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Update: Santander UK Group Holdings PLC

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Update: Santander UK Group Holdings PLC

Rating Score Snapshot

Issuer Credit Rating
BBB/Stable/A-2

SACP: bbb+ → **Support: +2** → **Additional factors: 0**

Anchor	bbb+	
Business position	Adequate	0
Capital and earnings	Adequate	0
Risk position	Adequate	0
Funding	Adequate	0
Liquidity	Adequate	
CRA adjustment		0

ALAC support	+2
GRE support	0
Group support	0
Sovereign support	0

Issuer credit rating
A/Stable/A-2
Resolution counterparty rating
A+/A-1

ALAC--Additional loss-absorbing capacity. CRA--Comparable ratings analysis. GRE--Government-related entity. ICR--Issuer credit rating. SACP--Stand-alone credit profile.

Credit Highlights

Overview

Key strengths	Key risks
Good position in U.K. retail banking.	Difficult U.K. macroeconomic conditions will squeeze borrowers' credit quality.
Strong earnings outlook from rising interest rates and tight cost control gives the firm financial flexibility.	Lower revenue and business diversification than larger U.K. competitors.
Conservative loan book profile and solid capitalization by S&P Global Ratings' measures.	Parental influence on the medium-term trajectory for SanUK's risk-adjusted capitalization remains uncertain.

Outlook

Santander UK Group Holdings PLC

The stable outlook reflects our view that Santander UK (SanUK) will maintain robust credit quality that will support earnings. It also reflects our expectation that SanUK will maintain a good position in U.K. retail banking and a conservative risk profile. We assume Banco Santander will continue to provide ongoing group support, despite our view of uncertain extraordinary group support in a severe stress scenario given its multiple-point-of-entry approach to resolution. This means that we believe the U.K. subgroup is more likely to support itself through the bail-in of its subordinated debt instruments for loss absorption and recapitalization than by relying on group support.

Downside scenario: We could lower the ratings over our two-year horizon if the uncertain U.K. economic environment compromises SanUK's performance significantly beyond our base case.

Upside scenario: We could revise the outlook to positive if SanUK delivers an S&P Global Ratings RAC ratio materially above 10% on a sustained basis. This would rest on the group's ability to generate strong earnings and capital generation from its robust U.K. mortgage business, alongside maintaining material excess capital to support the sustainability of its RAC ratio above 10%, as opposed to returning the excess capital to its parent.

Santander UK PLC

The stable outlook on the main operating subsidiary reflects our view of the group stand-alone credit profile (SACP). It also assumes that the additional-loss-absorbing capacity (ALAC) buffer will remain supportive of the issuer credit rating above our 6% threshold.

We could raise or lower our rating if the group SACP strengthened or weakened. We could also lower the ratings if the ALAC ratio were to fall below our 6% threshold, which would most likely be due to higher risk-weighted asset (RWA) inflation beyond our current expectations.

Rationale

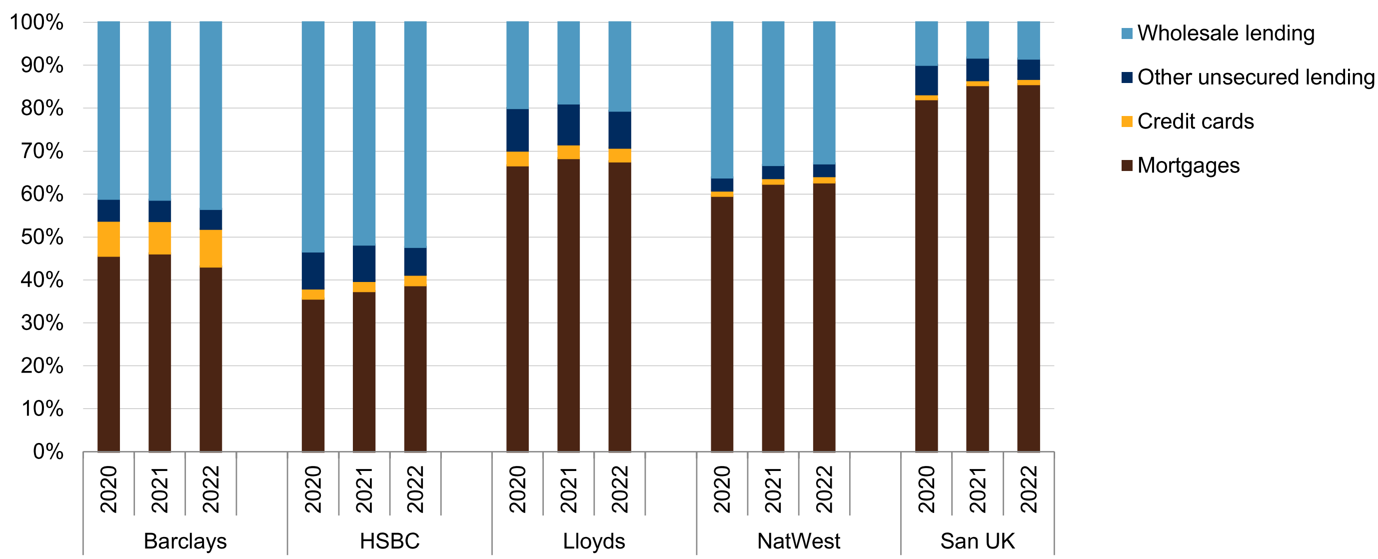
Our rating on SanUK balances its deep but relatively narrow U.K. banking franchise against its solid capital base and well-diversified funding and liquidity profile. Although it has developed a deep U.K. prime mortgage business, SanUK's overall scope remains narrower than U.K.-focused peers Lloyds and NatWest, both of which run materially larger commercial lending franchises, or Barclays, which has built an internationally diversified investment banking and credit card franchise. At the same time, SanUK's narrower scope, well managed balance sheet (in which corporate exposures have been steadily reduced), and focus on operating efficiency have enabled it to record resilient risk-adjusted earnings over the past 24 months. Furthermore, the combination of these factors has bolstered our view of its capitalization, with our risk-adjusted capital (RAC) ratio moving just above 10% in 2021, though falling back to 9.8% at year-end 2022 driven by RWA growth and following a special dividend payment of £300 million by the firm.

