FitchRatings

Banks
Retail & Consumer Banks
Germany

Santander Consumer Bank AG

Ratings

Foreign Currency

Long-Term IDR	A-
Short-Term IDR	F2
Derivative Counterparty Rating	A(dcr)
Viability Rating	a-
Support Rating	1

Sovereign Risk

Long-Term Foreign-Currency IDR	AAA
Long-Term Local-Currency IDR	AAA
Country Ceiling	AAA

Outlooks

Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Local-Currency IDR	Stable

Key Rating Drivers

Support and VR Drive IDRs: Santander Consumer Bank AG's (SCB AG) Issuer Default Ratings (IDRs) are driven by its Viability Rating (VR) and by Fitch Ratings' view of the strong support available from its ultimate parent Banco Santander, S.A. (Santander; A-/Stable), potentially channelled via SCB AG's intermediate parent Santander Consumer Finance SA (SCF; A-/Stable). We revised the Outlook on SCB AG's IDR in June 2021 to mirror the revision of Santander's Outlook and our view that SCB AG's VR offers sufficient headroom to navigate the pandemic.

Resilient Standalone Profile: SCB AG's VR reflects its leading German car and consumer financing franchise, which dominates the bank's business model, earnings and risk profile. The VR also factors in SCB AG's modest diversification into mortgage and SME lending. In June 2021, we revised to stable from negative the outlooks on its earnings and profitability and asset quality, which we expect to remain resilient to plausible downside scenarios to our baseline.

Deep Integration Underpins Support: We believe Santander's propensity and ability to support SCB AG are high, due to SCB AG's deep integration, shared brand name and small size relative to the group. Car financing and unsecured consumer finance are core business lines for the group. We expect Santander to increase SCB AG's capital to support organic growth and acquisitions whenever needed, as it has done in the past.

Resilient Profitability: In 2020, SCB AG's operating profit/risk-weighted assets (RWAs) remained solid at 2.0% (2019: 2.3%), underpinned by sound interest margins in consumer finance and good cost efficiency, despite loan impairment charges (LICs) rising by about 270% yoy. We believe that LICs largely related to actual defaults rather than management overlays. We expect moderately stronger profitability but still material LICs in 2021.

Robust Asset Quality: The large government support programmes available in Germany largely offset the impact of the pandemic on SCB AG's loan book. We expect non-performing loans (NPLs) to rise by end-2021, as support measures (e.g. furlough schemes) recede and the effects of the crisis become more apparent. However, we believe SCB AG's four-year-average NPL ratio (1.8% at end-2020 based on our calculation) will remain close to 2% in the medium term.

Adequate Capitalisation: Our assessment of SCB AG's capitalisation includes ordinary group support as the bank relies on capital injections from the group to back significant loan growth or acquisitions. The bank does not generate capital as it usually upstreams its full annual profits to its German parent based on a control-and-profit transfer agreement. However, SCB AG has some flexibility to retain some of its profits as part of the group's capital planning.

Increasingly Diverse Funding: Granular retail deposits will remain the main funding source despite SCB AG's rising use of bond and ECB financing. Its large stock of auto and consumer loans enables flexible management of liquid assets, which consist of ECB-eligible retained ABS.

Rating Sensitivities

Weaker Group Support: SCB AG's IDRs are primarily sensitive to changes in Santander's ability to support, as reflected in its IDR. A downgrade of Santander's IDRs would be likely to trigger a downgrade of SCB AG's VR, which benefits from ordinary group support. The sale of a large stake in SCB AG, or a decline in its strategic importance for Santander could reduce the group's propensity to support. However, we view these scenarios as highly unlikely.

Unexpectedly High Credit Losses: We may downgrade SCB AG's VR if the economic disruptions caused by the pandemic intensify, making a swift economic recovery in 2021 and 2022 less likely, potentially weakening revenue generation and driving credit losses significantly above our base case expectations.

