FitchRatings

Fitch Affirms Santander Consumer Bank AG at 'A-'; Outlook Stable

Fitch Ratings-Frankfurt/London-09 November 2018: Fitch Ratings has affirmed Santander Consumer Bank AG's (SCB AG) Long-Term Issuer Default Rating (IDR) at 'A-' and Short-Term IDR at 'F2'. The Outlook is Stable. Fitch has also affirmed SCB AG's Viability Rating (VR) at 'a-'. 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 are driven by both SCB AG's standalone strength, as captured in its VR, and institutional support.

SCB AG's IDRs and Support Rating reflect our view that if needed, SCB AG's ultimate parent, Banco Santander, S.A. (Santander, A-/Stable/F2/a-), would be extremely likely to provide support. This support could be provided either directly or via its intermediate parent Santander Consumer Finance, S.A. (SCF, A-/Stable/F2/bbb+). As Santander's German subsidiary, SCB AG is deeply integrated within SCF's operations.

Our view of support is derived from the shared brand name and SCB AG's deep integration within SCF and,ultimately,Santander's organisation and systems. SCB AG accounts for the largest share (about 40%) of SCF's consolidated loan portfolio, and Santander has publicly defined consumer finance as one of its 10 core markets. In addition, several capital injections from Santander in recent years to support SCB AG's organic and external growth underpin our view that Santander's willingness to support its subsidiary is strong. We view Santander's ability to provide support directly or via SCF as very strong given SCB AG's modest size relative to Santander's.

The VR reflects SCB AG's solid business model and franchise in Germany, which result in strong pricing power and adequate risk pricing, and considerable flexibility to mitigate earnings pressure arising from a low interest-rate environment.

Our assessment of SCB AG's business model also reflects our expectation that the bank's small mortgage and SME lending businesses will continue to grow gradually. This should erode the bank's strong operating RoAA and RoAE but also diversify its revenue base beyond its strong consumer finance operations. We expect the latter to continue to dominate the bank's business and underpin its strong performance and resilient financial profile. We believe the bank's profitability will improve in the short term as a result of the restructuring efforts undertaken in 2017.

SCB AG's funding consists primarily of retail deposits, and liquidity is robust. Funding is independent of Santander and has been significantly diversified in recent years by entering into the German covered bonds market, issuing medium-term notes and scaling up origination of retained auto and consumer ABS, which the bank has used as collateral to access the European Central Bank's (ECB) targeted longer-term refinancing operations (TLTRO). The bank's large pool of unencumbered ECB-eligible secured loans provides funding flexibility.

We believe SCB AG's strong asset margins and established franchise (despite its low market share) in the large German retail deposit market would enable the bank to collect sufficient deposits by moderately raising deposit remuneration. The EUR3 billion commercial paper programme set up in June 2018 provides further flexibility, should short-term liquidity needs arise.

Despite its strong performance, SCB AG cannot generate internal capital due to a control and profit transfer agreement that obliges the bank to upstream its entire annual profits to its immediate parent. However, we believe that capital injections from Santander would continue to be forthcoming, should SCB AG resume significant loan growth. In the context of this strong ordinary support from Santander, we view SCB AG's capitalisation as robust.

SCB AG's 'F2' Short-Term IDR is the lower of two possible Short-Term IDRs for a 'A-' rated bank because we do not consider funding and liquidity a particular strength relative to the bank's overall standalone credit profile.

SENIOR UNSECURED DEBT AND ISSUANCE PROGRAMME RATINGS, DERIVATIVE COUNTERPARTY RATING (DCR) AND DEPOSIT RATINGS
The long-term senior non-preferred debt and issuance programme ratings are equalised with SCB AG's Long-Term IDR as we believe the likelihood of default on senior non-preferred notes is similar to the likelihood of default of the bank. We have withdrawn the debt issuance programme's short-term rating for senior non-preferred debt issuance. This short-term rating is no longer relevant for Fitch's coverage because debt issued with original maturities of less than one year has preferred status under the new German resolution regime.

We have assigned new ratings for long-term and short-term senior preferred debt issuance under the bank's debt issuance programme. Due to its funding mix driven by retail deposits and ABS, SCB AG's buffer of junior and non-structured senior unsecured debt is still small, at about 3% of risk-weighted assets, and does not provide material incremental probability of default protection to preferred debt creditors, derivative counterparties or depositors or provide comfort that recoveries in a default scenario would be above average. Therefore, the senior preferred debt ratings, DCR and Deposit Ratings are equalised with the bank's IDRs

RATING SENSITIVITIES
IDRS, VR AND SUPPORT RATING
SCB AG's IDRs are sensitive to a change of the likelihood of support from Santander/SCF, in the case of need. Because our assessment of SCB AG's capitalisation incorporates strong ordinary support from Santander/SCF, a downgrade of Santander/SCF's IDRs would likely lead to a downgrade of SCB AG's VR.

The likelihood of support from Santander/SCF is sensitive to a change in their IDRs or in their propensity to provide such support. A higher likelihood of support could arise from an upgrade of Santander/SCF's IDRs, while a lower likelihood of support could arise from a downgrade of Santander/SCF's IDRs or be signalled by the sale of a significant stake in SCB AG or if we otherwise believe that SCB AG's role in the group is no longer key and integral.

An upgrade of SCB AG's VR would require improved revenue diversification and would also be contingent on an upgrade of Santander/SCF's IDRs. A downgrade of the VR could result from strong margin pressure in consumer finance or severe deterioration of German households' creditworthiness triggering significant asset quality pressure.

SENIOR UNSECURED DEBT AND ISSUANCE PROGRAMME RATINGS, DCR AND DEPOSIT RATINGS
The ratings are primarily sensitive to changes in SCB AG's IDRs. In addition, we could notch the senior preferred debt ratings, DCR and Deposit Ratings above the IDRs if the bank increases its qualifying junior and non-structured senior debt buffers to an extent sufficient to restore viability and prevent a default on its senior preferred debt, derivative obligations and deposits after a failure of the bank.

The rating actions are as follows:
Long-Term IDR affirmed at 'A-'; Outlook Stable
Short-Term IDR affirmed at 'F2'
Viability Rating affirmed at 'a-'
Support Rating affirmed at '1'
Derivative Counterparty Rating affirmed at 'A-(dcr)'
Deposit Ratings affirmed at 'A-'/'F2'
Long-term senior non-preferred debt and issuance programme ratings affirmed at 'A-'
Short-term senior non-preferred issuance programme rating withdrawn
Long-term senior preferred issuance programme ratings assigned at 'A-'
Short-term senior preferred issuance programme ratings affirmed at 'F2'

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Additional information is available on www.fitchratings.com

Applicable Criteria

Bank Rating Criteria (pub. 12 Oct 2018) (https://www.fitchratings.com/site/re/10044408)

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