SanUK runs a strong U.K. prime mortgage franchise, supported by smaller, but focused, commercial banking and consumer unsecured businesses. Over the past five years, SanUK has continued to grow its prime residential mortgage offering while tightening and focusing its consumer and corporate exposures. For example, while the group's residential mortgage book grew 19% over the past five years, the commercial and unsecured books have slightly shrunk by our calculations (see chart 1). This contraction has been achieved through a series of asset transfers to parent Banco Santander's U.K.-based commercial and investment bank, and managed wind-down of unprofitable business. Furthermore, even as it reduces its commercial exposures, we see good evidence that SanUK is actively leveraging the parent's international franchise by targeting internationally focused U.K. companies within its Corporate and Commercial Banking (CCB) segment. We expect this will continue--although related income expansion will lag the initial investment. Taken together, SanUK's strong mortgage growth and increasingly focused commercial book provide the group with a solid footing in the U.K. banking market.

Chart 1

SanUK's mortgage franchise continues to underpin its balance sheet

Loan book split by percentage



Source: S&P Global Ratings, company disclosures.

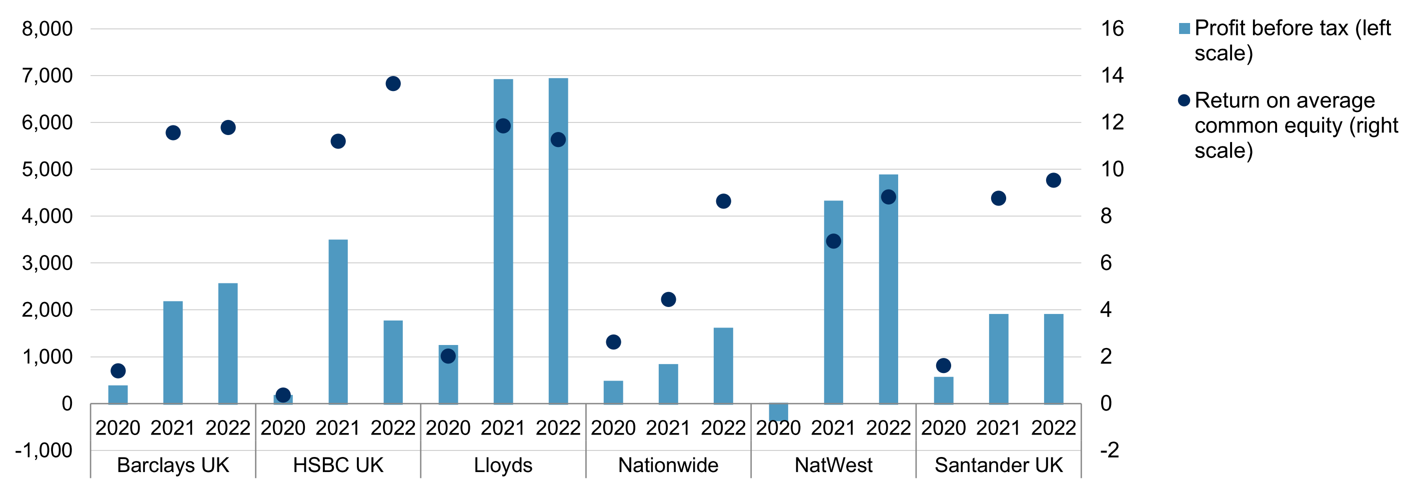
Rising interest rates and the group's cost discipline underpins a strong earnings outlook for SanUK. The elevated interest rate environment in the U.K. will continue to support SanUK's revenue in 2023 due to strong margins. This will be partially offset by reduced mortgage market volumes and greater pressure to pass on higher rates in the deposit book. On balance, in our view, this should see the group's full-year 2023 net interest margin for its banking book land fairly in line with the fourth-quarter 2022 position of 2.1%.

