28 Oct 2019 | Upgrade

Fitch Affirms Santander Consumer Finance's IDR at 'A-'; Upgrades Senior Preferred Debt to 'A'

Fitch Ratings-Barcelona-28 October 2019:

Fitch Ratings has affirmed Santander Consumer Finance, S.A.'s (SCF) Long-Term Issuer Default Rating (IDR) at 'A-', and Viability Rating (VR) at 'a-'.

At the same time, Fitch has upgraded SCF's long- and short-term senior preferred debt ratings to 'A' from 'A-' and 'F1' from 'F2', respectively. The agency has also assigned SCF deposit ratings at 'A'/'F1'.

The upgrade on the senior preferred debt ratings reflects Fitch's view that SCF's senior preferred creditors and depositors benefit from a sizeable buffer of qualifying junior debt (QJD) and senior non-preferred debt, which could be made available to protect them in case of failure. Fitch now expects SCF's senior preferred creditors to benefit from the same credit protection as those of its parent, Banco Santander, S.A. (A-/Stable/F2), because both are part of the same resolution group under the plans approved by the Single Resolution Board (SRB).

A full list of rating actions is at the end of this rating action commentary.

Key Rating Drivers

IDRS, VR AND SUPPORT RATING

The IDRs of SCF are driven by its intrinsic strength, as reflected in its VR. The IDRs are further underpinned by potential shareholder support. We believe the parent has strong incentives to provide support as SCF is a core group subsidiary of Banco Santander and it is subject to the same resolution perimeter, resulting in an extremely high probability of support if needed.

The VR of SCF reflects a strong consumer finance franchise in Europe, which supports sustained healthy profitability, resilient asset quality favoured by its geographic diversification, and its adequate capitalisation. The VR also factors in a diversified funding structure, which benefits from ordinary support from its parent but is biased towards wholesale funding.

SCF has a leading franchise in European consumer finance and ranks among the top three players in most of the markets where it operates, which provides the bank with some pricing power. Despite its business concentration towards consumer finance and, particularly, auto loans, SCF's business model benefits from geographical diversification, adequate product distribution and the granular nature of the bank's client base. The bank's operations are spread across Europe, with a clear bias towards strong northern-European economies. In March 2019, SCF continued to strengthen its franchise with the acquisition of a 51% stake in the captive bank of Hyundai Group in Germany.

SCF's solid franchise, adequate risk-pricing and geographic diversification result in sound and fairly stable profitability despite a low interest-rate environment and increased competition in some markets. We expect the bank's profitability to remain sound in the medium-term, supported by continued business growth despite a broad economic slowdown in the eurozone, which will offset a gradual increase of loan impairment charges to more normalised levels. SCF's cost/income ratio compares well with peers' at 45% in 1H19, benefiting from synergies derived from being part of the Santander group. Cost efficiency measures are planned in Germany, the Nordics and in some smaller units.

Asset quality metrics have proved resilient over the economic cycle as SCF's risk profile benefits from a well-balanced geographic footprint and large share of less-riskier secured lending, mainly auto loans. It also benefits from tight risk management controls and prudent risk appetite across different geographies. The bank's gross impaired loans (NPL; defined as stage 3 loans) ratio was low at 1.9% at end-June 2019, with a 102% coverage by loan impairment reserves. Despite the economic slowdown in Europe, and particularly in Germany to which SCF is most exposed, we expect its asset quality metrics to remain broadly stable in the medium-term. This will be supported by the bank's conservative underwriting standards and continued loan growth.

Capitalisation levels are adequate for SCF's risk profile and well-provisioned-for credit risks. The bank's common equity tier 1 (CET1) and total capital ratios stood at 12.4% and 14.9%, respectively, at end-June 2019. SCF has limited flexibility to retain earnings as Banco Santander largely manages the subsidiary's capitalisation on a "need-cost optimisation" basis. Our assessment of capitalisation takes into account ordinary support from the parent.

SCF's funding structure is stable and more diversified than wholesale-funded non-bank peers', as the bank benefits from its ability to take deposits, which accounted for about 40% of total funding at end-June 2019. Deposits are mostly originated in Germany, although they are growing in other geographies, providing funding diversification. Wholesale funding mainly comprises secured (including ABS) and unsecured funding. SCF's liquidity profile is adequate, with the stock of unencumbered liquid assets accounting for 9% of the bank's total assets at end-June 2019. Our assessment of SCF's funding and liquidity incorporates ordinary support from its parent.

