Fitch Ratings

07 Sep 2020 | Affirmation

Fitch Affirms Santander Consumer Finance's IDR at 'A-'/Negative; VR at 'a-'

Fitch Ratings-Barcelona-07 September 2020:

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-'. The Outlook on the IDR is Negative. The VR has been removed from Rating Watch Negative (RWN). A full list of rating actions is below.

The affirmation of the VR and removal from RWN reflects our view that the economic fallout from the coronavirus crisis represents a medium-term, rather than near-term, risk to SCF's VR. The bank's earnings and asset quality have proved resilient to the economic shock caused by the pandemic to date and despite the expectation of temporary deterioration, we expect them to recover over the medium to long term. However, as the economic crisis unfolds, we continue to see heightened downside risks to SCF's operating environment, which could make the execution of its strategic objectives, in particular business growth plans, difficult and pressurise earnings and asset quality.

Key Rating Drivers

IDRS, VR AND SUPPORT RATING

SCF's IDRs are driven by its intrinsic strength, as reflected in its VR. The IDRs are further underpinned by potential shareholder support. We believe its parent, Banco Santander (A-/Negative), has strong incentives to provide support to fully-owned SCF as we consider it a core 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, which is reflected in a Support Rating (SR) of '1', also takes into account that the parent and SCF operate in the same jurisdiction, are subject to the same regulations and under Banco Santander's multiple point-of-entry resolution strategy, belong to the same resolution perimeter in Spain. This results in an extremely high probability of support if needed, in our view. 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 VR reflects a strong consumer finance franchise in Europe, sound earnings generation capacity through economic cycles and adequate funding structure, the latter benefiting from ordinary support from its parent. The VR also factors in some degree of stability in its asset quality despite the cyclical nature of its business, aided by the bank's geographical diversification, a large share of less risky secured consumer lending and effective risk controls.

SCF has a leading franchise in European consumer finance and ranks among the top three players in most of the markets where it operates. The bank's business model benefits from geographical diversification in Europe, with a clear bias towards strong northern countries, adequate product distribution and the granular nature of its client base. New and used car financing are SCF's core offering, although the bank also offers durables financing and other consumer lending products. The bank uses agreements with auto-manufacturers and retail store chains, which provide recurrent business volumes and adequate credit loan quality.

SCF's franchise, adequate risk-pricing and operating efficiency (SCF's cost-to-income ratio was 44% in 1H20) results in resilient profitability structurally, which is a key rating strength, despite a low interest rate environment and increased competition in some of its geographies. Operating profit was an average 2.3% of risk-weighted assets (RWA) over the last 10 years, with limited volatility.

In 1H20, operating profit declined as a result of lower business activity, which particularly affected fees, and higher loan impairment charges (LICs) but it remained a still robust 2% of RWA (2.9% in 2019). LICs/gross loans increased to 0.95% on annualised basis (0.4% in 2019) driven by larger expected credit risks and changes in macroeconomic prospects. SCF also recorded a significant impairment of the Nordic unit's goodwill (not included in our estimations of operating profit) that additionally affected the bank's reported net income in 1H20.

New vehicle sales in Europe have been particularly affected by lockdown measures, falling by about 40% in 1H20. Fitch expects a recovery in 2H20 and 2021, albeit to a lower level than before the pandemic and despite various government programmes to promote car purchases. SCF's new lending declined also in 1H20 but at a slower pace, although it was still 18% lower yoy. The largest declines in new lending were in Spain (-38% yoy) and Italy (-28%), whereas the German and Nordic units, which represent more than half of SCF's geographic exposure, were more resilient (-6% and -11%, respectively). The decline in new lending affected the evolution of SCF's stock of loans, which declined by 3% compared with end-2019 levels.

Despite revenue pressures, we expect the bank to be able to maintain an operating profit at about 2% of RWA in the medium term, despite the expectation of temporary deterioration. We expect this level of medium-term operating profitability, which is in line with a 'a-' score for earnings and profitability, to be supported by some recovery in business volumes, lower cost of funding, and contained asset-quality deterioration. SCF is also accelerating efficiency measures with expected savings of EUR120 million (7% of bank's 2019 cost base) in 2H20-2021.

The impact of the economic crisis on SCF's asset quality metrics was still limited in 1H20 as the impaired loan ratio remained low at 2.2% at end-June 2020 (2.0% at end-2019), with reserve coverage of 102%. The bank has implemented a relatively small amount of loan moratoriums (5% of gross loans at end-June 2020) and the bulk of it resumed to performing status after expiration in July and August.

Fitch's current expectations of less acute increases in unemployment levels, government support measures and lower indebtedness levels for European households compared with the previous economic crisis should limit the increase in new inflows of impaired loans, although these remain sensitive to downside economic risks.

Capitalisation levels are adequate considering SCF's credit risk profile, limited market risks and ordinary support from the parent. The bank's common equity Tier 1 ratio increased to 13.4% at end-June 2020 from 12.5% at end-2019, benefiting from the new capital requirements regulation and other positive one-offs. SCF has limited flexibility to retain earnings as Banco Santander largely manages the subsidiary's capitalisation on a "need-cost optimisation" basis. SCF plans to maintain a dividend pay-out ratio of 50% contingent on regulatory approvals.