SanUK has been proactive in its cost control initiatives, with its multi-year transformation program continuing to reap benefits. These initiatives have translated into a cost-to income ratio of 47%, which compares well to peers. We expect it to remain below 50% in 2023 even with the inflationary pressure in the U.K.

The resilient income prospects for SanUK, and its improved cost control, lead us to forecast return on tangible equity of above 10% in 2023. This indicates SanUK's earnings stability through the economic cycle despite aggressive competition.

Chart 2

S&P Global Ratings' adjusted profit before tax and return on equity
Period up to most recent reporting date



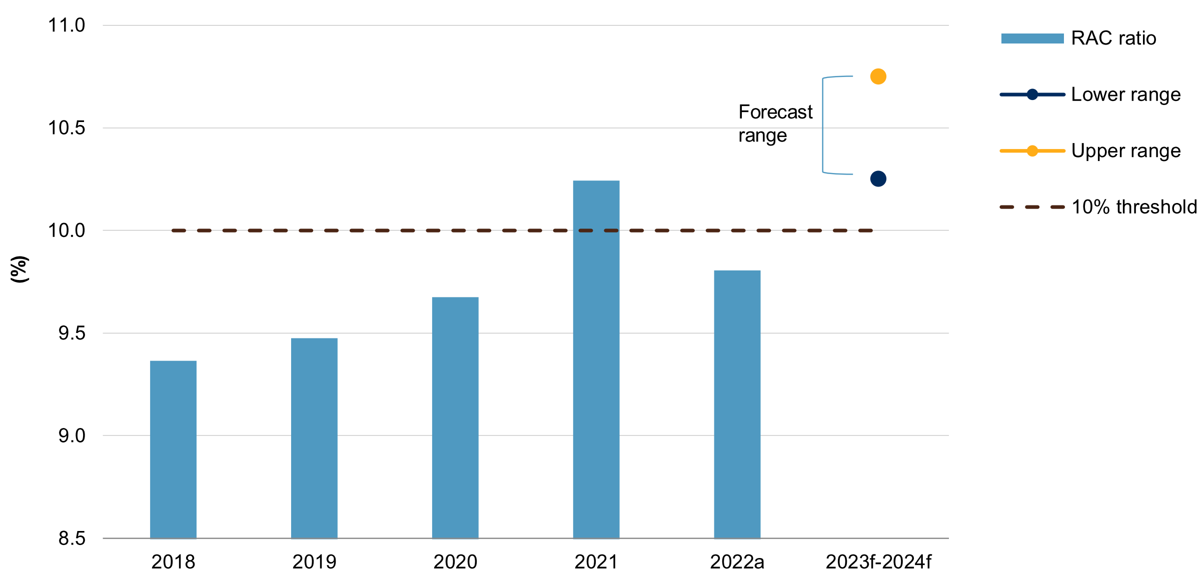
Source: S&P Global Ratings.

A robust and improving risk-adjusted capital position is tempered by potential distributions to the parent. S&P Global Ratings' risk-adjusted (RAC) and regulatory capitalization ratios for SanUK have gradually strengthened in recent years. We calculate a RAC ratio of 9.8% at Dec. 31, 2022, and project that it will remain around 10.25%-10.75% through to year-end 2024 (see chart 3).

