

Update on The Co-operative Bank's capital position and plan to meet The Co-operative Bank's capital requirements 17.06.13

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- √⁴ The Co-operative Group announces outcome of review of The Co-operative Bank's capital position
- Comprehensive plan agreed to generate capital and provide stability

The Boards of The Co-operative Group (the "Group") and The Co-operative Bank (the "Bank") have completed a review of the financial position of the Bank and have agreed capital and management actions to generate Common Equity Tier 1 capital.

Summary

- √⁴ The Co-operative Bank requires additional aggregate Common Equity Tier 1 capital of £1.5 billion which will meet current and longer-term requirements
 - £1 billion to be contributed in 2013
 - £0.5 billion to be contributed in 2014
- √⁴ The Group and the Bank have developed a comprehensive plan which will significantly strengthen the Bank's capital base and enable it to move forwards on a stable footing
 - Pro-forma fully loaded Common Equity Tier 1 ratio expected to be above 9% by end 2013 and to increase in following years
 - Leverage ratio expected to materially exceed 3% by end 2013
- √⁴ The Group has agreed to support the capital requirements which will involve:
 - An Exchange Offer to investors in the Bank's subordinated capital securities
 - Capital commitment from the Group, sourced from an issue of bonds by Group and the transfer of a significant minority equity interest in the Bank to Target Securityholders. Both will be effected through the Exchange Offer
 - Contribution in 2014 of further Common Equity Tier 1 capital by the Group to be committed on the Exchange Offer becoming effective
 - Implementation of previously announced self-help actions from the Bank
- √⁴ The Exchange Offer is designed to ensure the Group and investors in the Bank's subordinated capital securities make a joint contribution to the recapitalisation of Co-operative Bank and share in the upside of the Bank's transformation under the strengthened management team
- √⁴ The Co-operative Group and The Co-operative Bank are currently working on the detail of the Exchange Offer, which is expected to involve:
 - Issue of a fixed-income instrument by Co-operative Group
 - Issue of new shares by the Bank

- Appropriate proposals for small retail investors
- √¹ The actions planned will significantly strengthen the Bank's capital base and enable the Bank to move forwards on a stable footing
- √¹ The plan has been discussed in full with the regulator

Euan Sutherland, Chief Executive of The Co-operative Group, said:

"This announcement is good news for The Co-operative Group, The Co-operative Bank, its customers and our members. We have put in place a detailed and comprehensive solution to meet the current and longer-term capital requirements of the Bank. In doing so we have agreed a plan to ensure its future. We have discussed this plan in full with the regulator. The Co-operative Group, which clearly regards the Bank as a core part of the Group, is providing extra capital. Investors in the Bank's subordinated capital securities are also being asked to support the Bank at this crucial time by participating in a wider exchange offer. This solution, under which they will own a significant minority stake in the Bank, will then allow them to share in the upside of the transformation of the Bank. The Bank itself has outlined a series of self-help measures that underpin a more targeted strategy for a responsible, community bank focused on its retail and SME customers.

"The Group is confident that, under the Bank's strengthened management team, this plan offers the best way forward. We believe it is the right approach to ensure that we continue to provide great service for our 4.7 million Bank customers, while safeguarding the interest of other stakeholders.

"On behalf of everyone within the Group I would like to thank our customers and members who have supported us through the recent period of uncertainty, and all of our colleagues who have been working to deliver for customers. The plan that we have announced means that the whole Group can now look to the future with confidence."

Niall Booker, Chief Executive of Co-operative Bank, said:

"We have a strong core retail business in the Co-operative Bank. Whilst we recognise that the short-term outlook is challenging, the measures we are announcing today mean we now have a credible plan for addressing the capital shortfall we face and can turn our attention to managing our non-core assets down and restructuring our core bank. In doing the latter, I will be working closely with the strong team of people within the Bank to ensure that we are focused on delivering a profitable business, driven by our commitment to core relationship banking and providing our loyal customers with fairly priced products and high-quality service."

Richard Pym, Non-Executive Chairman of The Co-operative Bank, said:

"This announcement marks an important turning point for The Co-operative Bank. The Board of the Bank welcomes the support of The Co-operative Group in facilitating the Common Equity Tier 1 capital raising actions we are announcing, which will provide a much stronger capital structure for the Bank. The completion of the measures announced today will provide the foundations to support the long-term success of the Bank in offering a real alternative to customers."