Applicable Criteria

Bank Rating Criteria (February 2020)

Related Research

Global Economic Outlook (June 2021)

Fitch Revises Santander Consumer Bank AG's Outlook to Stable; Affirms IDR at 'A-' (June 2021)

Analysts

Markus Glabach
+49 69 768076 195
markus.glabach@fitchratings.com

Pau Labro Vila
+34 93 494 3464
pau.labrovila@fitchratings.com

Debt Rating Classes

Rating level	Rating
Deposits ratings	A/F1
Senior preferred	A/F1
Senior non-preferred	A-

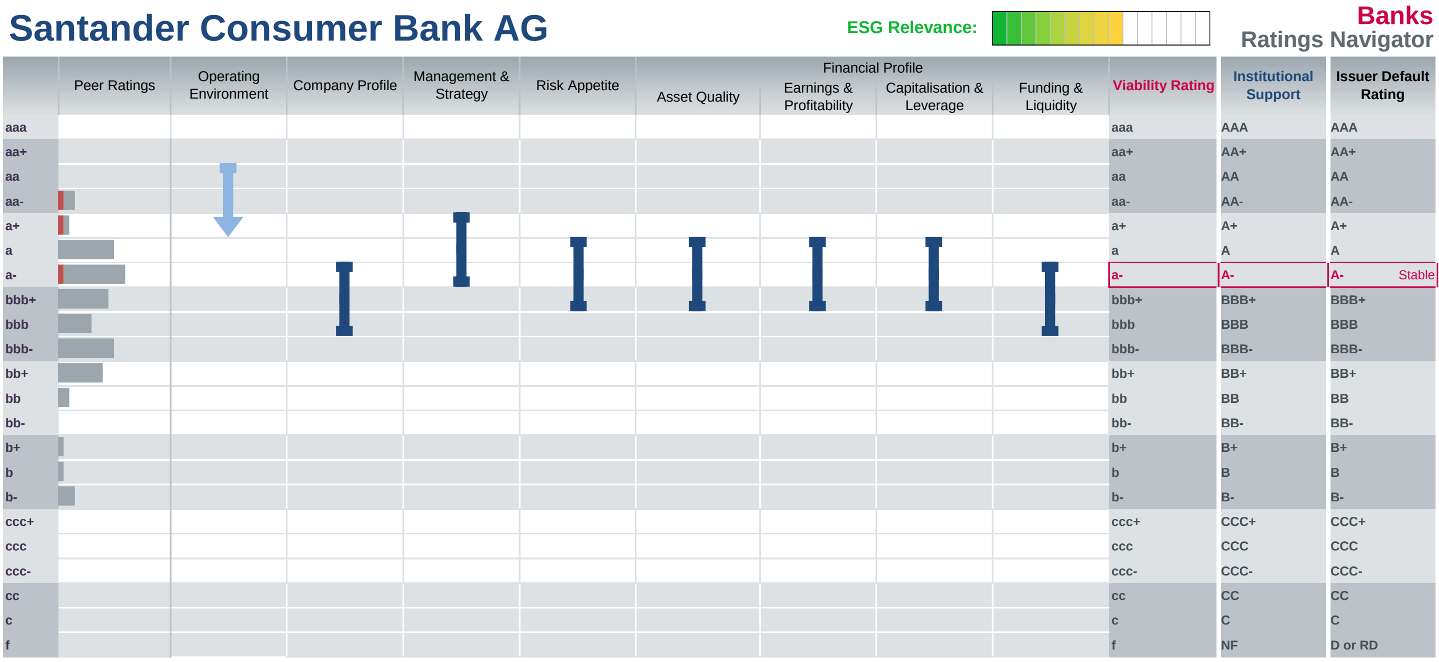
Source: Fitch Ratings

SCB AG's senior non-preferred (SNP) debt rating is aligned with its Long-Term IDR, as we expect the bank to continue to meet its resolution buffer requirements with SNP and more junior debt only.

The Short-Term IDR of ‘F2’ is aligned with that of Santander. It is also the lower of the two options mapping to SCB AG's Long-Term IDR of 'A-', because the bank's liquidity and funding score of 'bbb+' prevents a higher Short-Term IDR.