We forecast SanUK to exceed the 10% RAC threshold in the medium term, which would correspond to a stronger assessment of its capital position in our initial capital and earnings (C&E) assessment. That said, while we expect the firm to continue to generate meaningful surplus capital under our forecasts and maintain material headroom above its regulatory requirements, we do not expect it to maintain a comfortable headroom above our 10% RAC ratio over the medium term for a higher assessment of its C&E. This primarily reflects our belief that a material portion of excess capital could be distributed to the parent given its status as a subsidiary of a larger banking group. Indeed, Banco Santander generally runs its subsidiaries with limited excess capital. As such, we see a realistic chance that SanUK's excess capital will continue to be distributed to the parent in the medium term, and expect any material distribution will move our forecast for the RAC ratio back toward or below 10%. That said, we continue to view SanUK's capital position as solid and strengthening both from a regulatory and RAC ratio perspective on the back of strong earnings and limited RWA growth. Thus, our C&E assessment, driven by the RAC ratio, remains one of the key factors in our rating upside scenario for the firm over our two-year outlook horizon.

Chart 3

Santander UK's RAC ratio forecast
Historic and forecast S&P Global ratings-adjusted RAC ratio

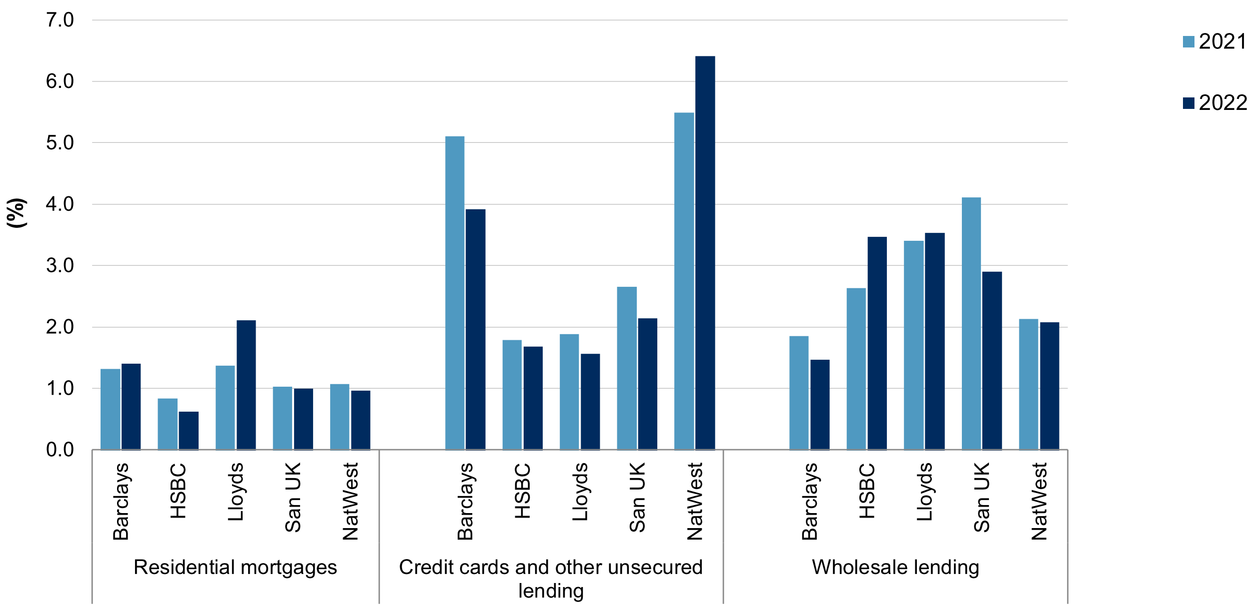


S&P Global Ratings' RAC ratio before diversification. RAC--Risk-adjusted capital. a--Actual. f--Forecast.
Source: S&P Global Ratings.

Asset quality is robust, despite some deterioration expected over 2023. SanUK's mortgage-centric book and narrow, high-quality consumer unsecured and corporate businesses have proved resilient throughout 2022 and year to date 2023. Nonperforming assets (NPAs) remain low, with our S&P Global Ratings-adjusted NPA ratio at 1.17% at year-end 2022, which is in line with peers. The group reported a modest provision build in 2022, reporting an S&P Global Ratings-adjusted impairment rate of 15 basis points (bps) for the year. The group's commercial book carries a significant portion of the non-performance, but the bank has continued to better manage and reduce this exposure over time. Even so, we expect that credit quality in the bank's loan portfolio will deteriorate and approach more normalized levels as persistent inflation, elevated interest rates, and sluggish economic growth hamper affordability. We expect the group's impairment charge to increase to around 20-25 bps in 2023 and then temper in 2024 as economic pressure eases in the U.K. Beyond 2023, the subdued economic outlook, characterized by low growth and elevated interest rates, will likely continue to squeeze credit quality, though we believe that SanUK will be able to withstand this challenging environment given its robust risk management and asset quality.

