S&P Global
Ratings

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Update: Santander UK Group Holdings Ltd.

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Rating Score Snapshot

Issuer Credit Rating
BBB/Stable/A-2

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

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

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

Additional factors: 0
Issuer credit rating
A/Stable/A-1
Resolution counterparty rating
A+/A-1
Holding company ICR
BBB/Stable/A-2

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

Credit Highlights

Key strengths	Key risks
Good position in U.K. retail banking.	Competitive U.K. mortgage market will continue to weigh on profitability, although the evolving interest rate environment may offset competitive pressure.
Conservative loan book profile compared with peers.	Narrower revenue and business diversification than its larger U.K. competitors.
Solid capitalization by our measures, underpinned by stable earnings outlook.	

Outlook

Santander UK Group Holdings PLC

The stable outlook reflects our view that the bank will maintain robust credit quality that will support earnings. It also reflects our expectation that the bank will continue to maintain a good position in U.K. retail banking and maintain 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-points-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.

We could lower the ratings over our two-year horizon if an uneven post-pandemic economic recovery compromises Santander UK's performance.

We could revise the outlook to positive if Santander UK were to materially strengthen its franchise, reaching a level of business and revenue diversification closer to U.K. domestic peers.

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 8% threshold.

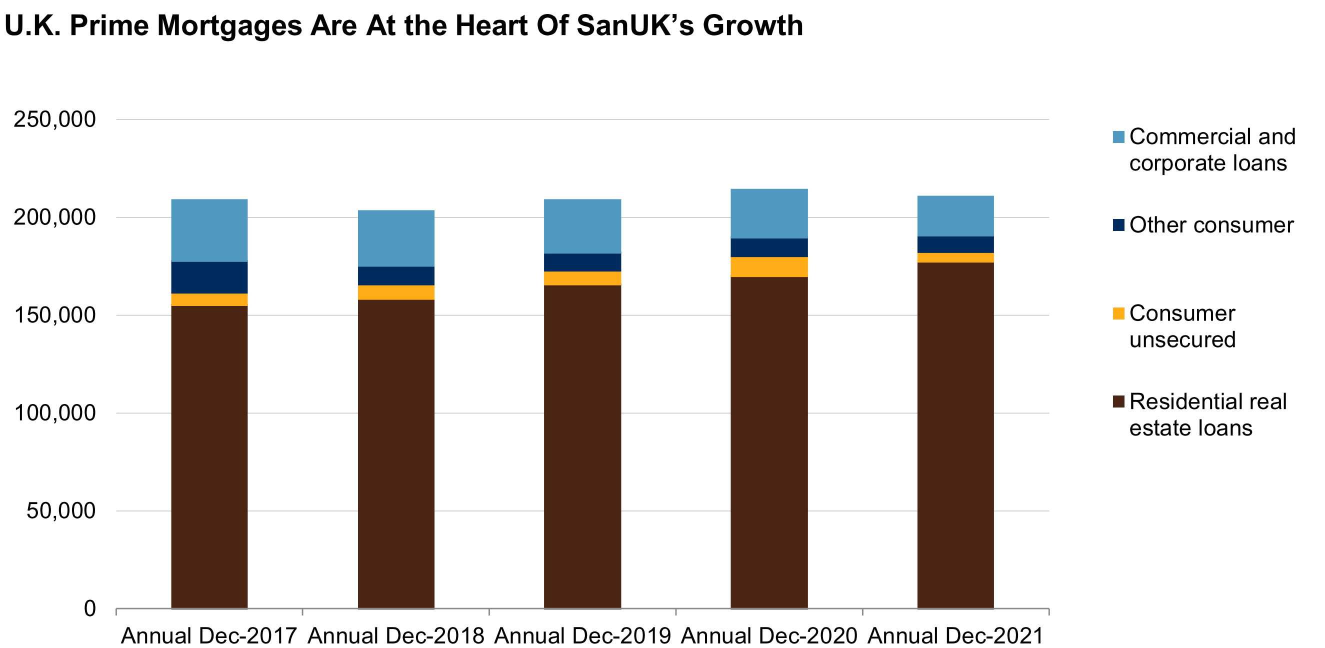
We could raise or lower our rating if the group SACP strengthened or worsened. We could also lower the ratings if the ALAC ratio were to fall below our 6% threshold, which would most likely be due to higher risk-weighted asset (RWA) inflation beyond our current expectations.

