FitchRatings

Banks
Bank Holding Companies
United Kingdom

Santander UK Group Holdings plc

Ratings

Santander UK Group Holdings plc
Foreign Currency

Long-Term IDR	A
Short-Term IDR	F1
Viability Rating	a
Support Rating	2

Santander UK plc
Foreign Currency

Long-Term IDR	A+
Short-Term IDR	F1
Derivative Counterparty Rating	A+(dcr)
Viability Rating	a
Support Rating	2

Santander Financial Services plc

Long-Term IDR	A
Short-Term IDR	F1
Support Rating	1

Sovereign Risk
Foreign Currency

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

Watches

Long-Term IDR	RWN
Sovereign Long-Term Foreign-Currency IDR	RWN
Sovereign Long-Term Local-Currency IDR	RWN

Related Research

Santander UK Group Holdings - Ratings Navigator (October 2019)

Fitch Maintains Santander UK Group's 'A' IDR on RWN; Affirms VR (September 2019)

Major UK Banks Prepared for Brexit Challenges Ahead (October 2019)

Applicable Criteria

Bank Rating Criteria (October 2018)

Short-Term Ratings Criteria (May 2019)

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Key Rating Drivers

Standalone Strength Drives IDRs: Santander UK Group Holdings plc's (SGH) Viability Rating (VR) drives its ratings and reflects the group's conservative risk appetite, moderate impaired loans, a solid retail banking franchise, adequate capitalisation, and a stable funding and liquidity profile. It also considers a less diversified business model, slightly weaker profitability metrics than similarly rated peers and above-average leverage.

Healthy Asset Quality: Asset quality has held up well despite economic uncertainty, aided by low interest rates and low unemployment in the UK. Impaired loans (Stage 3 under IFRS 9) represented a modest 1.2% of customer loans at end-3Q19 (including undrawn Stage 3 exposures) while credit losses were a low 9bp of gross loans. Fitch Ratings believes these are at cyclical lows and expects some deterioration if the UK economic environment deteriorates and affordability of the highly indebted UK household weakens.

Profitability Is under Pressure: Profitability remains adequate, despite pressure on earnings from intense competition in the UK mortgage market and heightened costs caused by a multi-year investment plan. Fitch expects performance to continue to be under pressure, particularly if risks to the domestic economy from Brexit crystallise.

Capitalisation Commensurate with Risk Profile: Capitalisation is broadly commensurate with SGH's risk profile. The group's fully loaded common equity Tier 1 (CET1) ratio improved in 9M19 to 13.9%, supported by sound internal capital generation and modest loan growth. SGH's reported Basel leverage ratio was 4.3% at end-3Q19, towards the lower end of the peer group.

Core Retail Deposit Base: The group's funding profile is stable and is supported by a granular core retail deposit base and good access to long-term wholesale funding markets. Liquidity is well managed, and the group's liquidity coverage ratio was a healthy 148% at end-3Q19.

High Probability of Parental Support: Fitch believes that SGH's parent, Banco Santander, S.A. (A-/Stable), has a strong propensity to support its UK subsidiaries given their strategic importance and the high reputational risk it would face in case of a default by its UK subsidiaries. However, its ability to provide support is constrained by the subsidiaries' large size relative to its own equity.

Operating Bank's IDR above VR: The Long-Term Issuer Default Rating (IDR) of SGH's main operating bank, Santander UK plc (San UK), is notched up once from its VR. This is due to the presence of a buffer of qualifying junior debt and eligible holding company senior debt, which could be made available to protect San UK senior debt from default in case of failure.

Rating Sensitivities

Brexit Is Main Sensitivity: The ratings are primarily sensitive to how the UK leaves the EU and how this affects the economic outlook. A "no-deal" Brexit would heighten the probability of a negative rating action, most likely with a Negative Outlook assigned reflecting risks to earnings, asset quality and strategic execution.

VR Upgrade Unlikely: Upside for SGH's VR is limited in the medium term unless the group shows a sustainable improvement in earnings with further diversification of its business model while maintaining its modest risk appetite. We believe this would take time to achieve.

