Fitch Ratings

Banks
Retail & Consumer Banks
Germany

Santander Consumer Bank AG

Key Rating Drivers

Support and VR Drive IDRs: Santander Consumer Bank AG's (SCB AG) Issuer Default Ratings (IDRs) are driven by its individual financial strength as reflected in its Viability Rating (VR) and by the strong support from its ultimate and intermediate parents, respectively Banco Santander, S.A. (Santander; A-/Negative) and Santander Consumer Finance S.A. (SCF; A-/Negative).

VR Off RWN: The removal of the VR from Rating Watch Negative (RWN) reflects Fitch Ratings' view that the economic fallout from the coronavirus crisis now represents a medium-term risk to SCB AG's VR rather than a near-term risk, as anticipated when we placed the VR on RWN in April 2020. SCB AG's Negative Outlook mirrors the Outlook on Santander and SCF.

Deep Integration Underpins Support: We believe that Santander's and SCF's propensity and ability to support SCB AG are high, due to the bank's deep integration, shared brand name and small size relative to the group. SCB AG predominantly offers car financing and unsecured consumer finance, which is a core activity for the group. We expect Santander to increase SCB AG's capital to support organic growth and acquisitions whenever needed as it did in the past.

Pandemic Pressurises Profitability: The Negative Outlook on SCB AG's earnings and profitability score reflects our expectation that muted new business in 2Q20 will weigh on net interest and commission income, while loan impairment charges (LICs) are likely to rise significantly. 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. This is in the context of its sound interest margins in consumer finance.

Asset Quality to Weaken: SCB AG entered the crisis with a low non-performing loan (NPL) ratio of 1.8% at end-2019 (based on Fitch's calculation). The recessionary economic environment is likely to pressurise SCB AG's consumer finance portfolio, which is inherently vulnerable to rising unemployment. The asset quality implications of the pandemic are not yet clear because state support measures will delay the deterioration of borrowers' credit quality until 2021.

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 sizeable loan growth or acquisitions. The bank does not generate capital as it usually up-streams its full annual profits to its German parent based on a control-and-profit transfer agreement although, as part of the group's capital planning, SCB AG has some flexibility to retain some of its profits.

Increasingly Diversified, Flexible Funding: Highly granular retail deposits will remain SCB AG's main funding source despite its rising proportion of covered and unsecured bonds. SCB AG's large stock of auto and consumer loans enables flexible management of its 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 or SCF's ability to support, as reflected in their IDRs. A downgrade of Santander's or SCF's IDRs would likely trigger a downgrade of SCB AG's VR, which benefits from ordinary group support. The sale of a sizeable 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.

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

Applicable Criteria

Bank Rating Criteria (February 2020)

Related Research

German Banks' Weaknesses Exposed as Economic Outlook Worsens (April 2020)

Fitch Affirms Santander Consumer Finance's IDR at 'A-'/Negative; VR at 'a-' (September 2020)

Fitch Affirms Santander Consumer Bank AG's IDR at 'A-'/Negative; VR at 'a-' (September 2020)

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Debt Rating Classes

Rating Level	Rating
Deposit ratings	A/F1
Senior preferred	A/F1
Senior non-preferred debt	A-