SCF is fully-owned by Banco Santander and we view it as a key and integral part of the group, given that it manages most of Banco Santander's consumer finance operations in Europe. Our assessment of institutional support also takes into account that the parent and SCF operate in the same jurisdiction and are subject to the same regulations as well as to the resolution perimeter in Spain under Banco Santander's multiple point-of-entry resolution strategy as approved by the SRB.

The high degree of integration of SCF's operations, risk management and controls, as well as management and corporate culture with those of Banco Santander, SCF's long and successful track record in supporting group objectives and brand-sharing also contribute to our overall support assessment.

SCF's Short-Term IDR of 'F2' is the lower of the two possibilities corresponding to the bank's Long-Term IDR of 'A-' and in line with Banco Santander's Short-Term IDR.

SENIOR PREFERRED DEBT AND DEPOSIT RATINGS

SCF's long-term senior preferred debt and deposit ratings are one notch above the bank's Long-Term IDR. Fitch views SCF as a closely integrated domestic subsidiary of Banco Santander and expects that SCF's senior preferred creditors and depositors will be protected by Banco Santander's large buffer of QJD and senior non-preferred debt. The ratings are also one notch above Spain's sovereign rating (A-/Stable), reflecting our view that Banco Santander benefits from its geographic diversification in highly rated economies.

Fitch calculates that the buffer of QJD and senior non-preferred debt at end-March 2019 was equal to around 12% of the parent bank's resolution perimeter risk-weighted assets. We believe these buffers should be sufficient to recapitalise the bank after a resolution without causing losses to senior preferred creditors. (see "Fitch Affirms Santander at 'A-'; Outlook Stable'" on 4 July 2019 at www.fitchratings.com for more details).

SCF's short-term senior preferred debt and deposit ratings are the lower of two options that map to an 'A' long-term rating, in line with Fitch's criteria.

RATING SENSITIVITIES

IDRS, VR, SR

SCF's IDRs could be upgraded if Banco Santander's IDRs or SCF's VR are upgraded. A downgrade would require a downgrade of both Banco Santander's IDRs and SCF's VR.

SCF's support rating would be downgraded if Banco Santander's consumer finance segment becomes less strategic for the group or if SCF becomes significantly less integrated within the group, which Fitch does not expect.

An upgrade of the VR is unlikely because of SCF's monoline business model. In addition, an upgrade would likely be contingent on an upgrade of Spain's sovereign rating.

Negative rating pressure could arise from a significant deterioration in asset quality, leading to pressure on earnings and capital pressure, or from a prolonged inability to competitively access wholesale markets.

SENIOR PREFERRED DEBT AND DEPOSIT RATINGS

SCF's long-term and short-term senior preferred debt and deposit ratings are notched up from SCF's IDR and in line with those of the parent and are therefore primarily sensitive to a change in the Long-Term IDRs. The ratings would no longer be one notch above SCF's Long-Term IDR if the buffer of QJD and senior non-preferred debt falls below our assessment of the recapitalisation amount of Banco Santander's resolution group. This amount is sensitive to our assessment of the resolution group's capital requirements and the level of investments in subsidiaries outside the resolution perimeter, which we deconsolidate.

We expect Banco Santander's combined QJD and senior non-preferred debt buffers to remain above the recapitalisation amount to the extent Banco Santander has to meet minimum Minimum Requirement for Own Funds and Eligible Liabilities (MREL) requirements on a sustained basis.

SCF's long-term senior preferred debt and deposit ratings are also sensitive to changes in the group's resolution strategy that result in SCF not being subject to the same resolution perimeter as the parent. In that case, we would expect that SCF's deposits and senior creditors will no longer benefit from the same credit protection as those of the parent, resulting in the ratings being equalised with SCF's Long-Term IDR.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or to the way in which they are being managed by the entity.

For more information on our ESG Relevance Scores, visit www.fitchratings.com/esg.

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Additional information is available on www.fitchratings.com

Applicable Criteria
Bank Rating Criteria (pub. 12 Oct 2018)
Short-Term Ratings Criteria (pub. 02 May 2019)

Additional Disclosures
Dodd-Frank Rating Information Disclosure Form
Solicitation Status
Endorsement Policy