Chart 4

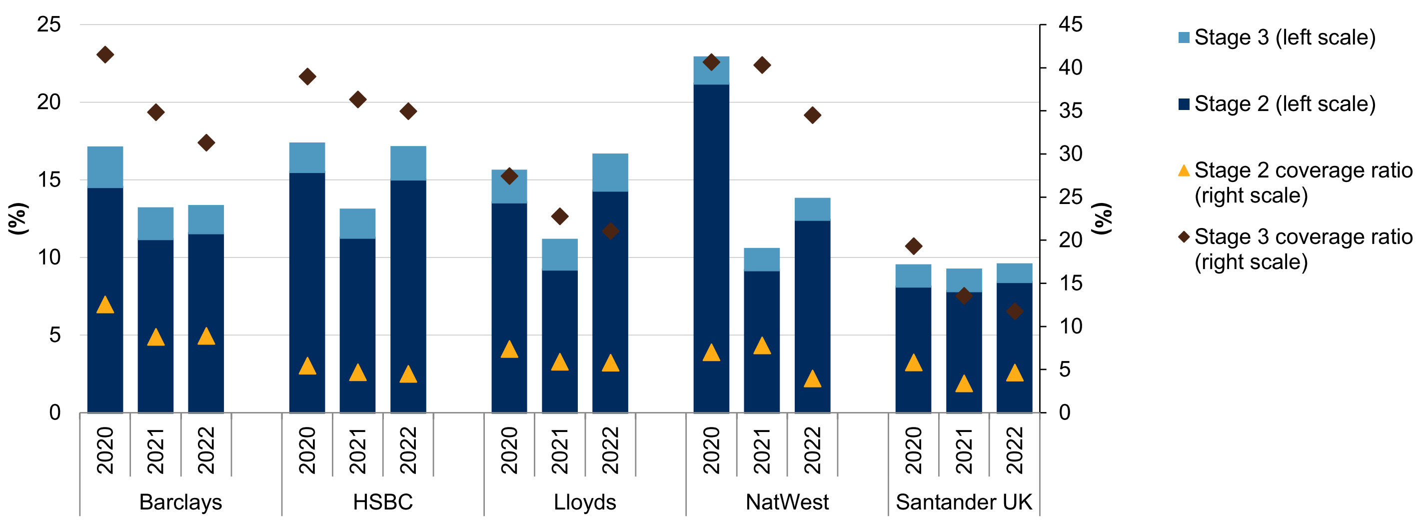
San UK's asset quality is solid
UK banks' gross stage 3 loans ratios by portfolio



Source: S&P Global Ratings-adjusted figures, company disclosures.

Chart 5

Growing stage 2 balances indicate that the group anticipates some deterioration
Stages 2 and 3 loans as percentages of total portfolios at Dec. 31, 2022

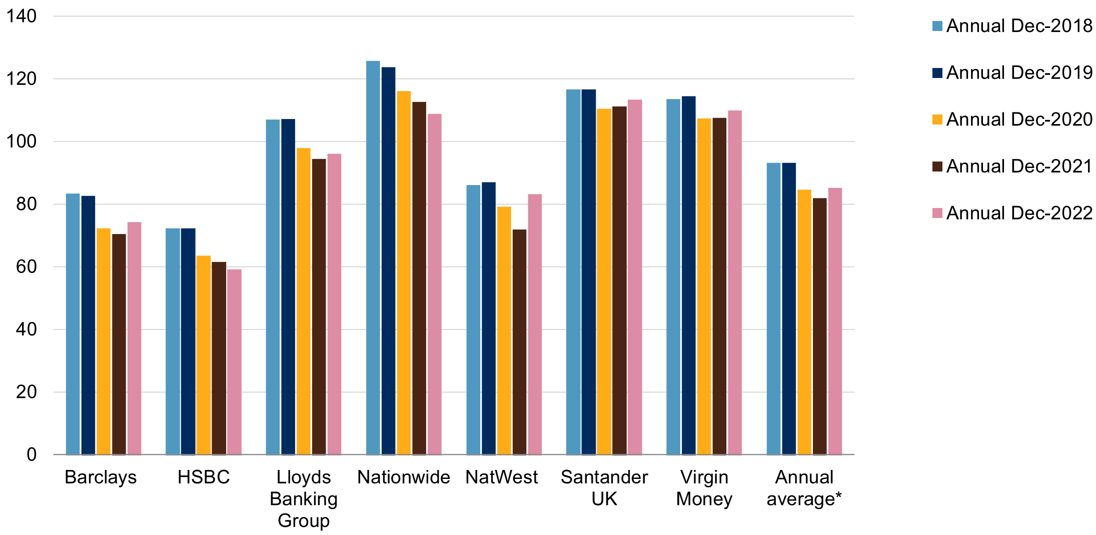


Source: S&P Global Ratings, company disclosures.