SCF's funding structure is stable and more diversified than wholesale-funded non-bank peers. The bank benefits from its ability to raise deposits, which accounted for about 40% of total funding at end-June 2020 and were mostly originated by the German unit. Wholesale funding comprises unsecured and secured debt (including auto-denominated ABS) and financing from the parent and the European Central Bank, which has increased following the new TLTRO-III. The bank was able to anticipate part of its annual plan for unsecured debt issuance in early 2020 ahead of the market volatility, and would be able to increase intragroup or deposit funding if needed. SCF's liquidity profile remains adequate, with a liquidity coverage ratio at about 300% at end-June 2020.

SCF's Short-Term IDR of 'F2' is the lower of the two possibilities corresponding to the bank's 'A-' Long-Term IDR 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 rated one notch above SCF's and Banco Santander's Long-Term IDRs to reflect the protection that accrues from buffers of junior and senior non-preferred debt in the resolution perimeter. Fitch estimates that the buffer of qualifying junior debt and senior non-preferred debt exceeds 10% of RWA (after deconsolidating subsidiaries that are in different resolution groups) on a sustained basis. The combination of these buffers was 12.5% of RWA at end-2019 and we expect Santander to continue issue a significant volume of senior non-preferred and junior debt to continue meeting the group's minimum requirement for own funds and eligible liabilities (MREL) and subordination requirements (see "Fitch Affirms Santander at 'A-'; Outlook Negative" on 22 June 2020 at www.fitchratings.com for more details).

The short-term senior preferred debt and deposit ratings of 'F1' benefit from the fact that equivalent long-term senior debt and deposit ratings have been notched up to reflect protection.

RATING SENSITIVITIES

IDRS, VR, SR

Factors that could, individually or collectively, lead to negative rating action/downgrade:

SCF's IDRs would be downgraded if both Banco Santander's IDRs and SCF's VR were downgraded. SCF's IDRs also remain sensitive to a downgrade of Spain's sovereign rating.

The most likely trigger for a downgrade of SCF's VR would be the bank's inability to maintain its good earnings generation capacity, resulting in an operating profit structurally below 2% of RWA and without credible prospects to restore over the medium to long term. This could stem from a structural deterioration in SCF's revenue (i.e. prolonged lower business activity or loss of captive agreements) or higher-than-expected credit risks. A lower group operating environment score (currently 'a-', supported by the bank's exposure to Germany and the Nordics) would also likely trigger a downgrade of the VR.

SCF's VR is also sensitive to a downgrade of Banco Santander's VR and hence Long-Term IDR given the contagion stemming from the close interlinks between the two banks in the form of operational integration, intragroup funding and the parent bank's policy to upstream capital through dividends.

SCF's SR 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.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

The Outlook could be revised to Stable following similar rating action on Banco Santander. An Outlook revision could also occur if SCF manages the challenges arising from the economic downturn successfully, limiting downside risks to its asset quality and profitability, as well as contagion risks from the parent.

An upgrade of SCF's IDRs is unlikely as reflected by the Negative Outlook. Positive rating action would require an upgrade of Banco Santander's IDRs and an upgrade of Spain's sovereign rating. An upgrade of SCF's VR is currently unlikely because of the bank's undiversified business model.

SENIOR PREFERRED DEBT AND DEPOSIT RATINGS

SCF's senior preferred debt and deposit ratings are primarily sensitive to changes in Banco Santander's IDRs. We would downgrade the long-term senior preferred and deposit ratings by one notch if the size of the combined buffer of junior and senior non-preferred debt at resolution perimeter sustainably fall below 10% of RWA (adjusted by deconsolidating subsidiaries that are in different resolution groups) given the resolution group partly meets its MREL with senior preferred debt.

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.

Best/Worst Case Rating Scenario

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579]

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

Public Ratings with Credit Linkage to other ratings

Support, debt and deposit ratings derived from Banco Santander S.A.

ESG Considerations

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

Santander Consumer Finance, S.A.; Long Term Issuer Default Rating; Affirmed; A-; RO:Neg
; Short Term Issuer Default Rating; Affirmed; F2
; Viability Rating; Affirmed; a-; RW: Off
; Support Rating; Affirmed; 1
----long-term deposits; Long Term Rating; Affirmed; A
----Senior preferred; Long Term Rating; Affirmed; A
----short-term deposits; Short Term Rating; Affirmed; F1
----Senior preferred; Short Term Rating; Affirmed; F1

Contacts:
Primary Rating Analyst
Pau Labro Vila,
Director
+34 93 494 3464
Fitch Ratings Espana. S.A.U.
Av. Diagonal 601
Barcelona 08028

Secondary Rating Analyst
Raphael Nascimento,
Director
+34 93 323 8406

Committee Chairperson
Francesca Vasciminno,
Senior Director
+39 02 879087 225

Media Relations: Louisa Williams, London, Tel: +44 20 3530 2452, Email: louisa.williams@thefitchgroup.com

Additional information is available on www.fitchratings.com

Applicable Criteria

Bank Rating Criteria (pub. 28 Feb 2020) (including rating assumption sensitivity)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Status

Endorsement Policy

that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third- party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees

---

ENDORSEMENT POLICY - Fitch's approach to ratings endorsement so that ratings produced outside the EU may be used by regulated entities within the EU for regulatory purposes, pursuant to the terms of the EU Regulation with respect to credit rating agencies, can be found on the EU Regulatory Disclosures page. The endorsement status of all International ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for all structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.