Update on capital requirements

Co-operative Group and Co-operative Bank have completed a review of the financial position of the Bank. As a result of that review, the Board of the Bank (the "Bank Board") has concluded that the Bank requires additional aggregate Common Equity Tier 1 capital of £1.5 billion. The Bank

Board believes that the capital and management actions being announced today will generate sufficient capital to meet the Bank's current and longer-term capital requirements.

The Group and the Bank have agreed on a plan to meet this additional capital requirement. The Board of the Group has resolved to commit the entire £1.5 billion irrevocably upon the exchange offer becoming effective, expected in Q4 2013. At least £1bn will be generated in 2013 from the exchange offer described below. The balance of up to £0.5 billion will be contributed during 2014.

The Group expects to source this balance primarily from proceeds of the disposals of insurance assets owned by the Group, savings on coupon payments on Target Securities tendered in the Exchange Offer and the planned management actions set out in this announcement, a number of which were announced by the Group and the Bank on 21 March 2013.

The Group has committed to support the Bank in this plan to satisfy the capital requirements of the Bank, which will be met, in three broadly equal proportions, from a combination of:

1. the capital generated from new shares in the Bank issued as part of an exchange offer to be made to holders of the Bank's subordinated capital securities ("Target Securityholders" and "Target Securities", respectively)
2. a further contribution from the Group by way of the issue of a fixed-income instrument as part of the exchange offer (items 1 and 2 together, the "Exchange Offer"); and
3. the contribution of sale proceeds of Co-operative Life Insurance and Asset Management and Co-operative General Insurance to the Bank (the "Insurance Proceeds Contribution"), interest savings on Target Securities and certain management actions by the Bank (the "Bank Management Actions", together with the Exchange Offer and the Insurance Proceeds Contribution, the "Capital Actions").

For the avoidance of doubt, the capital generated for the Bank through the Exchange Offer will be derived not only from items 1 and 2 above but also as a result of redeeming the Target Securities in the Exchange Offer below the Bank's current book value.

As a result of the Capital Actions, the Bank is significantly strengthening its capital base. On the basis of the Exchange Offer, the Bank Board expects the Bank's pro-forma fully loaded Common Equity Tier 1 ratio to be above 9 per cent by the end of 2013, and to increase further in the following years principally as a result of the Insurance Proceeds Contribution, Bank Management Actions and the intention of The Co-operative Bank management to return the Bank to profitability over time.

The Bank Board also expects the Bank's leverage ratio to materially exceed 3 per cent by the end of 2013. The capital requirements and Capital Actions take account of significant additional impairment charges expected for the current financial year.

The Bank Board believes that today's announcement will underpin the Bank's strong liquidity position which currently remains in excess of regulatory requirements.

The Board of Co-operative Group (the "Group Board") actively supports this solution, which will require the commitment of all stakeholders to succeed.

The Group and the Bank believe that the Capital Actions are in the long-term interest of all their respective stakeholders and of the Bank itself and will prevent more severe adverse consequences for all stakeholders which might occur in the absence of such support.

The Exchange Offer

The Exchange Offer will be made, subject to any applicable regulatory restrictions, to Target Securityholders, who will be invited to exchange their holdings of Target Securities for a combination of:

- √¹ (a) a senior unsecured fixed income instrument issued by the Group (the "Group Instrument") and, subject to the level of participation by Target Securityholders in the Exchange Offer, potentially also a fixed income instrument issued by the Bank (the "Bank Instrument"); and
- √¹ (b) ordinary shares in the Bank (the "Bank Shares", and together with the Group Instrument, the "Output Securities").

Whilst the exact terms of the Exchange Offer (including the ratio of Output Securities that will be offered to different rankings of the Target Securities) will only be finalised at the time of launch of the Exchange Offer, the current expectation of the Group and the Bank is that more junior ranking Target Securityholders are likely to be offered a substantially greater proportion of Bank Shares relative to the Group Instrument. The most senior ranking Target Securityholders are expected to be offered the substantial proportion of the Group Instrument.

The Group and the Bank currently expect that the launch of the Exchange Offer will be in October 2013.

The issue of the Group Instrument will be used by the Group to finance, indirectly, its subscription for additional ordinary shares in the Bank.

It is intended that any shares issued by the Bank in connection with the Exchange Offer would be ordinary shares and that the Bank would seek a listing for its ordinary shares on the London Stock Exchange.

The Capital Actions are intended to share the recapitalisation of the Bank, and the longer-term value potential from the recovery of the Bank, across the relevant stakeholders fairly.

The Group can meet the anticipated interest and principal payments of the Group Instrument from its existing resources. The Group's contribution, via the Group Instrument, is subject to a standard credit committee approval process from its banking syndicate and the Group is working constructively on this.