Debt Rating Classes

Santander UK Group Holdings plc Debt Ratings

Rating level	Rating
Long-term senior unsecured debt, including programmes	A
Short-term senior unsecured debt, including programmes	F1
Tier 2 subordinated debt	A-
Additional Tier 1 capital securities	BB+

Source: Fitch Ratings

Santander UK plc

Rating level	Rating
Long-term senior unsecured debt, including programmes	A+
Short-term senior unsecured debt, including programmes	F1
Tier 2 subordinated debt, including programmes	A-
Legacy upper Tier 2 debt	BBB
Non-innovative Tier 1 debt	BBB-

Source: Fitch Ratings

Santander Financial Services plc

Rating level	Rating
Short-term senior unsecured programmes	F1

Source: Fitch Ratings

Ratings Navigator

Santander UK Group Holdings plc

ESG Relevance:

Banks
Ratings Navigator

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

Navigator Peer Comparison

UK large banks	Operating Environment	Company Profile	Management & Strategy	Risk Appetite	Asset Quality	Earnings & Profitability	Capitalisation & Leverage	Funding & Liquidity	Viability Rating
Santander UK Group Holdings plc	aa-	a	a+	a	a	a-	a	a	a
Lloyds Banking Group plc	aa-	a+	a+	a	a	a	a	a	a
The Royal Bank of Scotland Group plc	aa-	a	a	a	a-	a-	a+	a	a
Nationwide Building Society	aa-	a-	a	a	a	bbb+	a-	a	a

Source: Fitch Ratings

Significant Changes

Brexit-Driven Uncertainty

SGH is domiciled in the UK (AA/RWN) and is domestically focused. Fitch's 'aa-' operating environment score reflects the UK's high income levels and limited structural weaknesses. GDP per capita, one of the two core metrics used in Fitch's *Bank Rating Criteria* to derive the implied operating environment score, indicates high levels of corporate earnings and household income, and the UK's high Ease of Doing Business ranking shows a transparent and stable corporate sector.

The negative trend on the operating environment score reflects the possible negative economic impact from the UK's exit from the EU combined with the high indebtedness of the UK private sector. Although the negative trend was first assigned in June 2016, when the UK's Long-Term IDR was downgraded by one notch to 'AA' and a Negative Outlook assigned to the sovereign rating, Fitch placed the RWN on the group's Long-Term IDR in March 2019, when we concluded that there was an increased likelihood of a disruptive exit from the EU.

Fitch believes that a no-deal Brexit cannot be excluded until the withdrawal agreement (WA) is approved and ratified by the UK parliament, and the WA bill enacted. Trade "cliff edge" risks would linger until a new UK-EU relationship is negotiated. Brexit is key to resolving the UK's and SGH's RWN.

Recent data revisions suggest the growth impact of Brexit uncertainty was less severe than previously thought, but we believe underlying economic momentum remains fragile. The table opposite provides Fitch's estimated growth under both a deal and a no-deal Brexit.

UK – Economic Forecasts

(%)	2018	2019f	2020f	2021f
Real GDP growth (base forecast[a])	1.4	1.1	1.2	1.7
Real GDP growth under no-deal Brexit	1.4	0.7	-1.5	1.8
Unemployment rate (base forecast[a])	4.1	4	4.3	4.4

[a] Base forecast assumes a no-deal Brexit is avoided
Source: Fitch Ratings, September 2019 Fitch Global Economic Outlook

Multi-Year Investment Programme

At the beginning on 2019, SGH began a multi-year investment in a strategic transformation programme, aimed at improving profitability, achieving operational efficiencies, enhancing the customer experience and strengthening the bank's competitive position. As part of this, management is targeting a medium-term cost/income ratio of about 50% and a return on tangible equity of 9%-11%. The programme reflects challenges facing UK banks, such as the low interest rate environment, an increasingly competitive UK retail banking sector and rising regulatory costs.

The programme includes significant investment in digitalisation and a restructuring of the bank's branch network and corporate division. GBP127 million was spent in 9M19, largely on restructuring the branch network and actions to reshape its corporate business, with a total of GBP400 million of investments (including 9M19) planned before the end of 2021. Costs are likely to remain elevated in the near term although if executed as planned, management expects to achieve a two to three-year payback on its investment, offsetting revenue pressures.