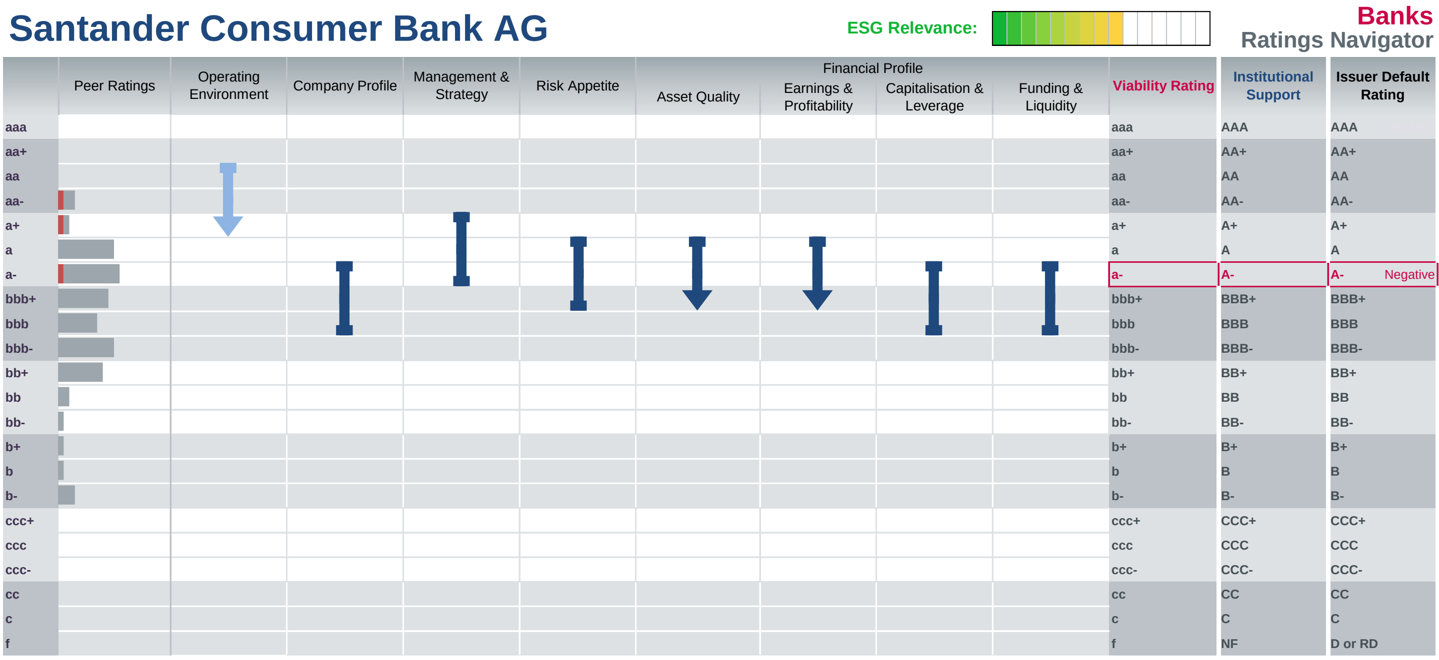
Source: Fitch Ratings

The senior non-preferred (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+' rules out 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 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 respective long-term ratings of 'A'. This is because the liquidity and funding score of 'bbb+' rules out higher short-term ratings.

Ratings Navigator



Significant Changes

Economic Outlook Rapidly Worsening

The ultimate economic and financial market implications of the coronavirus pandemic are unclear, but Fitch considers the risks to German banks' credit profiles to be clearly skewed to the downside. We revised our sector outlook for German banks to negative in December 2019 to reflect, at the peak of the credit cycle, the domestic banking sector's inability to generate adequate returns during periods of strong economic growth due to its structural weaknesses.

In addition, we lowered the operating environment score for German banks to 'aa-'/Negative from 'aa'/Stable in April 2020 as the coronavirus pandemic exacerbates banks' vulnerability to a rapid and severe deterioration of earnings and asset quality. The negative trend signals that we could lower the operating environment score further if there are signs that the German economy will suffer in the longer term from the crisis, or if the domestic banking sector is unable to restore acceptable profitability above pre-crisis levels. Such a situation would be likely to require greater pricing discipline and consolidation to remove excess capacity from the sector.

The German government has launched large support programmes to support companies and households affected by the crisis. Together with regulatory forbearance for the classification of crisis-driven NPLs, these programmes have strongly mitigated negative rating migration, risk-weighted assets (RWA) inflation and provisioning needs in 1H20 and will continue to do so in 2H20. However, credit quality is likely to deteriorate in 2021 as some vulnerable borrowers will not fully recover, and many corporates and SMEs are likely to emerge from the crisis with weaker credit profiles.

Sixt Leasing Acquisition

SCB AG's joint venture with Hyundai, Hyundai Capital Bank Europe, acquired in July a majority stake in Sixt Leasing SE, a medium-sized German car leasing provider (it had lease assets of EUR1.1 billion at end-1H20). The transaction diversifies SCB AG's client portfolio, while also increasing the weight of its auto leasing business. Therefore, we expect car financing to continue to dominate the bank's business model, earnings and risk profile in the foreseeable future, despite its slow diversification into mortgages, SME lending and asset management.