Until further notice, the Bank will only pay discretionary coupons on any Target Securities left outstanding if permitted to do so by the PRA, and in particular will not pay the coupon on the 13% Perpetual Subordinated Bonds (ISIN GB00B3VH4201) that would have been due on 31st July 2013 without such permission.

The Bank Board is mindful of the different interests of retail investors holding Target Securities. Ahead of the launch of the Exchange Offer, the Bank is considering a number of alternative options for small retail investors. In addition, the Bank is considering the manner in which it can facilitate the provision of independent financial advice to retail holders at the Bank's cost.

Insurance Proceeds Contribution by Group and Bank Management Actions

The Insurance Proceeds Contribution by Group consists of:

- √⁴ the contribution of sale proceeds of the Co-operative Life Insurance and Asset Management to the Bank by the Group when received. This transaction remains subject to regulatory approval; and
- √⁴ a sale of Co-operative General Insurance business and the contribution of sale proceeds to the Bank by the Group

The Bank Management Actions, which the Bank Board considers to be actionable to generate additional core capital, include:

- √⁴ a cost saving programme at Bank; and
- √⁴ deleveraging of the Bank's non-core assets, including potentially via selected asset sales where such sales do not materially reduce the core capital ratio of the Bank.

Anticipated impact of the Exchange Offer on Bank credit ratings

As a result of today's announcement of the Exchange Offer, the Bank anticipates that the credit ratings assigned to the Target Securities will be downgraded significantly and that the Bank's senior issuer credit rating will also be downgraded. Following the successful completion of the Exchange Offer, the Bank would expect the rating agencies to improve their ratings in due course.

Bank strategy and management

Going forward, the Bank will be a focussed core relationship Bank, serving retail and SME customers, with a division focussed on the management of non-core assets and deleveraging these exposures in a prudent manner. In addition to the assets and business lines identified as non-core at our annual results presentation on 21 March 2013, the Bank will also be treating as non-core larger corporate and commercial customers with complex product and servicing requirements which do not meet our risk appetite or fail to meet our minimum return on risk capital hurdle rates.

The Bank remains committed to the SME business market and, going forward, its focus will be on further improving its strong reputation in that sector with a view to growing market share over time. The core bank will be an attractive and differentiated customer franchise capable of delivering a return on equity above its cost of equity in the medium term and delivering a compelling proposition to its 4.7 million customers. Going forward the Bank will build upon its market-leading customer advocacy and continue to support its members through competitive ethical products and high-quality service, whilst recognising the need to generate an appropriate return on equity.

The medium-term business plan for the Bank will be described in further detail at our interim results presentation in August.

With the announcement on 28 May 2013 of the appointment of Niall Booker as Chief Executive of Bank and Deputy Chief Executive of Group and the appointment of Richard Pym as Chairman of Bank on 5 June 2013, the Bank and the Group continue the process of strengthening the management team. A strong and highly capable team are now in place to lead the Bank going forwards.

Co-operative Group and Co-operative Bank have been advised by UBS Investment Bank and Allen & Overy. Co-operative Bank has additionally been advised by HSBC in relation to the Exchange Offer.

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Details of the Target Securities	ISIN	Outstanding Principal Amount	Ranking in Bank capital structure*
9.25% Non-Cumulative Irredeemable Preference Shares	GB0002224516	£60,000,000	Tier 1
13% Perpetual Subordinated Bonds	GB00B3VH4201	£110,000,000	Upper Tier 2
5.5555% Perpetual Subordinated Bonds	GB00B3VMBW45	£200,000,000	Upper Tier 2
Floating Rate Callable Step-up Dated Subordinated Notes due 2016	XS0254625998	€34,980,000	Lower Tier 2
5.875% Subordinated Callable Notes due 2019	XS0189539942	£37,775,000	Lower Tier 2
9.25% Subordinated	XS0620315902	£275,000,000	Lower Tier 2

Notes due 28 April 2021

Fixed/Floating Rate Subordinated Notes due November 2021	XS0274155984	£8,747,000	Lower Tier 2
7.875% Subordinated Notes due 19 December 2022	XS0864253868	£235,402,000	Lower Tier 2
5.75% Dated Callable Step-up Subordinated Notes due 2024	XS0188218183	£200,000,000	Lower Tier 2
5.875% Subordinated Notes due 2033	XS0145065602	£150,000,000	Lower Tier 2

√¹ - Tier 1 is the most junior ranking of Target Securities. Lower Tier 2 is the most senior ranking of Target Securities

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