08 Sep 2020 | Affirmation

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

Fitch Ratings-Frankfurt am Main-08 September 2020:

Fitch Ratings has affirmed Santander Consumer Bank AG's (SCB AG) Long-Term Issuer Default Rating (IDR) at 'A-' with a Negative Outlook, Short-Term IDR at 'F2' and Support Rating (SR) at '1'. Fitch has also affirmed the bank's Viability Rating (VR) at 'a- 'and removed it from Rating Watch Negative (RWN). A full list of rating actions is below.

SCB AG's IDRs mirror those of its ultimate and intermediate parents, Banco Santander, S.A. (Santander, A-/Negative) and Santander Consumer Finance, S.A. (SCF, A-/Negative), respectively, based on Fitch's assessment of the institutional support available from both entities.

The affirmation of the VR and removal from RWN reflects our view that the economic fallout from the coronavirus crisis represents a medium-term risk to SCB AG's VR rather than a near-term risk, which was our base case when we placed the VR on RWN in April 2020. SCB AG's relative resilience in 1H20 and performance outlook for 2020 suggest that the bank should be able to retain a financial profile commensurate with its current VR through the crisis, even though its earnings and asset quality are likely to face some near-term pressure.

The Negative Outlook on SCB AG's Long-Term IDR mirrors that on Santander's and SCF's Long-Term IDRs. It also reflects downside risks to our expectations of SCB AG's relative resilience as a materially slower than expected economic recovery could have a greater weight on SCB AG's earnings and asset quality than our base case suggests.

Key Rating Drivers

IDRS, VR, SR AND SENIOR NON-PREFERRED (SNP) DEBT RATING

SCB AG's IDRs and SR reflect our view that extraordinary support directly from Santander or via SCF would be extremely likely, if needed. Several capital increases in recent years have proven the group's willingness to provide SCB AG with ordinary support to facilitate its loan growth. Santander's VR of 'a-' and SCB AG's small size relative to the group underpin our view that Santander's ability to support is very strong. SCB AG shares its parent's brand name, is closely integrated within SCF and ultimately Santander's organisation and systems, and accounted for

32% of SCF's loan portfolio end-2019. This underpins our view of Santander's high propensity to provide support.

SCB AG's leading German car and consumer financing franchise will continue to dominate the bank's business model, earnings and risk profile. The growing auto leasing business (most recently via the acquisition of a majority stake in Sixt Leasing SE in 3Q20) diversifies SCB AG's client portfolio but increases the weight of its car financing business. This is despite its ongoing diversification into mortgage and SME lending and asset management, which we expect to remain slow amid the current challenging market conditions and intense competition resulting in low margins in mortgage and SME lending.

Conversely, any significant growth in these asset classes would dilute SCB AG's profitability and could weaken its risk/return profile. Significant progress in diversifying the bank's customer base through its increased focus on e-commerce and asset management could support its business model and strengthen its franchise in the longer term.

We maintain a negative outlook on SCB AG's earnings and profitability score. This reflects our expectation that muted new business in 2Q20 will weigh on net interest and commission income this year. Loan impairment charges are likely to significantly rise when the benefits of the state support measures in place since March 2020 to alleviate the effects of the crisis abate. However, we believe SCB AG is one of the few larger German banks with the potential to continue to earn its cost of capital through the crisis and maintain profitability well above the sector average, thanks to its sound interest margins in consumer finance. In our base case, we expect SCB AG to be able to maintain its four-year average operating profit/risk-weighted assets (RWA) above around 1.5% through the crisis, in line with its earnings and profitability score of 'a-'.

SCB AG's strong pre-impairment income offers ample flexibility to absorb risk costs from the likely deterioration of its consumer finance portfolio, its dominant asset class, which is inherently vulnerable to rising unemployment in a recessionary environment. In addition, we expect SCB AG's strong management expertise and execution record and well-tested risk management framework in consumer finance to make the anticipated deterioration of credit quality in this asset class controllable.

Our assessment of SCB's asset quality takes into account its low starting non-performing loans ratio of 1.8% at end-2019 (based on Fitch's calculation). However, we maintain a negative outlook on the asset quality score, as state support measures (e.g. furlough schemes and the temporary suspension of the obligation for corporates to file for bankruptcy) are delaying the deterioration of borrowers' credit quality into late 2020 and 2021. As a result, it will take more time for the asset quality implications of the pandemic to become clearer.

SCB AG's capitalisation and leverage score is constrained by the existence of a profit transfer agreement that makes the bank generally upstream its annual profits in full to its immediate parent, although as part of the group's capital planning, SCB AG has some flexibility to retain a share of its profits for investments and growth. Fitch believes that Santander/SCF would inject additional capital to SCB AG to enable significant loan growth or large acquisitions in case of need. Consequently, we align SCB AG's score with Santander/SCF's of 'bbb+'/stable. The stable outlook on SCB AG's score also reflects our expectation that the bank will remain meaningfully profitable through the crisis and that capital support from Santander/SCF would be forthcoming if SCB AG experiences material crisis-induced RWA inflation.