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

Summary Financials and Key Ratios

	31 Dec 19		31 Dec 18	31 Dec 17	31 Dec 16
	Year end (USDm)	Year end (EURm)	Year end (EURm)	Year end (EURm)	Year end (EURm)
Summary income statement					
Net interest and dividend income	1,185	1,055	1,148	1,149	1,157
Net fees and commissions	174	155	110	150	178
Other operating income	125	111	90	127	100
Total operating income	1,484	1,321	1,348	1,426	1,436
Operating costs	936	833	815	933	807
Pre-impairment operating profit	548	488	533	493	628
Loan and other impairment charges	37	33	65	101	98
Operating profit	510	454	468	393	530
Other non-operating items (net)	n.a.	n.a.	-4	n.a.	n.a.
Tax	0	0.2	0.6	0.4	0.1
Net income	510	454	463	393	530
Other comprehensive income	n.a.	n.a.	n.a.	n.a.	n.a.
Fitch comprehensive income	510	454	463	393	530
Summary balance sheet					
Assets					
Gross loans	34,260	30,497	30,402	31,421	31,548
- Of which impaired	603	537	566	663	671
Loan loss allowances	602	536	548	622	647
Net loans	33,658	29,961	29,854	30,799	30,901
Interbank	2,418	2,152	1,530	1,025	910
Derivatives	n.a.	n.a.	n.a.	n.a.	n.a.
Other securities and earning assets	11,256	10,019	8,337	8,706	9,544
Total earning assets	47,332	42,133	39,722	40,529	41,356
Cash and due from banks	3,927	3,496	2,954	1,538	1,689
Other assets	532	474	372	354	408
Total assets	51,791	46,102	43,048	42,421	43,453
Liabilities					
Customer deposits	26,029	23,170	22,719	22,474	23,772
Interbank and other short-term funding	5,616	4,999	5,3734	5,943	5,914
Other long-term funding	14,939	13,298	10,475	9,527	9,238
Trading liabilities and derivatives	n.a.	n.a.	n.a.	n.a.	n.a.
Total funding	46,585	41,467	38,567	37,945	38,924
Other liabilities	1,391	1,238	1,194	1,190	1,242
Preference shares and hybrid capital	374	333	223	223	223
Total equity	3,441	3,063	3,063	3,063	3,063
Total liabilities and equity	51,791	46,102	43,048	42,421	43,453

Source: Fitch Ratings, Fitch Solutions, Bank

Summary Financials and Key Ratios

	31 Dec 19	31 Dec 18	31 Dec 17	31 Dec 16
Ratios (annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	2.3	2.5	1.9	2.6
Net interest income/average earning assets	2.6	2.9	2.8	2.9
Non-interest expense/gross revenue	63.1	60.5	65.4	56.2
Net income/average equity	14.8	15.1	12.8	17.3
Asset quality				
Impaired loans ratio	1.8	1.9	2.1	2.1
Growth in gross loans	0.3	-3.2	-0.4	2.2
Loan loss allowances/impaired loans	99.8	96.8	93.8	96.3
Loan impairment charges/average gross loans	0.1	0.2	0.3	0.3
Capitalisation				
Common equity Tier 1 ratio	13.0	13.9	12.5	13.2
Tangible common equity/tangible assets	6.2	6.7	6.8	6.5
Basel leverage ratio	7.0	7.4	7.4	7.4
Net impaired loans/common equity Tier 1	0.0	0.7	1.6	0.9
Funding and liquidity				
Loans/customer deposits	131.6	133.8	139.8	132.7
Liquidity coverage ratio	187.8	169.1	133.6	234.3
Customer deposits/funding	55.4	58.6	58.9	60.7

Source: Fitch Ratings, Fitch Solutions, Bank

Key Financial Metrics – Latest Developments

Pandemic Drives Increase in Impaired Loans

SCB AG's asset quality has benefited from strong pre-COVID 19 economic conditions. The NPL ratio fell to 1.8% in 2019 from 2.1% in 2016 (based on Fitch's calculation), supported by SCB AG's solid underwriting standards and regular NPL sales. In April 2020, we changed the Outlook on asset quality to negative as part of the COVID-19-driven review of German banks.

