

Santander UK Group Holdings plc

Update

Key Rating Drivers

Conservative Risk Profile, Less Diversified Business: Santander UK Group Holdings plc (SGH) and Santander UK plc's (San UK) Viability Ratings (VRs) are based on SGH's consolidated financial profile and reflect the group's conservative risk appetite, low impaired loans ratio, strong capitalisation, and stable funding and liquidity profiles. They also reflect a less-diversified business model than peers, which weighs on the group's earnings.

Weaker Economic Outlook: Fitch Ratings expects UK banks' performance to weaken in 2023, given the recession, materially higher interest rates, high inflation and a rise in unemployment, and for credit losses to rise from low levels. Net interest income growth will slow, in Fitch's view, as materially higher funding costs weigh on net interest margins. Loan growth is likely to slow as higher interest rates dampen demand and borrower confidence remains weak.

Conservative Underwriting: We view SGH's risk appetite as conservative, given a high 85% of customer loans at end-1Q23 were made up of lower-risk mortgage lending (91% owner-occupied), at low loan-to-value (average: 51%) ratios. Unsecured retail loans are low.

Asset-Quality Deterioration Expected: SGH's asset quality is underpinned by its large mortgage portfolio, and its impaired loans ratio was a low 1.3% at end-1Q23 (end-2022: 1.2%). However, we expect the impaired loans ratio to deteriorate toward – but to not exceed – 2% into 2024 given the expected recession, materially higher interest rates and borrower affordability pressures. Impairment charges are likely to rise with the weaker economic outlook, but will remain manageable given the largely secured loan book.

Earnings Uplift to Moderate: SGH's operating profit/risk-weighted assets (RWAs; 3.1% in 1Q23; 2022: 2.7%) ratio has benefitted from rising interest rates, particularly given its large low-cost current account deposit base. We expect the uplift from base rate rises to diminish, however, as deposit costs increase with competition. We expect cost efficiency to improve in 2023, given SGH's large cost-reduction programme.

Strong Capitalisation: SGH's common equity Tier 1 ratio has risen slightly (end-1Q23; 15.4%; end-2022: 15.2%) due to improved capital generation. Capital is managed to about a 5% UK leverage ratio (end-1Q23: 5.2%), given the low RWA density of the loan book. We expect excess capital to be repatriated to SGH's parent, Banco Santander, S.A. (A-/Stable), via dividends.

Stable Funding and Liquidity: SGH is largely deposit-funded, with a loans/deposit ratio of 113% at end-1Q23, and its funding costs benefit from its retail and SME current accounts (about half of customer deposits). Funding stability is supported by proven access to wholesale-funding markets, ordinary support and access to the Bank of England's liquidity schemes, if needed.

The Short-Term Issuer Default Ratings (IDRs) of 'F1' for SGH and its rated subsidiaries are the lower of two options mapping to the Long-Term IDRs, as our assessment of the group's funding and liquidity profile does not warrant a higher Short-Term IDR.

San UK IDR Uplift: San UK's Long-Term IDR is one notch above the VR because SGH's single-point-of-entry UK resolution plan envisages San UK's third-party senior creditors being protected in a bank failure by sufficient qualifying junior debt (QJD) and equity raised by SGH.

Ratings

Foreign Currency

Long-Term IDR	A
Short-Term IDR	F1

Viability Rating	a
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Shareholder Support Rating	bbb+
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Sovereign Risk (United Kingdom)

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

Outlooks

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

Applicable Criteria

[Bank Rating Criteria \(September 2022\)](#)

Related Research

[Fitch Affirms Santander UK Group Holdings at 'A'; Outlook Stable \(December 2022\)](#)

[Major UK Banks' Strong Performance to Soften as Funding Costs, Impairments Rise \(May 2023\)](#)

[UK Banks' Net Interest Margins Are Close to Peaking \(February 2023\)](#)

[Western European Banks Outlook 2023 \(December 2022\)](#)

[Fitch Affirms United Kingdom at 'AA-'; Outlook Negative \(June 2023\)](#)

[Major UK Banks – Peer Review 2022 \(October 2022\)](#)

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Rating Sensitivities

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

The ratings are primarily sensitive to changes in the VR, which could be downgraded if the deterioration in the UK operating environment is materially worse than we currently expect. SGH would retain some rating headroom in a scenario where the UK banks' operating environment score was downgraded to 'a+' from 'aa-', but we would downgrade its VR if we expected the impaired loans ratio to increase above 3% without a clear path to reduction, and if its CET1 ratio fell below 13%-14% on a sustained basis.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

An upgrade of the VR is unlikely given the weaker macroeconomic outlook in the UK and the negative outlooks on the operating environment score and the UK sovereign. Over the longer term, positive rating potential would require SGH's business model to become significantly more diversified, and comparable with those of higher-rated UK peers, which would result in stronger and more sustainable earnings, while capital ratios remain solid.