The DCR, long-term senior preferred (SP) debt and deposit ratings are one notch above the Long-Term IDR to reflect the protection accruing to preferred creditors from the SNP and junior debt buffers. SCB AG is issuing its resolution debt buffers internally to SCF/Santander, with which it shares a resolution group. The short-term SP debt and deposit ratings of 'F1' are the lower of the two options mapping to the respective long-term ratings of 'A', because the liquidity and funding score of 'bbb+' prevents higher short-term ratings.

Ratings Navigator



Institutional Support Assessment

Institutional Support			Value
Parent IDR			A-
Total Adjustments (notches)			+0
Institutional Support:			**A-**
Support Factors (negative)	**Equalised**	**1 Notch**	**2+ Notches**
Parent ability to support and subsidiary ability to use support			
Parent/group regulation	✓		
Relative size	✓		
Country risks	✓		
Parent Propensity to Support			
Role in group	✓		
Potential for disposal		✓	
Implication of subsidiary default	✓		
Integration	✓		
Size of ownership stake	✓		
Support track record		✓	
Subsidiary performance and prospects	✓		
Branding	✓		
Legal commitments			✓
Cross-default clauses			✓

Bar Chart Legend

Vertical bars – VR range of Rating Factor

Bar Colors – Influence on final VR

- Higher influence
- Moderate influence
- Lower influence

Bar Arrows – Rating Factor Outlook

- ⇧ Positive
- ⇩ Negative
- ⇳ Evolving
- ▫ Stable

Significant Changes

Resilient Financials, Moderate Impact from Pandemic

SCB AG's business model focusing on consumer finance proved resilient in 2020 despite a substantial decline in GDP and repeated lockdowns in Germany, where the bank operates. The moderate deterioration of its profitability and its robust asset quality so far during the pandemic underpin the bank's VR. We revised the outlooks for both factors to stable from negative in June 2021 as we expect sufficient resilience to plausible downside scenarios.

Large state programmes to support companies and households affected by the pandemic, and regulatory forbearance for the classification of crisis-driven loan payment holidays and NPLs have strongly mitigated German banks' negative rating migration, RWA inflation and provisioning needs since 2Q20. The extensive use of furlough schemes has protected households' income and contained the rise in the unemployment rate to 4.6% at end-2020. This has strongly supported borrowers' ability to service their loans. The use of loan moratoriums has been much lower than in most European countries since the start of the crisis.

Consumer spending declined less in Germany than in other European economies in 2020, despite restrictive lockdowns and tighter restrictions since December 2020, which continued well into 1H21 and required all non-essential outlets to close and led some regional governments to impose travel bans. Consumer spending contracted by 6.1% in 2020, compared with 11% in the UK and 8% on average in the eurozone.

SCB AG's operating revenue remained almost stable in 2020 yoy as new consumer lending business declined by only 3%, despite branch closures and widespread restrictions associated with the pandemic. The bank benefitted from its omni-channel approach, as it generated a growing share of its new business online. In the mobility segment (new and used car financing for consumers and dealerships), SCB AG's new business volume was also resilient (-3% yoy), despite new car registrations declining by 19% in Germany.

In 2021, recovering consumer confidence should support new car sales and SCB AG's new business. We expect the economy to regain momentum once restrictions ease and the deployment of vaccinations increases, but there are still downside risks to our forecasts. We believe SCB AG has the potential, as one of very few large German banks, to continue to earn its cost of capital through the crisis and maintain its profitability well above the sector average, thanks to its focus on consumer finance.

Brief Company Summary

Sound Execution and Highly Profitable Consumer Lending Operations

SCB AG runs Santander's German operations and focuses primarily on consumer finance, one of the group's core markets. Its four business segments are mobility, consumer financial services – point-of-sale (POS) consumer financing including for white goods and furniture, and invoicing for dealerships, and a rapidly growing e-commerce business (see below) – direct lending (unsecured consumer loans, credit cards and mortgage lending) and business and corporate banking. mostly for independent workers and export-driven SMEs. It also has small asset management operations.