SanUK's balance sheet is supported by its strong deposit franchise and its well-managed and diverse wholesale funding. We see SanUK's funding and liquidity profile as being broadly comparable with other U.K. and European peers, although its loan-to-deposit ratio remains high relative to the larger U.K banks. At year-end 2022, SanUK reported a loan-to-deposit ratio of 113%, larger than the peer group average of around 90%. That said, SanUK's deposit base has grown strongly in the past five years, with almost 20% total growth in deposits since 2018 . This has seen the group's deposits increase to 83% of its funding base from 71% in 2018--a solid support to an already well-diversified and stable funding base.

Chart 6

San UK's loan-to-deposit ratio is higher than most major U.K. bank peers



*Nationwide Building Society and Virgin Money UK PLC do not report for the period to Dec. 31 format so are excluded from the full year average. Data for Nationwide is as of October 2022, and Virgin Money is as of September 2022. Source: S&P Global Ratings, company disclosures.

A robust franchise, tight cost control, and resilient earnings outlook continue to underpin our 'A' issuer credit rating. We believe SanUK is well positioned at the 'A' issuer credit rating level for the opco, and that its combined franchise, underwriting discipline, cost control, and resilient earnings outlook position it well among domestic and European peers.

Environmental, Social, And Governance

ESG Credit Indicators

E-1	**E-2**	E-3	E-4	E-5	S-1	**S-2**	S-3	S-4	S-5	G-1	**G-2**	G-3	G-4	G-5

ESG credit indicators provide additional disclosure and transparency at the entity level and reflect S&P Global Ratings' opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are not a sustainability rating or an S&P Global Ratings ESG Evaluation. The extent of the influence of these factors is reflected on an alphanumerical 1-5 scale where 1 = positive, 2 = neutral, 3 = moderately negative, 4 = negative, and 5 = very negative. For more information, see our commentary "ESG Credit Indicators: Definition And Applications," published Oct. 13, 2021.

ESG factors have no material influence on our credit rating analysis of Santander UK Group Holdings PLC or Santander UK PLC. We note that SanUK received a £108 million fine from the Financial Conduct Authority last year for historic anti-money laundering issues, though overall conduct and litigation charges over recent years are broadly in line with peers. That said, the group's core businesses remain exposed to conduct and compliance risk given the retail-heavy nature of the business. We consider the payment protection insurance misselling episode to be an issue of the past and do not expect further provision going forward. That said, as the group accelerates its digital transformation, risks relating to cyber security, operational resilience, and financial crime also rise.

Key Statistics

Table 1

Santander UK Group Holdings PLC--Key figures					
	--Year ended Dec. 31--				
(Mil. £)	**2022**	**2021**	**2020**	**2019**	**2018**
Adjusted assets	290,693.0	292,131.0	297,415.0	286,712.0	287,567.0
Customer loans (gross)	225,112.0	214,885.0	214,094.0	208,879.0	202,952.0
Adjusted common equity	11,066.0	10,993.0	11,045.0	11,055.0	11,027.0
Operating revenues	5,013.0	4,471.0	3,958.0	4,170.0	4,543.0
Noninterest expenses	2,370.0	2,540.0	2,561.0	2,613.0	2,632.0
Core earnings	1,584.6	1,448.7	417.7	794.3	1,072.6

Table 2

Santander UK Group Holdings PLC--Business position					
	--Year ended Dec. 31--				
(%)	**2022**	**2021**	**2020**	**2019**	**2018**
Total revenues from business line (currency in millions)	5,013.0	4,576.0	3,958.0	4,170.0	4,543.0
Commercial banking/total revenues from business line	14.5	11.1	14.7	14.7	18.2
Retail banking/total revenues from business line	85.0	87.1	87.9	85.7	82.9
Commercial & retail banking/total revenues from business line	99.5	98.3	102.6	100.4	101.0
Other revenues/total revenues from business line	0.5	1.7	(2.6)	(0.4)	(1.0)
Return on average common equity	9.5	8.8	1.6	3.6	6.5