Rationale

SanUK's solid franchise, good capital and earnings position, improved funding and liquidity profile, and strong ALAC buffer support the group's rating. Across its well-positioned U.K. mortgage franchise, stable capital and earnings, and well-placed funding profile, SanUK's rating is built on solid foundations--although none of these factors are material enough to raise our view of SanUK's stand-alone creditworthiness above its anchor. In this context, SanUK's ALAC buffer is an essential support to our rating and a key ratings strength in our 'A' issuer credit rating (ICR). We estimate that the group's bail-inable capital comfortably exceeded 6% of S&P Global Ratings' RWA at Dec. 31, 2020, and expect this to remain the case. When combined with the group's solid credit position, this robust ALAC buffer (+2 notches) drives the rating.

SanUK runs a good U.K. prime mortgage franchise, supported by smaller commercial banking and consumer unsecured businesses. Over the past five years, Santander has continued to grow its prime residential mortgage offering while tightening and focusing its consumer and corporate exposures. By our calculations for example, while the group's residential mortgage book grew 15% over the past five years, the commercial book shrank by more than one third (chart 1). This shrinkage has been achieved through a series of asset transfers to parent Banco Santander's U.K.-based commercial and investment bank, and generally tight underwriting leading to a wind down in certain corners of the book. Alongside this, the group has focused the scope of its consumer unsecured business, selling its stake in PSA Finance UK Ltd. and maintaining a relatively modest consumer unsecured portfolio. These actions have helped focus the group's strategy but have somewhat narrowed its franchise. The group's growing and robust mortgage franchise, against its narrowing scope, are well balanced in our rating.

Chart 1

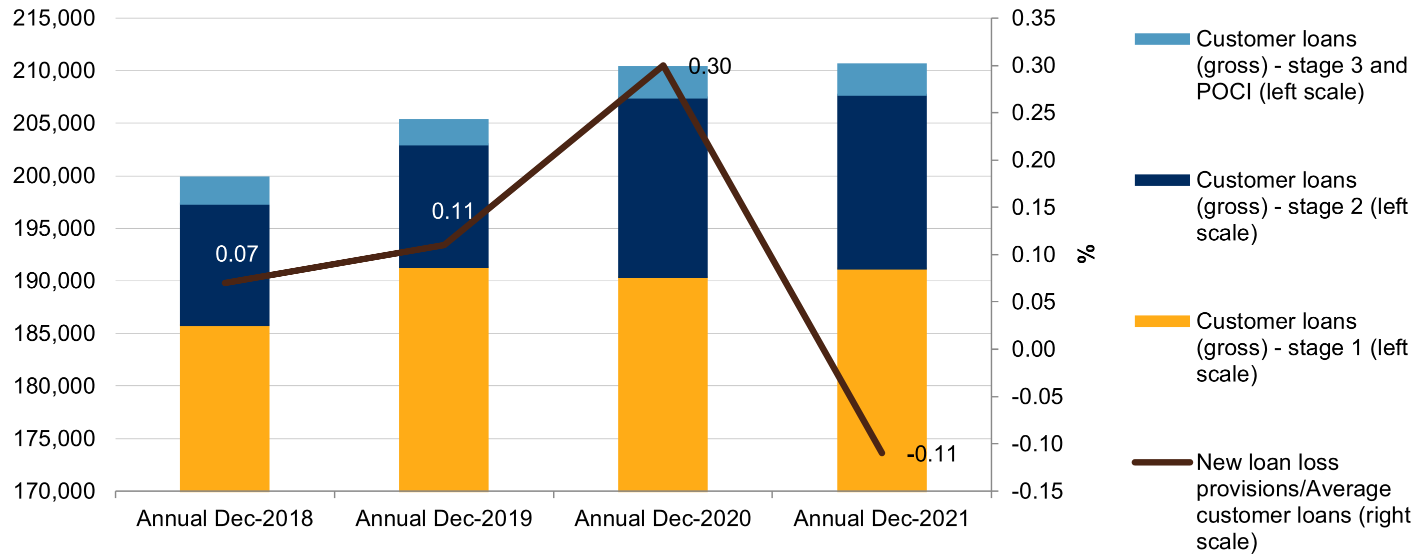


Source: S&P Global Ratings.

