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

Fitch Ratings-Frankfurt/London-20 July 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 by its VR, and institutional support.

SCB AG's IDRs and Support Rating of '1' also 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.

The bank has merged its brands Santander Consumer Bank (SCB) and Santander Bank (SB) and is now using the unified Santander brand to provide SCB AG's product range more efficiently and improve cross-selling between its core consumer finance products and its less developed franchise in its other retail banking businesses.

SCB AG's funding consists primarily of retail deposits, and liquidity is robust. Funding is independent of Santander and has been significantly diversified since 2014 by 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). Its large pool of unencumbered ECB-eligible secured loans provides funding flexibility. In recent years, SCB AG has focused on diversifying its funding sources, notably by entering into the German covered bonds market and by issuing medium-term notes in 2017. We believe SCB AG's high 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 raising deposit remuneration should additional liquidity needs arise.

We assess SCB AG's robust capitalisation in the context of strong ordinary support from Santander available through a control and profit transfer agreement (CPTA) that obliges SCF to compensate any annual loss SCB AG may incur. However, the CPTA also prevents internal capital generation at SCB AG despite the bank's strong performance as it forces SCB AG to transfer its entire net income to its immediate parent, Santander Consumer Holding GmbH (SCH), a German-based holding company. In light of SCH's limited resources, this could create a reliance on capital injections from Santander, should SCB AG resume significant loan growth, envisages acquisitions or incurs large operating losses.

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 NON-PREFERRED DEBT RATINGS
The debt issuance programme and senior unsecured debt ratings are equalised
with SCB AG's IDRs as we believe the likelihood of default on senior unsecured notes reflect the likelihood of default of the bank.

DERIVATIVE COUNTERPARTY RATING (DCR) AND DEPOSIT RATINGS
Due to its funding mix driven by retail deposits and ABS, SCB AG's buffer of junior and vanilla senior debt is still small, at about 3% of risk-weighted assets, and does not provide material incremental probability of default protection to derivative counterparties or depositors or provide comfort that recoveries in a default scenario would be above average. Therefore, the bank's 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 underpinned by the CPTA, 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 of 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 NON-PREFERRED DEBT RATINGS
The ratings are primarily sensitive to changes in SCB AG's IDRs.

DCR AND DEPOSIT RATINGS
SCB AG's DCR and Deposit Ratings are primarily sensitive to changes in the bank's IDRs. In addition, we could notch the DCR and Deposit Ratings above the IDRs if the bank increases its qualifying junior and vanilla senior debt buffers to an extent sufficient to restore viability and prevent a default on its 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'
Senior unsecured debt issuance programme affirmed at 'A-'/"F2'
Senior non-preferred debt affirmed at 'A-
Commercial paper programme affirmed at 'F2'

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**Applicable Criteria**
Bank Rating Criteria (pub. 22 Jun 2018)
(https://www.fitchratings.com/site/re/10034713)

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