SCB AG has consistently been one of the most profitable German banks and a reliable source of strong returns for Santander, with an average return on equity of about 14% over the past four years. It closely aligns its strategic objectives and performance targets with Santander's and benefits from the group's resources and expertise. It has played a key role in SCF's formation of leading European consumer banking operations through acquisitions over the past decade. The bank generally fills senior management vacancies with Santander executives with substantial international experience, reinforcing intragroup cohesion and consistency.

Sound Underwriting Standards, Cautious Loan Growth

SCB AG benefits from its decades-long expertise in German consumer lending, which includes tested and highly effective proprietary scoring, underwriting, monitoring and NPL collection processes. The bank's risk management organisation is also closely integrated into Santander's.

SCB AG's much shorter risk-management record in housing and corporate lending has yet to be tested through the cycle. However, this is adequately mitigated by management's cautious growth in both asset classes, which positively contrasts with several foreign banks' aggressive attempts to gain market shares in the overcrowded German market. Most of SCB AG's retail loans are secured by mortgages on residential real estate or by the transfer of title of the financed vehicles by way of security or by the security assignment of wage claims to the bank. Strict valuation and Pfandbrief eligibility criteria support its mortgage underwriting standards.

Competition in the market is increasing, driven from a rising number of banks (including large ones) that have belatedly identified consumer lending as one of few areas that enable sound risk/return profiles in German banking. In this context, SCB AG's high market penetration in consumer finance makes incremental gains of market shares increasingly challenging. However, the bank continues to defend its margins in what remains by far its most profitable asset class.

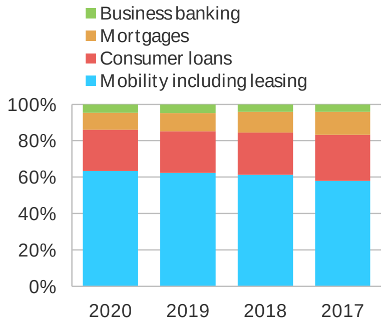
We expect the small business and corporate banking segment's growth to remain modest in absolute terms, constrained by inherently high regulatory risk weights, intense price competition and the bank's niche positioning with a primary focus on German SMEs with links to Latin America, where Santander's presence is strong.

Mobility and Unsecured Consumer Lending Will Continue to Dominate

We expect mobility to remain the largest segment given SCB AG's slow diversification into other products. SCB AG has about 4 million clients in total. It is the largest non-captive car financing provider in Germany (excluding the unconsolidated savings and cooperative banking groups) and the second largest overall behind VW Bank and ahead of BMW Bank and Daimler Bank. The direct loans segment's multi-channel strategy is well advanced, with virtual branches (i.e. active online sales and advisory) in place and an increasing share of fully digitalised processes.

Fitch does not expect asset management to make a large contribution to SCB AG's profits any time soon. The bank's very small asset management franchise mirrors its low share of a current account market, in which households' entrenched risk aversion will continue to hinder the conversion of deposits into asset management products despite the strong incentive to invest in securities that arises from the low-rate environment. Similarly, the underdeveloped German credit card market offers low growth potential. Fitch believes mortgage lending will not generate significant cross-selling into higher-yielding products as long as the bank's origination remains muted.

Loan Portfolio by Business Line



Source: Fitch Ratings, SCB AG

E-Commerce Increasingly Crucial to Leverage Consumer Lending Franchise

We estimate that SCB AG's revenue growth potential will increasingly depend on its ability to rapidly develop a large franchise in e-commerce financing to serve online buyers and merchants. In our view, this will be necessary to fend off the risk of losing market shares and existing client relationships to high-growth, pure online payment providers such as PayPal or Klarna, which threaten to rapidly capture a large share of the consumer finance market. We believe that SCB AG's highly efficient processing of large numbers of small tickets is a key attribute to adapting to the evolving competitive environment.

SCB AG's diversification efforts into e-commerce rest on its domestic market leadership in the low-yielding consumer goods segment, whose main function historically has been to generate large numbers of POS client relationships and cross-sell them to the much more profitable mobility and direct lending segments. The expertise of the bank's POS business with invoicing for high-street retailers should be transferable to the e-commerce payment market.