SanUK's narrow business franchise has led to consistently better credit quality and losses than U.K. peers. Its mortgage-centric book and narrow, high-quality consumer unsecured and corporate businesses have proved resilient throughout the pandemic (chart 2). Loss rates peaked at about 30 bps of gross loans in 2020, which was well below our estimated systemwide cost of risk of around 70 basis points. After this sharply weaker but relatively resilient performance, impairments have improved dramatically in 2021 for the group, with a provision release of £230 million for the full year. This was mostly driven by the improving U.K. economic outlook, responsible for £170 million of the release. The vast majority of the remainder was from the group's post model adjustment (PMA), where the release totaled around £53 million. A PMA is an additional loan loss provision most U.K. financial institutions put in place during the pandemic to manage the rapidly evolving economic environment and to manage provisions on balance sheet at a level over and above the outputs from their International Financial Reporting Standard 9 models. Importantly for SanUK, a PMA of £236 million remains as of December 2021 a portion of which is highly likely to remain through the next economic cycle. This implies, then, that further net provision releases are unlikely but that a gradual PMA normalization will keep impairment charges low in 2022. These evolutions in the balance sheet should see the group's loan-book staging return toward pre-pandemic levels.

Chart 2

SanUK's Staging Has Begun To Normalise, But Stage 2 Remains Elevated (For Now)

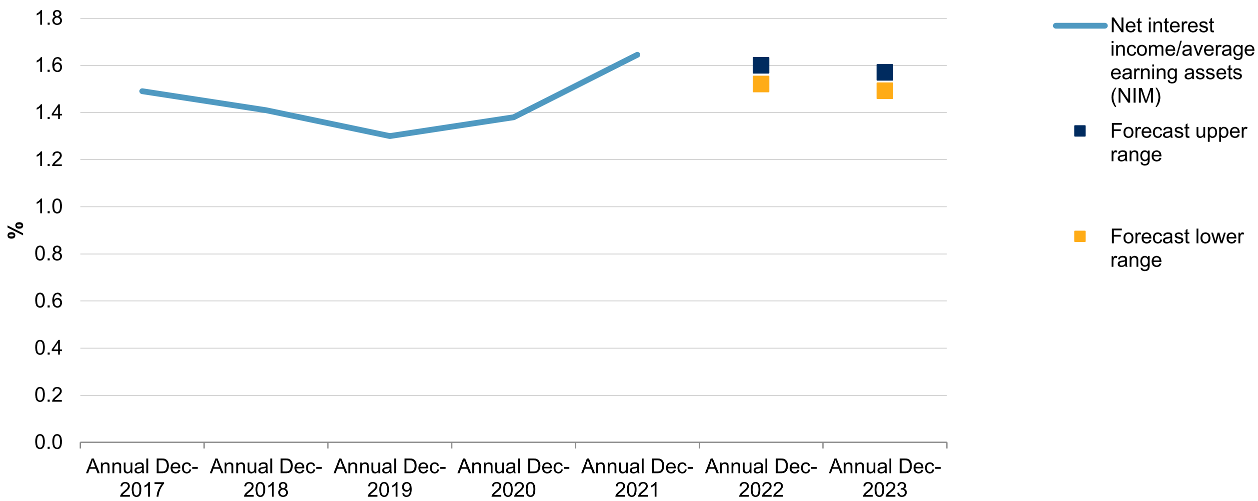


Source: S&P Global Ratings.

After good margins in 2021, SanUK faces rising competition and tight new mortgage pricing in 2022. During most of 2020 and 2021, the U.K. mortgage market wrote new mortgage business at significantly elevated margins well above the five-year average. Throughout the third and fourth quarters of 2021, though, new business margins tightened considerably, led by sharp mortgage competition. Even as swap rates widened through September and October and the first Bank of England base rate hikes loomed, margins tightened. That said, in its fourth-quarter trading update the group signalled net interest income upside of £89 million in 2022 from an increase in the bank base rate of 25 basis points--driven by the sensitivity of its net interest margin to the managed margin on customer balances. We would assume this upside to grow slightly in 2023 as the group's rolling structural hedge is reinvested at a higher return on top of product re-pricing. Together, our base case for the group's net interest margin is a modest tightening balancing sharp U.K. mortgage competition against the more gradual effects of interest rate changes on SanUK's balance sheet (see chart 3).