Table 3

Santander UK Group Holdings PLC--Capital and earnings					
	--Year ended Dec. 31--				
(%)	**2022**	**2021**	**2020**	**2019**	**2018**
Tier 1 capital ratio	18.3	19.3	18.6	17.9	16.2
S&P Global Ratings' RAC ratio before diversification	N/A	10.2	9.7	9.5	9.4
S&P Global Ratings' RAC ratio after diversification	N/A	9.3	8.9	8.8	8.9
Adjusted common equity/total adjusted capital	83.4	83.4	83.1	83.1	84.3
Double leverage	100.7	100.7	100.3	100.3	100.7
Net interest income/operating revenues	89.2	89.4	86.8	79.0	79.4
Fee income/operating revenues	6.5	6.3	9.7	16.5	16.5
Market-sensitive income/operating revenues	0.8	(0.1)	1.9	0.6	2.8
Cost to income ratio	47.3	56.8	64.7	62.7	57.9

Table 3

Santander UK Group Holdings PLC--Capital and earnings (cont.)					
	--Year ended Dec. 31--				
(%)	**2022**	**2021**	**2020**	**2019**	**2018**
Preprovision operating income/average assets	0.9	0.7	0.5	0.5	0.6
Core earnings/average managed assets	0.5	0.5	0.1	0.3	0.4

RAC--Risk-adjusted capital. N/A--Not applicable.

Table 4

Santander UK Group Holdings PLC RACF [Risk-Adjusted Capital Framework] Data					
(Mil. £)	**Exposure***	**Basel III RWA**	**Average Basel III RW(%)**	**S&P Global RWA**	**Average S&P Global RW (%)**
Credit risk					
Government & central banks	54,600	0	0	239	0
Of which regional governments and local authorities	0	0	0	0	0
Institutions and CCPs	4,011	600	15	840	21
Corporate	22,300	13,600	61	27,394	123
Retail	210,900	44,000	21	88,397	42
Of which mortgage	193,600	33,400	17	70,722	37
Securitization§	1,451	375	26	428	29
Other assets†	7,300	4,800	66	9,542	131
Total credit risk	300,562	63,375	21	126,840	42
Credit valuation adjustment					
Total credit valuation adjustment	--	200	--	0	--
Market Risk					
Equity in the banking book	10	36	370	73	750
Trading book market risk	--	300	--	450	--
Total market risk	--	336	--	523	--
Operational risk					
Total operational risk	--	7,172	--	7,873	--
(Mil. £)	**Exposure**	**Basel III RWA**	**Average Basel II RW (%)**	**S&P Global RWA**	**% of S&P Global RWA**
Diversification adjustments					
RWA before diversification	--	71,083	--	135,236	100
Total Diversification/ Concentration Adjustments	--	--	--	9,616	7
RWA after diversification	--	71,083	--	144,852	107
(Mil. £)		**Tier 1 capital**	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global RAC ratio (%)**
Capital ratio		Standard & Poor's RWA	Standard & Poor's RWA	Standard & Poor's RWA	Standard & Poor's RWA
Capital ratio before adjustments		13,039	18.3	13,262	9.8
Capital ratio after adjustments‡		13,039	18.3	13,262	9.2

Table 4

Santander UK Group Holdings PLC RACF [Risk-Adjusted Capital Framework] Data (cont.)

*Exposure at default. §Securitization Exposure includes the securitization tranches deducted from capital in the regulatory framework. †Exposure and S&P Global Ratings' risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions. ‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. Sources: Company data as of 'Dec. 31 2022', S&P Global Ratings.

Table 5

Santander UK Group Holdings PLC--Risk position

	--Year ended Dec. 31--				
(%)	**2022**	**2021**	**2020**	**2019**	**2018**
Growth in customer loans	4.8	0.4	2.5	2.9	(2.8)
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	9.7	8.4	7.2	4.8
Total managed assets/adjusted common equity (x)	26.4	26.7	27.1	26.1	26.2
New loan loss provisions/average customer loans	0.1	(0.1)	0.3	0.1	0.1
Net charge-offs/average customer loans	0.1	0.1	0.2	0.2	0.2
Gross nonperforming assets/customer loans + other real estate owned	1.2	1.4	1.4	1.1	1.2
Loan loss reserves/gross nonperforming assets	35.3	28.2	45.0	34.3	30.1

RWA--Risk-weighted asset. N/A--Not applicable.