Summary Financials and Key Ratios

	31 Dec 20 (EURm)	31 Dec 19 (EURm)	31 Dec 18 (EURm)	31 Dec 17 (EURm)
Summary income statement				
Net interest and dividend income	1,010	1,055	1,148	1,149
Net fees and commissions	158	155	110	150
Other operating income	130	111	90	127
Total operating income	1,298	1,321	1,348	1,426
Operating costs	780	833	815	933
Pre-impairment operating profit	518	488	533	493
Loan and other impairment charges	124	33	65	101
Operating profit	394	454	468	393
Tax	0.8	0.2	0.6	0.4
Net income	394	454	463	393
Summary balance sheet				
Gross loans	29,749	30,497	30,402	31,421
- Of which impaired	528	537	566	663
Loan loss allowances	532	536	548	622
Net loans	29,217	29,961	29,854	30,799
Interbank	2,860	2,152	1,531	1,025
Derivatives	n.a.	n.a.	n.a.	n.a.
Other securities and earning assets	12,196	10,019	8,337	8,706
Total earning assets	44,273	42,133	39,722	40,529
Cash and due from banks	5,348	3,496	2,954	1,538
Other assets	506	474	372	354
Total assets	**50,127**	**46,102**	**43,048**	**42,421**
Customer deposits	22,774	23,170	22,719	22,474
Interbank and other short-term funding	7,254	4,999	5,374	5,943
Other long-term funding	15,217	13,298	10,475	9,527
Trading liabilities and derivatives	n.a.	n.a.	n.a.	n.a.
Total funding	45,245	41,467	38,567	37,945
Other liabilities	1,161	1,238	1,194	1,190
Preference shares and hybrid capital	408	333	223	223
Total equity	3,313	3,063	3,063	3,063
Total liabilities and equity	**50,127**	**46,102**	**43,048**	**42,421**

Summary Financials and Key Ratios (Cont.)

	31 Dec 20 (EURm)	31 Dec 19 (EURm)	31 Dec 18 (EURm)	31 Dec 17 (EURm)
Ratios (annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	2.0	2.3	2.5	1.9
Net interest income/average earning assets	2.3	2.6	2.9	2.8
Non-interest expense/gross revenue	60.1	63.1	60.5	65.4
Net income/average equity	12.4	14.8	15.1	12.8
Asset quality				
Impaired loans ratio	1.8	1.8	1.9	2.1
Growth in gross loans	-2.5	0.3	-3.2	-0.4
Loan loss allowances/impaired loans	100.8	99.8	96.8	93.8
Loan impairment charges/average gross loans	0.4	0.1	0.2	0.3
Capitalisation				
Common equity Tier 1 ratio	14.4	13.0	13.9	12.5
Tangible common equity/tangible assets	6.2	6.2	6.7	6.8
Basel leverage ratio	7.5	7.0	7.4	7.4
Net impaired loans/common equity Tier 1	0.0	0.0	0.7	1.6
Funding and liquidity				
Loans/customer deposits	130.6	131.6	133.8	139.8
Liquidity coverage ratio	236.6	187.8	169.1	133.6
Customer deposits/funding	49.9	55.4	58.6	58.9

Source: Fitch Ratings, Fitch Solutions, SCB AG

Key Financial Metrics

Stable Asset Quality Benefits from State Support to the Economy

SCB AG's NPL ratio slightly improved yoy to 1.8% at end-2020 thanks to NPL sales and write-offs. At 41bp of gross loans in 2020, LICs exceeded the 2015-2019 average of 27bp, but the increase was, unlike domestic peers', attributable to actual asset quality deterioration rather than management's precautionary adjustments. Thanks to its resilient pre-impairment income (also helped by cost reductions driven by lower staff expenses and pandemic-related cost savings), the bank maintained its strong loan loss-absorption capacity, resulting in a good return on equity of 12.4% at end-2020, well above the sector's average.