Chart 3

2021's Good Net Interest Margins Look Set To Tighten

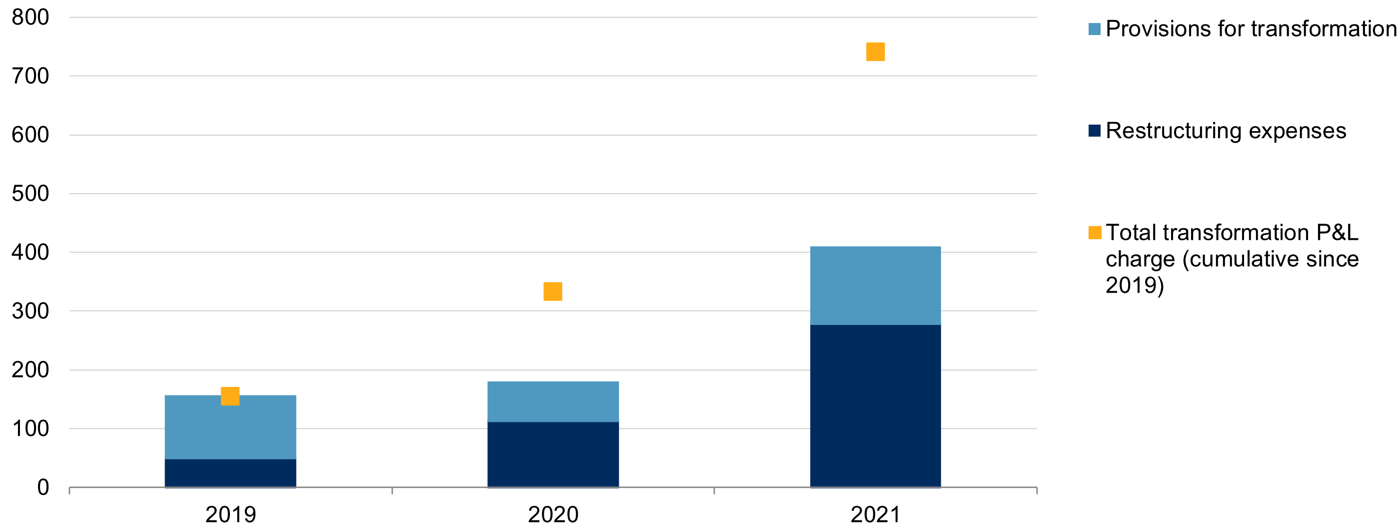


Source: S&P Global Ratings.

SanUK has focused intensely on its transformation program over the past 36 months and we expect this to support earnings in 2022, even at a lower margin. To date the group has invested around £740 million to achieve £480 million of run-rate savings (chart 4). These initiatives have translated into an underlying cost-to-income ratio of 50% for full-year 2021. We expect this to deteriorate modestly in 2022 as the group's top line comes under pressure while cost is kept under control, even as inflationary pressures bite.

Chart 4

SanUK's Transformation Program Has Absorbed Earnings, But Promises Decent Returns From 2022



Source: S&P Global Ratings.

The pressurized but relatively resilient income outlook for SanUK, and its improved cost control, lead us to forecast profit before tax of more than £1.5 billion for fiscal 2022. This indicates SanUK's resilience through the economic cycle and in the face of aggressive competition.

With its stabilizing earnings profile, low RWA density, and good risk profile, SanUK's capital position is at the upper end of our assessment. Coming into 2021 SanUK's RAC ratio sat at 9.7%, close to the 10% threshold for a stronger assessment (table 1). That said, with S&P Global Ratings-estimated RWA growth for 2021 of about 1%, and flat total adjusted capital after a £1.3 billion dividend for the year, we expect some attrition in this ratio to around 9.5% for year-end 2021--a solid level. Despite being slightly lower year-on-year, our forecasted earnings for the group should see the RAC ratio build back toward the 10% threshold over the next two-to-three years. When combined with its low, manageable, and sustainable risk profile, our combined capital and earnings and risk position are a stable support for our ratings on SanUK.

