework. According to the regulator, Co-operative Bank failed to design, maintain and oversee appropriately its three lines of defence risk management model. In addition to risk management and control failures, the bank failed to act in a transparent and co-operative manner with the regulator and did not provide timely disclosures on important changes in the bank's senior management. We, however, note these areas are already in the process of remediation as part of the bank's restructuring plan.

The assigned BCA of caa2 is positioned in the middle of a scorecard-calculated BCA range of caa1-caa3.

Notching Considerations

Loss Given Failure (LGF)

Co-operative Bank is subject to the UK implementation of the EU Bank Resolution and Recovery Directive (BRRD), which we consider to be an Operational Resolution Regime. We assume residual tangible common equity of 3% and losses post-failure of 8% of tangible banking assets, a 25% run-off in "junior" wholesale deposits, and a 5% run-off in preferred deposits. These are in line with our standard assumptions. Particular to Co-operative Bank, we assume the proportion of deposits considered junior at 10%, relative to our standard assumption of 26%, due to largely retail-oriented depositor base of the bank.

Our LGF analysis indicates that the bank's deposits are likely to face a moderate loss-given-failure rate driven by (1) declining deposit volume and (2) a relatively low level of subordinated debt in the liability structure that would otherwise provide a loss absorbing cushion for deposits. This results in the Preliminary Rating Assessment (PRA) for the deposits in line with the adjusted BCA at caa2.

Senior unsecured debt is also likely to face a moderate loss-given-failure rate according to our LGF analysis and its PRA of caa2 is at the same level as the adjusted BCA.

Government Support

The implementation of the BRRD has caused us to reconsider the potential for government support to benefit certain creditors. In the case of the Co-operative Bank, whose systemic importance has reduced, we now expect a low probability of support for deposits, resulting in no uplift from the PRA.

Counterparty Risk Assessment

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than both the likelihood of default and the expected financial loss suffered in the event of default and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (e.g., swaps), letters of credit, guarantees and liquidity facilities.

The Co-operative Bank's CR Assessment is positioned at B2(cr)/NP(cr), three notches above the Adjusted BCA of caa2, based on the cushion against default provided to the senior obligations represented by the CR Assessment by more subordinated instruments - including junior deposits and senior unsecured debt. The main difference with our Advanced LGF approach used to determine instrument ratings is that the CR Assessment captures the probability of default on certain senior obligations, rather than expected loss, therefore we focus purely on subordination and take no account of the volume of the instrument class.

The CR Assessment does not benefit from any additional notches of uplift due to government support, in line with our assumptions of a low probability of UK Government support for Co-operative Bank's senior obligations in the event of failure.

About Moody's Scorecard

Our Scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our Scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The Scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating Methodology and Scorecard Factors

Exhibit 5

Co-Operative Bank Plc

Macro Factors							
Weighted Macro Profile	**Very Strong -**	**100%**					

Financial Profile						
Factor	**Historic Ratio**	**Macro Adjusted Score**	**Credit Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	7.3%	baa3	← →	caa1	Quality of assets	Operational risk
Capital						
TCE / RWA	14.7%	aa3	↓ ↓	caa3	Stress capital resilience	Nominal leverage
Profitability						
Net Income / Tangible Assets	-1.6%	caa3	↑	caa1	Return on assets	Earnings quality
Combined Solvency Score		baa3		caa2		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	12.6%	a1	← →	baa3	Market funding quality	Deposit quality
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	27.4%	a2	← →	a2	Quality of liquid assets	
Combined Liquidity Score		a1		baa1		
Financial Profile				b2		
Business Diversification				-1		
Opacity and Complexity				0		
Corporate Behavior				-2		
Total Qualitative Adjustments				-3		
Sovereign or Affiliate constraint:				Aa1		
Scorecard Calculated BCA range				caa1-caa3		
Assigned BCA				caa2		
Affiliate Support notching				0		
Adjusted BCA				caa2		

Balance Sheet	**in-scope (GBP)**	**% in-scope**	**at-failure (GBP)**	**% at-failure**
Other liabilities	4,269	15.2%	5,815	20.7%
Deposits	22,085	78.7%	20,539	73.2%
Preferred deposits	19,877	70.8%	18,883	67.3%
Junior Deposits	2,209	7.9%	1,656	5.9%
Senior unsecured bank debt	400	1.4%	400	1.4%
Dated subordinated bank debt	460	1.6%	460	1.6%
Junior subordinated bank debt				
Preference shares (bank)				
Senior unsecured holding company debt				
Dated subordinated holding company debt				
Junior subordinated holding company debt				
Preference shares (holding company)				
Equity	842	3.0%	842	3.0%
Total Tangible Banking Assets	28,055	100%	28,055	100%

Debt class	De jure waterfall		De facto waterfall		Notching		LGF notching guidance versus BCA	Assigned LGF notching	Additional notching	Preliminary Rating Assessment
	Instrument volume + subordination	Sub-ordination	Instrument volume + subordination	Sub-ordination	De jure	De facto				
Counterparty Risk Assessment	12.0%	12.0%	12.0%	12.0%	3	3	3	3	0	b2 (cr)
Deposits	12.0%	4.6%	12.0%	6.1%	0	1	0	0	0	caa2
Senior unsecured bank debt	12.0%	4.6%	6.1%	4.6%	0	-1	0	0	0	caa2

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency rating	Foreign Currency rating
Counterparty Risk Assessment	3	0	b2 (cr)	0	B2 (cr)	--
Deposits	0	0	caa2	0	Caa2	Caa2
Senior unsecured bank debt	0	0	caa2	0	Caa2	--

Source: Moody's Financial Metrics

Ratings

Exhibit 6

Category	Moody's Rating
CO-OPERATIVE BANK PLC	
Outlook	Positive
Bank Deposits	Caa2/NP
Baseline Credit Assessment	caa2
Adjusted Baseline Credit Assessment	caa2
Counterparty Risk Assessment	B2(cr)/NP(cr)
Senior Unsecured -Dom Curr	Caa2
Commercial Paper -Dom Curr	NP
Other Short Term -Dom Curr	(P)NP

Source: Moody's Investors Service

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