Pre-Impairment Profitability in Consumer Finance Is Strong First Line of Defence

Our base case estimates that SCB AG's operating profit/RWAs will remain close to 2% through the crisis. Earnings resilience is supported by the bank's above-average pricing power in consumer finance. Its strong pre-impairment income offers ample flexibility to absorb risk costs from a possible deterioration, as a result of the pandemic, of consumer loans, its dominant asset class, which is inherently vulnerable to rising unemployment. We expect the bank's strong management expertise, execution record and well-tested risk management framework in consumer finance to contain provisioning needs and the deterioration of its credit quality.

Capital Benefits from Ordinary Support

SCB AG's upgraded 'a-'/stable capital score reflects our expectation that the bank will remain clearly profitable through the crisis and maintain a common equity Tier 1 (CET1) ratio above 13% despite some pressure from loan growth in the medium term. The CET1 ratio rose to 14.4% at end-2020, thanks to the capital increase and a large ABS issuance aimed at reducing RWAs.

As part of Santander's capital planning, SCB AG has some flexibility to retain some profits for investments and growth, although under the control-and-profit transfer agreement it generally up-streams its full annual profits to its German parent Santander Consumer Holding. In 3Q20, Santander confirmed its willingness to support SCB AG's growth by increasing SCB AG's capital by EUR250 million to finance the acquisition of Sixt Leasing SE. We expect the joint ventures with Hyundai, Volvo and Banque PSA Finance to remain key sources of business growth.

SCB AG's high Basel III leverage ratio of 7.5% at end-2020 reflects its high share of unsecured loans, which results in a fairly high RWA density of 40% at end-2020. The bank expects minimal RWA inflation from the output floor to be implemented as part of the Basel III reform until 2027. This seems plausible given its small exposure to secured real-estate loans, which are generally among the most sensitive to the output floor.

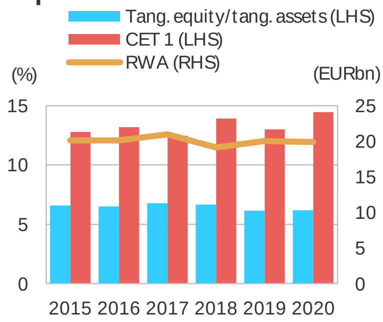
Diversified Funding Profile and Adequate Liquidity

Granular retail deposits now only account for about half of total funding as SCB AG has gradually diversified its funding mix toward bond issuance and ECB financing (through retained ABS) in recent years. However, retail deposits remain its main funding source, and the bank has significant flexibility to increase its stock of deposits by raising their remuneration if needed, given its profitability, which has been consistently among the strongest in the German banking sector.

SCB AG further diversified its funding profile by issuing its initial SNP debt in 2017 and SP debt in 2019. It does not make significant use of its commercial paper programme established in 2018, but the programme provides additional flexibility to address short-term funding needs. The bank also issued its initial covered bond in 2017 and a further EUR500 million in 1Q20, bringing the total outstanding to EUR1 billion at end-2020. The stock of mortgage loans is decreasing as repayments continue to exceed origination volumes. However, the mortgage book offers some potential to issue further benchmark covered bonds in the medium term.

The bank makes extensive use of retained auto and consumer ABS as collateral to access ECB funding, predominantly targeted longer-term refinancing operations (TLTRO), which rose to EUR6.8 billion at end-2020 from EUR1.9 billion at end-2019. This strong increase reflects SCB AG's opportunistic take-up of TLTRO III, whose conditions the ECB further eased in 2Q20 to tackle the impact of the pandemic. This large take-up has temporarily strongly inflated the bank's excess liquidity, leading to a high Liquidity Coverage Ratio of 237% at end-2020 (188% at end-2019).

Capitalisation



Source: Fitch Ratings, SCB AG

Environmental, Social and Governance Considerations

SCB AG's 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, either due to their nature or the way in which they are being managed by the bank.

FitchRatings **Santander Consumer Bank AG**

Banks
Ratings Navigator

Credit-Relevant ESG Derivation

Santander Consumer Bank AG has 5 ESG potential rating drivers

- Santander Consumer Bank AG has exposure to compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security) but this has very low impact on the rating.
- Governance is minimally relevant to the rating and is not currently a driver.