Santander UK Group Holdings PLC--Key Ratios And Forecasts

	--Fiscal year ended Dec. 31--				
(%)	**2019a**	**2020a**	**2021e**	**2022f**	**2023f**
Growth in operating revenue	(8.2)	(5.1)	14.9	(2.9)-(3.6)	1.5-1.8
Growth in customer loans	2.9	2.5	(1.8)	1.8-2.2	0.9-1.1
Growth in total assets	(0.3)	3.7	(2.6)	1.6-1.9	0.9-1.1
Net interest income/average earning assets (NIM)	1.3	1.4	1.7	1.5-1.7	1.5-1.7
Cost to income ratio	62.7	64.7	55.9	54.0-56.8	51.6-54.2

Santander UK Group Holdings PLC--Key Ratios And Forecasts (cont.)					
	--Fiscal year ended Dec. 31--				
(%)	**2019a**	**2020a**	**2021e**	**2022f**	**2023f**
Return on average common equity	3.6	1.6	8.8	7.0-7.8	7.8-8.6
Return on assets	0.2	0.1	0.5	0.4-0.5	0.4-0.5
New loan loss provisions/average customer loans	0.1	0.3	(0.1)	0.1-0.1	0.1-0.1
Gross nonperforming assets/customer loans	1.7	2.0	2.2	2.1-2.3	2.0-2.2
Net charge-offs/average customer loans	0.2	0.2	0.1	0.1-0.1	0.1-0.1
Risk-adjusted capital ratio	9.5	9.7	9.5	9.4-9.9	9.7-10.2

All figures are S&P Global Ratings-adjusted. a--Actual. e--Estimate. f--Forecast. NIM--Net interest margin.

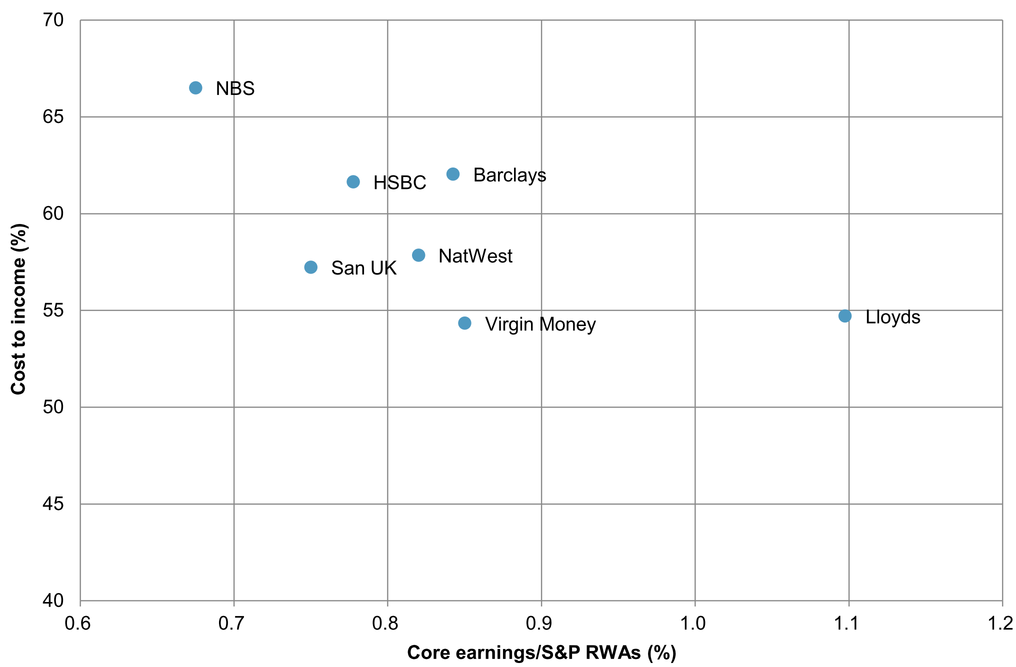
SanUK's deposit base has grown throughout the pandemic, boosting its funding and liquidity position. As with many U.K. and European peers, SanUK has seen unprecedented growth in its deposit base in the past 18 months. Since December 2019, the group's deposit base has grown from £193 billion of total deposit funding to around £212 billion as of the half year to June 2021, the last period for which granular deposit information is available. While we expect some evolution in deposits over the next 24 months as consumer and business behavior normalizes, when we combine the strong deposit base and the group's long-term wholesale funding, SanUK's stable funding ratio is at 107% at June 30, 2021--above the multiyear average and an improvement of 6 percentage points from December 2019.

A robust franchise, tight cost control, and a resilient earnings outlook underpin our 'A' issuer credit rating. We believe SanUK is well positioned at the 'A' issuer credit rating level, and that its combined franchise, underwriting discipline, cost control, and resilient earnings outlook position it well among domestic and European peers (chart 5).

