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Research Update:

Santander Consumer Finance Outlook Revised To Negative On Same Action On Parent Due To COVID-19; Affirmed At 'A-/A-2'

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Overview

- Despite governments' measures to contain the COVID-19 pandemic, European economies, including Spain, face an unprecedented challenge ahead.
- In our view, Santander Consumer Finance S.A.'s (SCF's) focus on auto and consumer lending render it particularly vulnerable to the economic shock, with mounting pressure on its earnings and asset quality. That said, we anticipate that the bank's ample capital buffer will enable it to absorb the impact within manageable levels.
- We are revising our outlook on SCF and its core subsidiary SCB to negative from stable, and affirming our 'A-/A-2' ratings on both banks. This is in line with the similar action on the parent, Banco Santander S.A.
- The negative outlook on SCF mirrors that on Banco Santander, and the ratings will remain one notch below, and move in tandem with, those on the parent as long as we continue to assess SCF as a highly strategic subsidiary.

Rating Action

On April 29, 2020, S&P Global Ratings revised to negative from stable its outlook on Santander Consumer Finance S.A. (SCF) and affirmed its 'A-/A-2' long- and short-term issuer credit ratings on the bank.

At the same time, we affirmed our 'A/A-1' long- and short-term resolution counterparty ratings on SCF, as well as all our issue ratings on the bank's debt.

In a related action, we revised to negative from stable our outlook on Santander Consumer Bank AG (SCB), the German subsidiary of SCF. We affirmed our 'A-/A-2' long- and short-term issuer credit ratings on the SCB, as well as the 'A/A-1' long- and short-term resolution counterparty ratings.

Rationale

Our rating actions take into account the much more challenging economic environment that Spanish banks will face over the next couple of years. This led us to revise to negative from stable our economic risk trend under our Banking Industry Country Risk Assessment for Spain.

In addition to the human cost, the COVID-19 pandemic has caused large parts of economic activity in Spain to grind to a halt. With isolation strategies still very much in force--Spain is heading for a two-month lockdown--our economists expect a sharp economic contraction in the second quarter of 2020, followed by a rebound starting in the third quarter. However, they are now more cautious on the strength of recovery through end-2020 and into 2021, envisaging that GDP in Spain will contract by 8.8% in 2020 and expand by 5.1% in 2021. It will take time for some sectors that are relevant for the Spanish economy, such as tourism, to recover, while the comparatively higher share of temporary workers in Spain will probably lead to a greater increase in numbers of unemployed compared with other countries. Indeed, we are forecasting unemployment to rise to 16.4% by end-2020, from 14.1% in 2019, and barely changing in 2021. The Spanish private sector faces this economic shock with significantly lower debt levels than in the past, the real estate market shows no sign of imbalances, and banks have largely worked out their legacy problematic assets from the previous recession, although their remaining nonperforming assets are still higher than those of other European countries.

Authorities have also delivered unprecedented policy responses in the form of monetary, fiscal, and regulatory support to their economies, and their measures will help to contain, although not fully avoid, the damage.

The revision to negative of the outlook on SCF, which we asses as highly strategic to Banco Santander, mirrors the revision of the outlook on the parent. We also expect that the sharp economic contraction in many of the markets where SCF operates will intensify pressure on its earnings and asset quality, particularly due to its focus on auto and consumer segments, and given weaker business prospects ahead in many consumer finance segments. That said, we do not anticipate a pronounced capital depletion, given SCF's existing buffers and still-high-margin business to cope with the economic and credit distresses stemming from the COVID-19 pandemic. In particular, we now anticipate that SCF's return on equity will stand at about 5%-7% this year and next, versus our previous expectation of 11%-12%, and its risk-adjusted capital (RAC) will be 12.0%-12.5%. A potential deterioration of economic risk in Germany, Spain, France, and Italy would likely shave around 80 bps from SCF's RAC. At the same time, we believe that SCF will be able to defend its solid, top positions in most countries of operations, while continuing to benefit from a sizable deposit base in Germany and funding support from its parent if needed.