Table 6

Santander UK Group Holdings PLC--Funding and liquidity

	--Year ended Dec. 31--				
(%)	**2022**	**2021**	**2020**	**2019**	**2018**
Core deposits/funding base	72.1	70.5	69.5	66.5	64.7
Customer loans (net)/customer deposits	113.6	111.0	110.2	116.2	116.4
Long-term funding ratio	92.6	92.5	86.4	84.0	87.7
Stable funding ratio	112.8	116.0	108.6	102.6	108.2
Short-term wholesale funding/funding base	7.7	7.9	14.3	16.9	13.0
Regulatory net stable funding ratio	136.8	N/A	N/A	N/A	N/A
Broad liquid assets/short-term wholesale funding (x)	2.6	2.9	1.6	1.2	1.6
Broad liquid assets/total assets	18.6	21.3	21.2	18.5	19.1
Broad liquid assets/customer deposits	27.6	32.5	32.8	29.8	31.8
Net broad liquid assets/short-term customer deposits	17.1	21.5	12.5	4.6	12.2
Regulatory liquidity coverage ratio (LCR) (x)	162.8	N/A	N/A	N/A	N/A
Short-term wholesale funding/total wholesale funding	27.0	26.1	45.5	49.2	35.9

N/A--Not applicable.

Table 7

Santander UK Group Holdings PLC--Rating Component Scores

Issuer Credit Rating	**A/Stable/A-2**
SACP	bbb+
Anchor	bbb+
Economic risk	4
Industry risk	3
Business position	Adequate

Table 7

Santander UK Group Holdings PLC--Rating Component Scores (cont.)	
Issuer Credit Rating	**A/Stable/A-2**
Capital and earnings	Adequate
Risk position	Adequate
Funding	Adequate
Liquidity	Adequate
Comparable ratings analysis	0
Support	+2
ALAC support	+2
GRE support	0
Group support	0
Sovereign support	0
Additional factors	0

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

Related Criteria

- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- 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: Principles Of Credit Ratings, Feb. 16, 2011

Ratings Detail (As Of June 29, 2023)*	
Santander UK Group Holdings PLC	
Issuer Credit Rating	BBB/Stable/A-2
Junior Subordinated	BB-
Senior Unsecured	BBB
Short-Term Debt	A-2
Subordinated	BB+
Issuer Credit Ratings History	
24-Jun-2021	BBB/Stable/A-2
23-Apr-2020	BBB/Negative/A-2
10-Apr-2015	BBB/Stable/A-2
Sovereign Rating	
United Kingdom	AA/Stable/A-1+

Ratings Detail (As Of June 29, 2023)*(cont.)	
Related Entities	
Banco Santander (Brasil) S.A.	
Issuer Credit Rating	BB-/Positive/B
Brazil National Scale	brAAA/Stable/brA-1+
Banco Santander-Chile S.A.	
Issuer Credit Rating	A-/Stable/A-2
Commercial Paper	
Foreign Currency	A-2
Senior Unsecured	A-
Banco Santander S.A.	
Issuer Credit Rating	A+/Stable/A-1
Resolution Counterparty Rating	AA-/--/A-1+
Commercial Paper	A-1
Senior Subordinated	A-
Banco Santander SA (London Branch)	
Certificate Of Deposit	
Local Currency	A-1
Banco Santander S.A. (New York Branch)	
Commercial Paper	
Local Currency	A-1
Banco Santander Totta S.A.	
Issuer Credit Rating	BBB+/Stable/A-2
Resolution Counterparty Rating	BBB+/--/A-2
Senior Unsecured	BBB+
Banque Stellantis France	
Issuer Credit Rating	BBB+/Stable/A-2
Senior Unsecured	BBB+
Santander Bank, N.A.	
Issuer Credit Rating	A-/Stable/A-2
Senior Unsecured	A-
Short-Term Debt	A-2
Subordinated	BBB+
Santander Consumer Bank AG	
Issuer Credit Rating	A/Stable/A-1
Resolution Counterparty Rating	A+/--/A-1
Commercial Paper	A-1
Senior Unsecured	A
Santander Consumer Finance S.A.	
Issuer Credit Rating	A/Stable/A-1
Resolution Counterparty Rating	A+/--/A-1
Commercial Paper	
Local Currency	A-1
Senior Subordinated	BBB+
Senior Unsecured	A

Ratings Detail (As Of June 29, 2023)*(cont.)	
Short-Term Debt	A-1
Subordinated	BBB
Santander Financial Services PLC	
Issuer Credit Rating	A-/Stable/A-2
Resolution Counterparty Rating	A/--/A-1
Santander Holdings U.S.A Inc.	
Issuer Credit Rating	BBB+/Stable/A-2
Senior Unsecured	BBB+
Santander Totta SGPS, S.A.	
Senior Unsecured	BBB+
Santander UK PLC	
Issuer Credit Rating	A/Stable/A-1
Resolution Counterparty Rating	A+/--/A-1
Junior Subordinated	BB
Junior Subordinated	BB+
Preference Stock	BB
Senior Secured	AAA/Stable
Senior Unsecured	A-1

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.