Other Debt and Issuer Ratings

Rating level	Rating
Senior unsecured: long term	A
Senior unsecured: short term	F1
Tier 2 subordinated debt	BBB+
Additional tier 1 debt	BBB-

Source: Fitch Ratings

Senior Unsecured Debt

The senior unsecured debt instruments of all entities are rated in line with their Long-Term IDRs.

Derivative Counterparty Ratings (DCR)

San UK's DCR is at the same level as the bank's Long-Term IDR because derivative counterparties have no preferential status over other senior obligations in a resolution under UK legislation.

Subordinated Debt and Hybrid Securities

The ratings of all subordinated debt and hybrid securities issued by SGH and San UK are notched down from their VRs, reflecting our expectation of poor recovery prospects.

SGH's additional Tier 1 capital securities are rated four notches below the group's VR to reflect loss severity risk (two notches) and higher risk of non-performance as coupon payments are fully discretionary (two notches). Dated lower Tier 2 legacy instruments are notched down twice from the VR for poor recovery prospects.

Legacy Tier 1 securities issued by San UK are rated four notches below the bank's VR to reflect loss severity risk (two notches) and higher risk of non-performance due to discretionary coupon payments (two notches). Legacy upper Tier 2 securities are rated three notches below San UK's VR (two for loss severity and one for non-performance). Legacy dated Lower Tier 2 instruments are notched down twice from the VR for loss severity.

Significant Changes from Last Review

San UK recorded strong profitability in 2022 (operating profit/RWAs: 2.7%; 2021: 2.6%), primarily due to higher net interest income (NII: up 12% yoy) as a result of higher policy rates and relatively low loan impairment charges (LICs). We expect the higher-interest-rate environment to continue to support the bank's profitability. However, for the rest of the year the incremental benefit will gradually be eroding by the increasing pass-through rate on deposits together with the increasing share of interest-bearing deposits, while asset margins, particularly on mortgage loans, remain tight due to competitive pressures.

San UK's gross loans contracted 4% in 1Q23 (Ytd) reflecting the softer mortgage market and subdued credit demand in the higher interest rate environment. Customer deposits fell 3% in 1Q23 as the bank strategically reduced more expensive deposits and as deposit competition intensified across the sector.

San UK's underlying asset quality remained resilient in 1Q23 with LICs amounting to 11bp of average gross loans (2022: 13bp) and primarily reflecting the worsening economic outlook, and San UK's largely secured loan portfolio. San UK's CET1 ratio of 15.4% at end-March 2023 (end-2022: 15.2%) provides headroom against economic uncertainty.

Ratings Navigator

Santander UK Group Holdings plc							ESG Relevance:	Banks Ratings Navigator		
Operating Environment	Business Profile	Risk Profile	Financial Profile			Implied Viability Rating	Viability Rating	Shareholder Support	Issuer Default Rating	
			Asset Quality	Earnings & Profitability	Capitalisation & Leverage					Funding & Liquidity
	20%	10%	20%	15%	25%	10%				
aaa							aaa	aaa	AAA	
aa+							aa+	aa+	AA+	
aa							aa	aa	AA	
aa-							aa-	aa-	AA-	
a+							a+	a+	A+	
a							a	a	A Sta	
a-							a-	a-	A-	
bbb+							bbb+	bbb+	BBB+	
bbb							bbb	bbb	BBB	
bbb-							bbb-	bbb-	BBB-	
bb+							bb+	bb+	BB+	
bb							bb	bb	BB	
bb-							bb-	bb-	BB-	
b+							b+	b+	B+	
b							b	b	B	
b-							b-	b-	B-	
ccc+							ccc+	ccc+	CCC+	
ccc							ccc	ccc	CCC	
ccc-							ccc-	ccc-	CCC-	
cc							cc	cc	CC	
c							c	c	C	
f							f	ns	D or RD	

The Key Rating Driver (KRD) weightings used to determine the implied VR are shown as percentages at the top. In cases where the implied VR is adjusted upwards or downwards to arrive at the VR, the KRD associated with the adjustment reason is highlighted in red. The shaded areas indicate the benchmark-implied scores for each KRD.

VR - Adjustments to Key Rating Drivers

The operating environment score of 'aa-' is at the lower end of the range because it is constrained by the UK sovereign rating of 'AA-/Negative (negative).