SanUK's closest U.K. peer is Nationwide Building Society (NBS). The core of NBS' franchise is its prime mortgage business in which it represents around 14% of the market, which is complemented by a modest commercial lending book that remains in managed run-off. On balance, NBS' narrower, if somewhat stronger (by scale) strategic profile in the U.K. banking market is a broadly neutral point of peer comparison vis-à-vis SanUK. The primary rating differentiator is the significant excess capital at NBS. With our forecasted RAC ratio for NBS in excess of 12% in the next 24 months, our view of its capital is notably stronger than for SanUK. That said, SanUK is on the threshold of a stronger assessment and this could be a point of rating upside in the medium term. Furthermore, it operates with a similar ratio of core earnings to RWA, and with a lower cost-to-income ratio, supporting our broadly favorable view of its capital position.

Chart 5

SanUK's Profitability And Cost Control Are Well Positioned Against UK Peers



Source: S&P Global Ratings. Chart depicts average metrics from 2020a-2023f. For NBS (April balance sheet date) and Virgin Money (Sept.), 2021 reflects actuals. For other peers (December) 2021 is a forecast. CTI--Cost to income. S&P RWAs--Risk-weighted assets under S&P Global Ratings' framework.

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. Although SanUK has experienced less severe conduct and litigation charges than peers in recent times, the group's core businesses remain exposed to conduct and compliance risk. 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 digital transformation of the group accelerates so do risks relating to cyber security, operational resilience, and financial crime.

Key Statistics

Table 1

Santander UK Group Holdings PLC--Key Figures

	--Year ended Dec. 31--				
(Mil. £)	**2021***	**2020**	**2019**	**2018**	**2017**
Adjusted assets	290,218.0	297,415.0	286,712.0	287,567.0	313,018.0
Customer loans (gross)	212,942.0	214,094.0	208,879.0	202,952.0	208,838.0
Adjusted common equity	11,730.0	11,045.0	11,055.0	11,027.0	11,456.0
Operating revenues	2,141.0	3,958.0	4,170.0	4,543.0	4,864.0
Noninterest expenses	1,341.0	2,561.0	2,613.0	2,632.0	2,595.0
Core earnings	551.0	417.7	794.3	1,072.6	1,256.2

* figures as of H1 2021.

Table 2

Santander UK Group Holdings PLC--Business Position

	--Year ended Dec. 31--				
(%)	**2021***	**2020**	**2019**	**2018**	**2017**
Total revenues from business line (mil. £)	2,236.0	3,958.0	4,170.0	4,543.0	4,912.0
Commercial banking/total revenues from business line	11.4	14.7	14.7	18.2	9.5
Retail banking/total revenues from business line	86.5	87.9	85.7	82.9	79.7
Commercial and retail banking/total revenues from business line	97.9	102.6	100.4	101.0	89.3
Trading and sales income/total revenues from business line	N/A	N/A	N/A	N/A	8.9
Other revenues/total revenues from business line	2.1	(2.6)	(0.4)	(1.0)	1.8
Investment banking/total revenues from business line	N/A	N/A	N/A	N/A	8.9
Return on average common equity	6.4	1.6	3.6	6.5	7.5

*figures as of H1 2021. N/A--Not applicable.

Table 3

Santander UK Group Holdings PLC--Capital And Earnings

	--Year ended Dec. 31--				
(%)	**2021***	**2020**	**2019**	**2018**	**2017**
Tier 1 capital ratio	18.7	18.6	17.9	16.2	15.0
S&P Global Ratings' RAC ratio before diversification	N/A	9.7	9.5	9.4	9.3
S&P Global Ratings' RAC ratio after diversification	N/A	8.9	8.8	8.9	8.9
Adjusted common equity/total adjusted capital	84.3	83.1	83.1	84.3	84.8
Double leverage	N/A	100.3	100.3	100.7	100.0
Net interest income/operating revenues	90.1	86.8	79.0	79.4	78.2
Fee income/operating revenues	6.9	9.7	16.5	16.5	16.6
Market-sensitive income/operating revenues	0.0	1.9	0.6	2.8	3.6
Cost-to-income ratio	62.6	64.7	62.7	57.9	53.4
Preprovision operating income/average assets	0.5	0.5	0.5	0.6	0.7

Table 3

Santander UK Group Holdings PLC--Capital And Earnings (cont.)					
	--Year ended Dec. 31--				
(%)	2021*	2020	2019	2018	2017
Core earnings/average managed assets	0.4	0.1	0.3	0.4	0.4

*figures as of H1 2021. N/A--Not applicable. RAC--Risk adjusted capital.

