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

Fitch Ratings - Milan - 08 Nov 2023: 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 Franchise, Resilient Profits: SCF's ratings reflect a strong consumer finance franchise in Europe, sound earnings generation capacity through economic cycles, and adequate capitalisation. Its funding is stable but largely reliant on wholesale sources, and together with capitalisation benefits from ordinary support from parent bank, 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 sound risk controls.

Shareholder Support Underpins IDRs: While SCF's IDRs are driven by its intrinsic strength, the ratings are underpinned by potential shareholder support, which is reflected in the Shareholder Support Rating (SSR) of 'a-'. Fitch believes the bank's parent has strong incentives to provide support to fully-owned SCF, as the agency considers it a core and integral part of the group, given that it manages most of Banco Santander's consumer finance operations in Europe, and SCF belongs to the same resolution perimeter.

Leading European Consumer Franchise: SCF has a leading franchise in European consumer finance and ranks among the top peers in the markets in which it operates. The bank's business model is concentrated in the consumer finance business with reliance on a few auto manufacturers. However, it 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.

Well-Managed Risks: SCF's focus on auto lending, which we view as lower risk than the unsecured consumer business, results in moderate risk appetite. However, the bank has tight underwriting standards and sound risk controls, which together with geographical diversification mitigate risks, resulting in stable asset quality throughout cycles.

Stable Asset Quality: SCF's asset-quality metrics have remained resilient in the past few years, partly aided by recurrent write-offs, with an impaired loan ratio of around 2% and a high reserve coverage ratio (91% at end-June 2023). Loan impairment charges (LICs)/gross loans have stayed at relatively low levels in the last years, but we expect them to increase to more normalised levels in 2023-25, considering the 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 (RWAs) over the past decade, with limited volatility. In 1H23 this declined to 2.1%, driven by a decrease in the net interest margin due to assets repricing more slowly than liabilities. We expect this decline to be temporary and for operating profit to gradually recover to levels around 2.5% of RWAs, driven by an increase in rates of new loan production and a larger portion of cheaper customer deposits in the funding mix, partially offset by higher operating expenses and LICs.

Adequate Capitalisation: Capital ratios are adequate considering SCF's risk profile and have satisfactory buffers over requirements. Capitalisation is supported by strong earnings generation capacity and potential ordinary support from the parent. We expect the bank to maintain a common equity Tier 1 ratio of 12-12.5% in the medium term.

Wholesale-Based Funding Profile: SCF's funding structure is stable. Wholesale funding comprises unsecured and secured debt, intragroup funding and ECB's targeted long-term refinancing operations. SCF raises deposits (about 38% of total funding at end-June 2023), mainly through its northern European subsidiaries, and is planning to increase its deposit base to reduce the cost of funding. SCF has well-established access to the capital markets and would be able to increase intragroup funding if needed.

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 or SCF's VR were downgraded.

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 its revenue (i.e. prolonged lower business activity or loss of captive agreements), higher-than-expected credit risks or the inability to manage its cost of funding as planned.

A downgrade of Banco Santander's VR, and hence its Long-Term IDR, would likely trigger a downgrade of SCF's VR, given the contagion stemming from the close links between the two banks in the form of operational integration, intragroup funding and the parent bank's policy to upstream subsidiaries' 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, resulting in a better assessment of the group's operating environment. An upgrade of SCF's VR is currently unlikely, given its business profile and concentrated 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 RWAs (after deconsolidating subsidiaries that are in different resolution groups) on a sustained basis.

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

The senior preferred debt and deposit ratings are primarily sensitive to changes in SCF's and ultimately 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 falls below 10% of RWAs, 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 has been assigned in line with the implied score. International Operations was identified as a relevant positive factor in the assessment.

The Business Profile score has been assigned above the implied score due to the following adjustment reason(s): Group Benefits and Risks (positive).

The Capitalisation & Leverage score has been assigned above the implied score due to the following adjustment reason(s): Capital Flexibility and Ordinary Support (positive).

The Funding & Liquidity score has been assigned above the implied score due to the following adjustment reason(s): Non-Deposit Funding (positive), Ordinary Support (positive).

Sources of Information

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

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

SCF's SSR is linked to Banco Santander's Long-Term IDR.

ESG Considerations

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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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-
• 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.01 Sep 2023) (including rating assumption sensitivity)

Additional Disclosures

Solicitation Status

Endorsement Status

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

DISCLAIMER & DISCLOSURES

Endorsement policy

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