Financials

Financial Statements

	31 Mar 23		31 Dec 22	31 Dec 21	31 Dec 20	31 Dec 19
	3 months - 1st quarter (USDm)	3 months - 1st quarter (GBPm)	Year end (GBPm)	Year end (GBPm)	Year end (GBPm)	Year end (GBPm)
	Unaudited	Unaudited	Audited - unqualified	Audited - unqualified	Audited - unqualified	Audited - unqualified
Summary income statement						
Net interest and dividend income	1,465	1,184.0	4,472.0	3,997.0	3,437.0	3,295.0
Net fees and commissions	n.a.	n.a.	324.0	280.0	383.0	689.0
Other operating income	153	124.0	217.0	194.0	138.0	186.0
Total operating income	1,619	1,308.0	5,013.0	4,471.0	3,958.0	4,170.0
Operating costs	866	700.0	2,791.0	2,919.0	2,685.0	2,780.0
Pre-impairment operating profit	752	608.0	2,222.0	1,552.0	1,273.0	1,390.0
Loan and other impairment charges	75	61.0	321.0	-233.0	645.0	220.0
Operating profit	677	547.0	1,901.0	1,785.0	628.0	1,170.0
Other non-operating items (net)	n.a.	n.a.	-7.0	105.0	-76.0	-189.0
Tax	179	145.0	471.0	485.0	114.0	272.0
Net income	497	402.0	1,423.0	1,405.0	438.0	709.0
Other comprehensive income	n.a.	n.a.	-1,682.0	465.0	-252.0	-336.0
Fitch comprehensive income	497	402.0	-259.0	1,870.0	186.0	373.0
Summary balance sheet						
Assets						
Gross loans	267,965	216,529.0	225,134.0	214,910.0	214,148.0	208,344.0
- Of which impaired	3,341	2,700.0	2,600.0	2,940.0	2,896.0	2,289.0
Loan loss allowances	1,273	1,029.0	955.0	853.0	1,357.0	846.0
Net loans	266,691	215,500.0	224,179.0	214,057.0	212,791.0	207,498.0
Interbank	n.a.	n.a.	1,105.0	1,420.0	2,004.0	2,583.0
Derivatives	n.a.	n.a.	-215.0	1,720.0	3,451.0	3,363.0
Other securities and earning assets	n.a.	n.a.	13,875.0	19,385.0	30,105.0	41,529.0
Total earning assets	266,691	215,500.0	238,944.0	236,582.0	248,351.0	254,973.0
Cash and due from banks	n.a.	n.a.	46,635.0	50,494.0	43,537.0	26,395.0
Other assets	93,559	75,600.0	6,664.0	6,600.0	7,176.0	7,120.0
Total assets	360,250	291,100.0	292,243.0	293,676.0	299,064.0	288,488.0
Liabilities						
Customer deposits	236,867	191,400.0	197,313.0	192,914.0	193,088.0	179,006.0
Interbank and other short-term funding	n.a.	n.a.	41,250.0	50,671.0	42,503.0	38,465.0
Other long-term funding	79,574	64,300.0	33,683.0	28,373.0	40,209.0	47,535.0
Trading liabilities and derivatives	n.a.	n.a.	1,906.0	1,822.0	3,354.0	3,422.0
Total funding and derivatives	316,441	255,700.0	274,152.0	273,780.0	279,154.0	268,428.0
Other liabilities	24,751	20,000.0	3,036.0	3,174.0	3,321.0	3,375.0
Preference shares and hybrid capital	n.a.	n.a.	2,540.0	2,535.0	2,820.0	2,820.0
Total equity	19,058	15,400.0	12,515.0	14,187.0	13,769.0	13,865.0
Total liabilities and equity	360,250	291,100.0	292,243.0	293,676.0	299,064.0	288,488.0
Exchange rate		USD1 = GBP0.80805	USD1 = GBP0.828638	USD1 = GBP0.74438	USD1 = GBP0.745156	USD1 = GBP0.76211