Table 4

Santander UK Group Holdings PLC--Risk-Adjusted Capital Framework Data					
(Mil. £)	Exposure*	Basel III RWA	Average Basel III RW(%)	S&P Global Ratings RWA	Average S&P Global Ratings RW (%)
Credit risk					
Government & central banks	55,500.0	0.0	0.0	371.0	1.0
Of which regional governments and local authorities	0.0	0.0	0.0	0.0	0.0
Institutions and CCPs	4,665.0	500.0	11.0	832.0	18.0
Corporate	28,900.0	17,600.0	61.0	33,491.0	116.0
Retail	197,600.0	41,900.0	21.0	83,603.0	42.0
Of which mortgage	179,500.0	30,700.0	17.0	65,571.0	37.0
Securitization§	3,431.0	1,038.0	30.0	956.0	28.0
Other assets†	6,609.0	4,100.0	62.0	8,661.0	131.0
Total credit risk	296,705.0	65,138.0	22.0	127,914.0	43.0
Credit valuation adjustment					
Total credit valuation adjustment	--	300.0	--	0.0	--
Market risk					
Equity in the banking book	200.0	600.0	300.0	1,500.0	750.0
Trading book market risk	--	200.0	--	300.0	--
Total market risk	--	800.0	--	1,800.0	--
Operational risk					
Total operational risk	--	6,800.0	--	7,749.0	--
	Exposure	**Basel III RWA**	**Average Basel II RW (%)**	**S&P Global Ratings RWA**	**% of S&P Global Ratings RWA**
Diversification adjustments					
RWA before diversification	--	73,038.0	--	137,462.0	100.0
Total diversification/ concentration adjustments	--	--	--	11,538.0	8.0
RWA after diversification	--	73,038.0	--	149,000.0	108.0
		Tier 1 capital	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global Ratings RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		13,531.0	18.5	13,286.0	9.7
Capital ratio after adjustments‡		13,531.0	18.6	13,286.0	8.9

Table 4

Santander UK Group Holdings PLC--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, 2020, S&P Global Ratings.

Table 5

Santander UK Group Holdings PLC--Risk Position

	--Year ended Dec. 31--				
(%)	**2021***	**2020**	**2019**	**2018**	**2017**
Growth in customer loans	(1.1)	2.5	2.9	(2.8)	2.0
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	8.4	7.2	4.8	4.5
Total managed assets/adjusted common equity (x)	24.9	27.1	26.1	26.2	27.5
New loan loss provisions/average customer loans	(0.1)	0.3	0.1	0.1	0.1
Net charge-offs/average customer loans	0.1	0.2	0.2	0.2	0.1
Gross nonperforming assets/customer loans + other real estate owned	1.4	2.0	1.7	1.8	1.9
Loan loss reserves/gross nonperforming assets	39.4	30.7	21.8	20.7	23.6

*figures as of H1 2021. N/A--Not applicable. RWA--Risk weighted assets.

Table 6

Santander UK Group Holdings PLC--Funding And Liquidity

	--Year ended Dec. 31--				
(%)	**2021***	**2020**	**2019**	**2018**	**2017**
Core deposits/funding base	72.0	69.5	66.5	64.7	63.8
Customer loans (net)/customer deposits	110.4	110.2	116.2	116.4	117.5
Long-term funding ratio	87.6	86.4	84.0	87.7	82.2
Stable funding ratio	106.9	108.6	102.6	108.2	105.9
Short-term wholesale funding/funding base	13.1	14.3	16.9	13.0	18.7
Broad liquid assets/short-term wholesale funding (x)	1.7	1.6	1.2	1.6	1.3
Net broad liquid assets/short-term customer deposits	13.0	12.5	4.6	12.2	9.8
Short-term wholesale funding/total wholesale funding	45.5	45.5	49.2	35.9	50.5
Narrow liquid assets/3-month wholesale funding (x)	N/A	N/A	N/A	N/A	1.7

*figures as of H1 2021. N/A--Not applicable.

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, July 1, 2019

- 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
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings Detail (As Of March 2, 2022)*	
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+
Related Entities	
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
Senior Unsecured	A-1
Short-Term Debt	A-1
Subordinated	BBB-

*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.