			Overall ESG Scale
key driver	0	issues	5
driver	0	issues	4
potential driver	5	issues	3
not a rating driver	4	issues	2
	5	issues	1

Environmental (E)

General Issues	E Score	Sector-Specific Issues	Reference	E Scale
GHG Emissions & Air Quality	1	n.a.	n.a.	5
Energy Management	1	n.a.	n.a.	4
Water & Wastewater Management	1	n.a.	n.a.	3
Waste & Hazardous Materials Management; Ecological Impacts	1	n.a.	n.a.	2
Exposure to Environmental Impacts	2	Impact of extreme weather events on assets and/or operations and corresponding risk appetite & management; catastrophe risk; credit concentrations	Company Profile; Management & Strategy; Risk Appetite; Asset Quality	1

Social (S)

General Issues	S Score	Sector-Specific Issues	Reference	S Scale
Human Rights, Community Relations, Access & Affordability	2	Services for underbanked and underserved communities: SME and community development programs; financial literacy programs	Company Profile; Management & Strategy; Risk Appetite	5
Customer Welfare - Fair Messaging, Privacy & Data Security	3	Compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security)	Operating Environment; Company Profile; Management & Strategy; Risk Appetite	4
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Company Profile; Management & Strategy	3
Employee Wellbeing	1	n.a.	n.a.	2
Exposure to Social Impacts	2	Shift in social or consumer preferences as a result of an institution's social positions, or social and/or political disapproval of core banking practices	Company Profile; Financial Profile	1

Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference	G Scale
Management Strategy	3	Operational implementation of strategy	Management & Strategy	5
Governance Structure	3	Board independence and effectiveness; ownership concentration; protection of creditor/stakeholder rights; legal /compliance risks; business continuity; key person risk; related party transactions	Management & Strategy; Earnings & Profitability; Capitalisation & Leverage	4
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Company Profile	3
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Management & Strategy	2
				1

How to Read This Page
ESG scores range from 1 to 5 based on a 15-level color gradation. Red (5) is most relevant and green (1) is least relevant.

The Environmental (E), Social (S) and Governance (G) tables break out the individual components of the scale. The right-hand box shows the aggregate E, S, or G score. General Issues are relevant across all markets with Sector-Specific Issues unique to a particular industry group. Scores are assigned to each sector-specific issue. These scores signify the credit-relevance of the sector-specific issues to the issuing entity's overall credit rating. The Reference box highlights the factor(s) within which the corresponding ESG issues are captured in Fitch's credit analysis.

The Credit-Relevant ESG Derivation table shows the overall ESG score. This score signifies the credit relevance of combined E, S and G issues to the entity's credit rating. The three columns to the left of the overall ESG score summarize the issuing entity's sub-component ESG scores. The box on the far left identifies some of the main ESG issues that are drivers or potential drivers of the issuing entity's credit rating (corresponding with scores of 3, 4 or 5) and provides a brief explanation for the score.

Classification of ESG issues has been developed from Fitch's sector ratings criteria. The General Issues and Sector-Specific Issues draw on the classification standards published by the United Nations Principles for Responsible Investing (PRI) and the Sustainability Accounting Standards Board(SASB).

Sector references in the scale definitions below refer to Sector as displayed in the Sector Details box on page 1 of the navigator.

CREDIT-RELEVANT ESG SCALE

How relevant are E, S and G issues to the overall credit rating?

5	Highly relevant, a key rating driver that has a significant impact on the rating on an individual basis. Equivalent to "higher" relative importance within Navigator.
4	Relevant to rating, not a key rating driver but has an impact on the rating in combination with other factors. Equivalent to "moderate" relative importance within Navigator.
3	Minimally relevant to rating, either very low impact or actively managed in a way that results in no impact on the entity rating. Equivalent to "lower" relative importance within Navigator.
2	Irrelevant to the entity rating but relevant to the sector.
1	Irrelevant to the entity rating and irrelevant to the sector.

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.