We believe the economic fallout from the pandemic will weigh in the next two years on SCB AG's asset quality, which largely correlates with the development of unemployment. The pandemic is likely to lead to a strong increase in the number of insolvencies in Germany at end-2020 for businesses that are over-indebted due to the coronavirus crisis, but are otherwise solvent, after a law suspending the obligation for companies to file for insolvency lapses at end-3Q20. We estimate, in our base case, SCB AG's NPL ratio to remain below 3% by end-2021. In addition, we expect the government's support measures to mitigate credit losses.

Strong Profitability, Robust First Line of Defence

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. We expect SCB AG's strong management expertise and execution record, along with a well-tested risk management framework in consumer finance, to make the expected deterioration in credit quality and provisioning requirements in this asset class controllable.

We estimate, in our base case, SCB AG's operating profit/RWAs to exceed 1.5% through the crisis. SCB AG's earnings resilience is supported by its above-average pricing power derived from its sound German consumer finance franchise.

Capital Benefits from Ordinary Support

Under the control-and-profit transfer agreement, SCB AG up-streams its full annual profits to its German parent Santander Consumer Holding although, as part of the group's capital planning, SCB AG has some flexibility to retain some 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 if needed. SCB AG received a capital injection of EUR101 million in 2013 intended to finance the acquisition of Santander Consumer Leasing GmbH. Since then, the bank did not require any capital injection, though we believe that the group is likely to support the recent acquisition of Sixt Leasing SE, which increases SCB AG's RWAs.

We believe that SCB AG's Common Equity Tier 1 (CET1) ratio will remain stable at about 13%, which is reflected in the stable outlook on SCB AG's capital score, as we expect the bank to remain clearly profitable through the crisis. We expect capital support from Santander/SCF would be forthcoming if SCB AG experienced material crisis-induced RWA inflation.

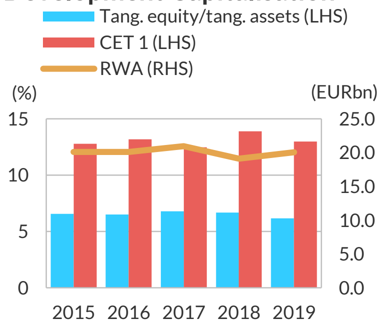
SCB AG's high Basel III leverage ratio of 7.0% at end-2019 reflects its high share of unsecured loans, which results in a fairly high RWA density of 44% at end-2019. The bank expects minimal RWA inflation from the output floor to be implemented as part of the Basel III reform until 2027. This seems plausible given its small exposure to secured real-estate loans, which are generally among the most sensitive to the output floor.

Gradually Diversified Funding Profile and Adequate Liquidity

SCB AG's main source of funding are retail deposits, which SCB AG has significant flexibility to increase by raising its deposit remuneration if needed, given its profitability, which has been consistently among the strongest in the German banking sector. The bank issued its initial covered bond in 2017 and issued a further EUR500 million in 1Q20, bringing the total outstanding to EUR1 billion at end-1H20. SCB AG's mortgage stock is decreasing, due to amortisations more than offsetting its mortgage origination. Nevertheless, Fitch expects further covered bond benchmark issuances in the short/medium term.

SCB AG issued its initial SNP debt in 2017 and SP note in 2019, which increased the diversification of its funding profile. The bank 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.

Development Capitalisation



Source: Fitch Ratings, SCB AG

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 ow nership stake	✓		
Support track record		✓	
Subsidiary performance and prospects	✓		
Branding	✓		
Legal commitments			✓
Cross-default clauses			✓

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 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
GHG Emissions & Air Quality	1	n.a.	n.a.
Energy Management	1	n.a.	n.a.
Water & Wastewater Management	1	n.a.	n.a.
Waste & Hazardous Materials Management; Ecological Impacts	1	n.a.	n.a.
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

E Scale: 5, 4, 3, 2, 1

Social (S)

General Issues	S Score	Sector-Specific Issues	Reference
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
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
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Company Profile; Management & Strategy
Employee Wellbeing	1	n.a.	n.a.
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

S Scale: 5, 4, 3, 2, 1

Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference
Management Strategy	3	Operational implementation of strategy	Management & Strategy
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
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Company Profile
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Management & Strategy

G Scale: 5, 4, 3, 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 Priniciples 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.