SCB AG has gradually diversified its funding profile in recent years and maintains adequate liquidity. Its main source of funding are retail deposits, which it has significant flexibility to increase by raising its deposit remuneration if needed, given its profitability, which has consistently been among the strongest in the German banking sector. The bank issued its initial covered bond and SNP debt in 2017 and its initial senior preferred (SP) note in 2019. It makes extensive use of retained auto and consumer ABS as collateral to access the ECB's targeted longer-term refinancing operations. Its commercial paper programme established in 2018, provides additional flexibility to address short-term funding needs.

The SNP debt rating is aligned with the Long-Term IDR, as we expect the bank to meet its resolution buffer requirements with SNP and more junior debt.

The Short-Term IDR of 'F2' is aligned with those of Santander/SCF, and is the lower of the two options mapping to its Long-Term IDR of 'A-', because SCB AG's liquidity and funding score of 'bbb+' prevents a higher Short-Term IDR.

DERIVATIVE COUNTERPARTY RATINGS (DCR), SP DEBT AND DEPOSIT RATINGS

The DCR, long-term SP debt and deposit ratings are one notch above the Long-Term IDR to reflect the protection accruing to preferred creditors from SNP and more junior resolution debt and equity buffers. SCB AG is part of the same resolution group as SCF and Santander. We expect it to source its resolution debt buffers from the parent. The short-term SP debt and deposit ratings of 'F1' are the lower of the two options mapping to the long-term ratings of 'A', because the liquidity and funding score of 'bbb+' prevents higher short-term ratings.

RATING SENSITIVITIES

IDRS, VR, SR AND SNP DEBT RATINGS

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

An upgrade of Santander/SCF's IDRs would trigger an upgrade of SCB AG's IDRs and SNP debt ratings, unless we expect group support to weaken, which could warrant notching down SCB AG's ratings from those of its parents.

An upgrade of SCB AG's VR would require an upgrade of Santander's/SCF's VRs as well as significant revenue diversification with limited dilution of SCB AG's operating profit/RWA.

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

SCB AG's IDRs and SNP debt ratings would be downgraded if its VR is downgraded, and if Fitch's estimates that the availability of support from Santander/SCF has decreased. The likelihood of extraordinary support from Santander/SCF is sensitive to a change in their IDRs or to their propensity to provide support. A downgrade of Santander/SCF's IDRs, the sale of a significant stake in SCB AG or declining importance of SCB AG for the group could reduce the likelihood of extraordinary support and trigger a downgrade of SCB AG's SR.

A downgrade of Santander/SCF's IDRs would likely lead to a downgrade of SCB AG's VR because the VR benefits from ordinary group support, given SCB AG's strong integration into the group. SCB AG's VR may also be downgraded if the economic disruptions caused by the pandemic intensify, making a swift economic recovery in 2021 and 2022 less likely. The most likely trigger for a downgrade of SCB AG's VR would be the bank's inability to maintain its sound earnings generation capacity, resulting in an operating profit structurally below 1.5% of RWA and without credible prospects to restore it over the medium to long term. This could stem from a structural deterioration in SCB AG's revenue (i.e. prolonged lower business activity) or higher than expected credit risks.

DCR, SP DEBT AND DEPOSIT RATINGS

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

A downgrade of SCB AG's IDRs would trigger a downgrade of the DCR, SP debt and deposit ratings. We could also downgrade these ratings if we expect the buffer of junior and SNP unsecured debt to decrease, in particular if the bank decides to use SP debt to meet its resolution buffer requirement, unless the buffer of junior and SNP debt is likely to remain sustainably above 10% of its RWAs.

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

An upgrade of SCB AG's IDRs would trigger an upgrade of the DCR, SP debt and deposit ratings, unless the buffer of junior and SNP debt decreases below the level required to maintain the one-notch uplift above the bank's Long-Term IDR. This could be the case if the bank decides to use SP debt to meet its resolution buffer requirement, and if this reduces the buffer of junior and SNP debt below 10% of its RWA.

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 ratings of SCB AG are linked to the ratings of Santander and SCF.

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 Bank AG; 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
; Derivative Counterparty Rating; Affirmed; A(dcr)
----Senior non-preferred; Long Term Rating; Affirmed; A-
----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
Markus Glabach,
Director
+49 69 768076 195
Fitch Ratings – a branch of Fitch Ratings Ireland Limited
Neue Mainzer Strasse 46 - 50
Frankfurt am Main D-60311

Secondary Rating Analyst
Caroline Lehmann,
Associate Director
+49 69 768076 176

Committee Chairperson
Konstantin Yakimovich,
Senior Director
+44 20 3530 1789

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

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