Similarly, the outlook on SCB is now to negative. SCB has a high market share in the domestic consumer finance business, and it benefits from the currently still-low, but somewhat increasing, economic risks in Germany. SCB is exposed to revenue concentration in a more volatile segment of the banking sector. Despite a profit transfer agreement with SCF, its intermediate parent, SCB shows robust capitalization, and would likely benefit from further capital contributions if needed. This capital strength is, in our view, offset by the concentration of SCB's loan book on consumer finance.

Outlook

Santander Consumer Finance S.A.

The negative outlook on SCF reflects that on Banco Santander S.A. As long as we continue to assess SCF as highly strategic to Banco Santander, our ratings on SCF will remain one notch below, and move in tandem with, those on the parent.

In particular, a downgrade of SCF in the next 18-24 months could follow a similar action on Banco Santander, or if we believed that the parent's commitment to SCF had weakened, leading us to revise downward our view of the subsidiary's long-term strategic importance for the Santander group.

Conversely, we could revise the outlook on SCF to stable following a similar action on Banco Santander.

Santander Consumer Bank AG

The negative outlook on SCB mirrors that on SCF, since we expect it to remain a core subsidiary that is directly affected by strengthening or weakening of its parent's credit profile. The negative economic risk and industry risk trends in Germany could trigger a downward revision of the anchor for our ratings on SCB and consequently the bank's stand-alone credit profile (SACP). However, this alone will not affect the issuer credit or issue ratings.

Ratings Score Snapshot

Santander Consumer Finance S.A.

	To	From
Issuer Credit Rating	A-/Negative/A-2	A-/Stable/A-2
SACP	bbb	bbb
Anchor	bbb+	bbb+
Business Position	Moderate (-1)	Moderate (-1)
Capital and Earnings	Strong (+1)	Strong (+1)
Risk Position	Moderate (-1)	Moderate (-1)
Funding and Liquidity	Average and Adequate (0)	Average and Adequate (0)
Support	2	2
ALAC Support	0	0
GRE Support	0	0
Group Support	2	2
Sovereign Support	0	0
Additional Factors	0	0

Santander Consumer Bank AG

	To	From
Issuer Credit Rating	A-/Negative/A-2	A-/Stable/A-2
SACP	bbb+	bbb+
Anchor	a-	a-

Business Position	Moderate (-1)	Moderate (-1)
Capital and Earnings	Strong (+1)	Strong (+1)
Risk Position	Moderate (-1)	Moderate (-1)
Funding and Liquidity	Average and Adequate (0)	Average and Adequate (0)
Support	1	1
ALAC Support	0	0
GRE Support	0	0
Group Support	1	1
Sovereign Support	0	0
Additional Factors	0	0

SACP--Stand-alone credit profile. ALAC--Additional loss-absorbing capacity. GRE--Government-related entity.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Methodology For Assigning Financial Institution Resolution Counterparty Ratings, April 19, 2018
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- Criteria | Financial Institutions | Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria | Financial Institutions | Banks: Commercial Paper I: Banks, March 23, 2004

Related Research

- How COVID-19 Risks Prompted European Bank Rating Actions, April 29, 2020
- Outlooks Revised To Negative On Several Spanish Banks On Deepening COVID-19 Downside Risks, April 29, 2020

- Coronavirus Impact: Key Takeaways From Our Articles, April 28, 2020
- Credit Conditions In Europe Darken As Costs Of Lockdowns Add Up, April 27, 2020
- Europe's AT1 Market Faces The COVID-19 Test: Bend, Not Break, April 22, 2020
- How COVID-19 Is Affecting Bank Ratings, April 22, 2020
- Europe Braces For A Deeper Recession In 2020, April 20, 2020
- European Banks' First-Quarter Results: Many COVID-19 Questions, Few Conclusive Answers, April 1, 2020
- COVID-19: The Steepening Cost To The Eurozone And U.K. Economies, March 26, 2020
- Full Analysis: Spain, March 20, 2020
- Full Analysis: Santander Consumer Finance S.A., Oct. 8, 2019