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Fitch Affirms Santander Consumer Finance at 'A-'; Outlook Stable

Fitch Ratings - Barcelona - 22 Nov 2022: Fitch Ratings has affirmed Santander Consumer Finance, S.A.'s (SCF) Long-Term Issuer Default Rating (IDR) at 'A-' with a Stable Outlook and Viability Rating (VR) at 'a-'. A full list of rating actions is below.

Key Rating Drivers

Strong Consumer Finance Franchise, Resilient Profits: SCF's ratings reflects a strong consumer finance franchise in Europe, sound earnings generation capacity through economic cycles and adequate capitalisation and funding structure. The latter two factors benefit from ordinary support from its parent Banco Santander S.A. (A-/Stable). The VR also factors in some degree of stability in SCF's asset quality despite the cyclical nature of its business, aided by the bank's exposure to highly-rated countries, a large share of less risky secured consumer lending and effective risk controls.

Shareholder Support Further Underpins IDRs: While SCF's IDRs are driven by its intrinsic strength, the ratings are further underpinned by potential shareholder support, which is reflected in the Shareholder Support Rating (SSR) of 'a-'. We believe its parent 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.

Alongside the parent's strength, as reflected in its 'A-' Long-Term IDR, our assessment of institutional support also considers that the parent and SCF operate in the same jurisdiction, are subject to the same regulations and belong to the same resolution perimeter in Spain. The high degree of integration of SCF's operations, risk management and controls with those of Banco Santander as well as SCF's long and successful record of supporting group objectives also contribute to our overall support assessment.

Leading European Auto Loan Franchise: SCF has a leading franchise in European consumer finance and ranks among the top players in 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 recently reached an agreement with Stellantis N.V. (BBB/Stable) that should support business volumes in the medium term and could result in a slightly change in geographical exposure, although without altering its overall business and risk profiles. The bank, together with digital bank Openbank, is also integrated in the Digital Consumer Bank division of Banco Santander to exploit business opportunities in the non-auto consumer segment.

Stable Asset Quality: SCF's asset quality metrics have remained resilient in the past years, partly aided by recurrent write-offs, with an impaired loan ratio of 2.1% (2.7% including net write-offs) and a high reserve coverage ratio of 93% at end-June 2022 (end-2021: 104%). Loan impairment charges (LICs)/gross loans also remained contained (0.5% in 1H22) but we expect these to increase to more normalised levels in 2023, considering heightened economic risks across SCF's geographies.

Resilient Operating Profitability: SCF's franchise, adequate risk-pricing and operating efficiency result in structurally resilient operating profitability. Operating profit has been an average 2.5% of risk-weighted assets (RWA) over the last 10 years, with limited volatility. In 2021-1H22, operating profit recovered to 2.9% of RWA from 2.3% in 2020, supported by higher fee income and lower LICs. We expect the bank to maintain an operating profit of above 2% of RWA in the medium term, despite a normalisation of LICs and inflationary pressures. SCF has a negative, albeit small, sensitivity to higher interest rates in the short term due to the structure of its balance sheet, with a large proportion of loans with fixed interest rates but short maturities.

New business lending origination recovered above pre-pandemic levels in 1H22 despite shrinking auto sales as the bank gained market shares. The economic slowdown in Europe, with likely recessions in Germany and Italy, and persisting supply chain issues will pressure the bank's business opportunities. However, we believe the pent-up demand of cars built during the pandemic and SCF's new agreement with Stellantis will support growth in the medium-term.

Adequate Capitalisation: Capitalisation levels are adequate considering SCF's credit risk profile, limited market risks and ordinary support from the parent. We expect the bank to maintain a common equity Tier 1 ratio of 12% (12.3% at end-June 2022) and a dividend pay-out ratio of 50%, in line with its strategic targets. The limited retained earnings reflect Banco Santander largely managing the subsidiary's capitalisation on a "need-cost optimisation" basis.

Diversified Funding Profile: SCF's funding structure is stable and more diversified than wholesale-funded non-bank peers. Wholesale funding comprises unsecured and secured debt (including auto ABS) and financing from the parent and the European Central Bank, which has increased following the TLTRO-III. The bank raises deposits, particularly through its northern European subsidiaries, which represent about 40% of total funding. SCF is planning to increase its retail deposit base due to its lower cost compared with alternative sources. The bank has well-established access to capital markets and would be able to increase intragroup funding if needed.

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

Rating Sensitivities

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

SCF's IDRs would be downgraded if Banco Santander's IDRs and SCF's VR were downgraded. SCF's IDRs are also 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. This could stem from a permanent deterioration in SCF's revenue (i.e. prolonged lower business activity or loss of captive agreements) or higher-than-expected credit risks. SCF's VR is also sensitive to a lower operating environment assessment (currently scored at 'a-', supported by the bank's sizeable exposure to Germany and the Nordics).

A downgrade of Banco Santander's VR and hence Long-Term IDR would likely trigger a downgrade of SCF's VR, 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 SSR would be downgraded if Banco Santander's IDR was downgraded, if the consumer finance segment becomes less strategic for the group or if SCF becomes significantly less integrated, which Fitch does not expect.

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

Positive rating action would require an upgrade of Banco Santander's IDRs, which in turn is contingent upon an upgrade of Spain's sovereign rating. An upgrade of SCF's VR is currently unlikely because of the bank's undiversified business model.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

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. We expect Banco Santander to continue issuing 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 Stable" on 25 May 2022 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.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

SCF's senior preferred debt and deposit ratings are primarily sensitive to changes in Banco Santander's IDRs. We would also 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 falls 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.

VR ADJUSTMENTS

The operating environment score of 'a-' is in line with the 'a' implied category score. International operations are a relevant positive factor in the assessment.

The business profile score of 'a-' is above the 'bbb' implied category score due to the following adjustment reason: Group benefits and risks (positive).

The asset quality score of 'bbb+' is below the 'a' implied category score due to the following adjustment reason: Impaired loan formation (negative).

The capitalisation and leverage score of 'a-' is above the 'bbb' implied category score due to the following adjustment reason: Capital flexibility and ordinary support (positive)

The funding and liquidity score of 'bbb' is above the 'b' implied score due to the following adjustment reasons: Non-deposit funding (positive) and Liquidity access and ordinary support (positive).

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

The SSR is derived from Banco Santander'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 the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Santander Consumer Finance, S.A.	LT IDR	A-	Affirmed		A-
	ST IDR	F2	Affirmed		F2
	Viability	a-	Affirmed		a-
	Shareholder Support	a-	Affirmed		a-

ENTITY/DEBT	RATING			RECOVERY	PRIOR
• long-term deposits	LT	A	Affirmed		A
• Senior preferred	LT	A	Affirmed		A
• short-term deposits	ST	F1	Affirmed		F1
• Senior preferred	ST	F1	Affirmed		F1

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

Bank Rating Criteria (pub.07 Sep 2022) (including rating assumption sensitivity)

Additional Disclosures

Solicitation Status

Endorsement Status

Santander Consumer Finance, S.A.	EU Issued, UK Endorsed

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