Source: Fitch Ratings, Fitch Solutions, Santander UK Group Holdings plc

Key Ratios

	31 Mar 23	31 Dec 22	31 Dec 21	31 Dec 20	31 Dec 19
Ratios (annualised as appropriate)					
Profitability					
Operating profit/risk-weighted assets	3.1	2.7	2.6	0.9	1.6
Net interest income/average earning assets	2.1	2.0	1.8	1.5	1.4
Non-interest expense/gross revenue	53.5	55.7	65.3	67.8	66.7
Net income/average equity	11.7	9.5	9.0	2.9	4.8
Asset quality					
Impaired loans ratio	1.3	1.2	1.4	1.4	1.1
Growth in gross loans	-3.8	4.8	0.4	2.8	2.9
Loan loss allowances/impaird loans	38.1	36.7	29.0	46.9	37.0
Loan impairment charges/average gross loans	0.1	0.1	-0.1	0.3	0.1
Capitalisation					
Common equity Tier 1 ratio	15.4	15.2	15.9	15.2	14.3
Fully loaded common equity Tier 1 ratio	n.a.	15.2	15.9	n.a.	n.a.
Tangible common equity/tangible assets	5.3	3.8	4.3	4.1	4.2
Basel leverage ratio	n.a.	4.4	4.3	4.3	4.3
Net impaired loans/common equity Tier 1	15.2	15.2	19.2	13.9	13.8
Funding and liquidity					
Gross loans/customer deposits	113.1	114.1	111.4	110.9	116.4
Liquidity coverage ratio	164.0	162.8	166.0	150.0	142.0
Customer deposits/total non-equity funding	74.9	71.6	70.1	69.0	66.4
Net stable funding ratio	n.a.	136.8	n.a.	n.a.	n.a.

Source: Fitch Ratings, Fitch Solutions, Santander UK Group Holdings plc

Support Assessment

Shareholder Support

Parent IDR	A-
Total Adjustments (notches)	-1
Shareholder Support Rating	bbb+

Shareholder ability to support

Shareholder Rating	A-/ Stable
Shareholder regulation	1 Notch
Relative size	1 Notch
Country risks	Equalised

Shareholder propensity to support

Role in group	1 Notch
Reputational risk	Equalised
Integration	1 Notch
Support record	1 Notch
Subsidiary performance and prospects	Equalised
Legal commitments	2+ Notches

The colours indicate the weighting of each KRD in the assessment.

Higher influence Moderate influence Lower influence

The 'bbb+' Shareholder Support Ratings (SSR) of SGH and San UK are one notch below Santander's Long-Term IDR because we view Santander's ability to provide support as constrained by the UK entities' large relative size, as well as by possible regulatory restrictions. In our view, Santander has a strong propensity to support both entities, given the strategic importance of the UK as well as the high reputation risk Santander would face in the case of a default by its UK entities.

Santander Financial Services plc's (SFS) 'a' SSR is in line with SGH's IDR and reflects SGH's strong propensity to support SFS, given SFS's role in the group, and a strong ability to provide support, given SFS's small size.

Subsidiaries and Affiliates

SFS

Fitch does not assign a VR to SFS as its business model and strong reliance on SGH prevent a meaningful standalone analysis of the entity. SFS's IDRs are based on support from SGH. SFS's 'a' SSR is in line with SGH's IDR and reflects SGH's strong propensity to support SFS, given SFS's role in the group, and a strong ability to provide support, given SFS's small size. We have lifted SFS's IDR one notch above SGH's IDR because we expect that the group's QJD and equity will protect SFS's third-party senior creditors should the group fail.

SFS's ratings are primarily sensitive to changes in SGH's IDRs. They are also sensitive to a reduction in SGH's propensity to support SFS, which we do not expect.

Environmental, Social and Governance Considerations

FitchRatings Santander UK Group Holdings plc

Banks
Ratings Navigator

Credit-Relevant ESG Derivation

Santander UK Group Holdings plc has 5 ESG potential rating drivers		Overall ESG Scale		
<ul style="list-style-type: none"> Santander UK Group Holdings plc 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. 	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	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.
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	Business Profile (incl. Management & governance); Risk Profile; Asset Quality	1	

Social (S)

General Issues	S Score	Sector-Specific Issues	Reference	S Scale	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.
Human Rights, Community Relations, Access & Affordability	2	Services for underbanked and underserved communities; SME and community development programs; financial literacy programs	Business Profile (incl. Management & governance); Risk Profile	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; Business Profile (incl. Management & governance); Risk Profile	4	
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Business Profile (incl. Management & governance)	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	Business Profile (incl. Management & governance); Financial Profile	1	

Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference	G Scale	CREDIT-RELEVANT ESG SCALE How relevant are E, S and G issues to the overall credit rating?
Management Strategy	3	Operational implementation of strategy	Business Profile (incl. Management & governance)	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.
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	Business Profile (incl. Management & governance); Earnings & Profitability; Capitalisation & Leverage	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.
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Business Profile (incl. Management & governance)	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.
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Business Profile (incl. Management & governance)	2	Irrelevant to the entity rating but relevant to the sector.
				1	Irrelevant to the entity rating and irrelevant to the sector.

Unless otherwise disclosed in this section, the 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 on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

For information on the solicitation status of the ratings included within this report, please refer to the solicitation status shown in the relevant entity's summary page of the Fitch Ratings website.

For information on the participation status in the rating process of an issuer listed in this report, please refer to the most recent rating action commentary for the relevant issuer, available on the Fitch Ratings website.

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