Company Summary and Key Qualitative Assessment Factors

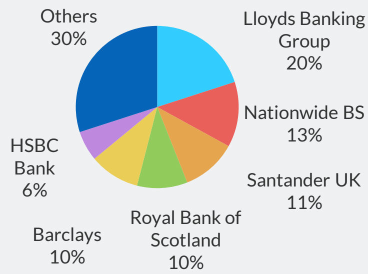
Solid UK Retail Franchise

SGH's UK retail franchise is well-entrenched with solid market shares in retail current accounts and mortgages. SGH is the third-largest mortgage provider with an 11% share of the UK market, although pricing power is constrained by a highly competitive sector, exacerbated by the recent influx of lending capacity from ring-fenced banks. It also reflects a reliance on intermediary channels – a typical characteristic for UK mortgage lenders – and a fairly standardised product range. The group has built up a healthy market share in current accounts over several years through its '123' account, resulting in a stable funding base.

SGH's competitive position and market share in the business banking and corporate lending segments lag that of its large UK peers. This is partly due to ring-fencing – SGH transferred a large part of its corporate and institutional business to its Spanish parent. However, expanding its retail, SME and mid-corporate businesses within the scope of its ring-fence is a key area for the group and is being supported by an acceleration of IT and digital investments and a continuation of its loyalty-based strategy, underpinned by the bank's '123' product range.

UK Mortgage Market Share

End-2018



Source: Fitch Ratings, UK Finance

Low-Risk, Stable Business Model

SGH's business model is stable and low-risk supported by a focus on retail banking, which generates the majority of the group's earnings and profits. Although diversified by product, SGH's business model is not as broad as larger UK competitors reflecting smaller contributions from corporate banking and capital-light activities (e.g. wealth management and insurance).

On the retail asset side, SGH offers residential owner-occupied and buy-to-let (BTL) mortgages in addition to small business banking, motor finance, unsecured personal loans and credit cards. On the liability side, there is a wide range of retail current and savings accounts. The corporate and commercial banking division serves the group's larger SMEs, medium-sized businesses and larger corporates with an increasing focus on businesses with international trade ambitions in high growth sectors where the bank can leverage the global footprint of its parent.

SGH – Single Point of Entry Resolution Group

SGH's ultimate parent, Banco Santander, is subject to a multiple point of entry resolution plan with SGH and its subsidiaries being a single point of entry resolution group. SGH is the holding company of San UK and Santander Financial Services plc (SFS, formerly Abbey National Treasury Services plc) and acts as the UK sub-group's issuing entity for loss-absorbing capital, facilitating a single point of entry resolution approach, which is in line with the UK Prudential Regulatory Authority's preferences.

The 'wide' ring-fenced model adopted by SGH resulted in only a small proportion (about 10%) of risk-weighted assets (RWAs) sitting outside of the ring-fenced San UK, commensurate with SGH's largely retail-focused business model. Its derivatives business with financial institutions and US branches have been transferred to Banco Santander; the wealth management businesses and branches in the Crown Dependencies were transferred to SFS. The longer-term role of SFS is being worked through.

Strategic Objectives Support Parent's Objectives

SGH's strategy is to develop its SME and corporate franchises with a view to broadening the diversification of the business model. This is supported by the international footprint of the Santander group, enabling SGH to target clients with services to support their expansion globally, in particular through the establishment of targeted trade corridors. The bank is also seeking to increase the loyalty of its retail customer base — building on the success of its '123' proposition — by deepening the wallet of each customer through cross-selling and investments in digital as part of its transformation programme.

Strong Execution Record

SGH has a good record of executing on its strategic objectives with resilient performance through the cycle, particularly with respect to asset quality. The bank has achieved notable success in growing its '123' current account, resulting in a more stable and cost-effective funding base and enabling it to compete effectively with larger peers. Progress in diversifying the business model has not been as strong as anticipated due to competitive pressures and the implementation of ring-fencing legislation in the UK.

Lower Appetite for Higher-Risk Segments

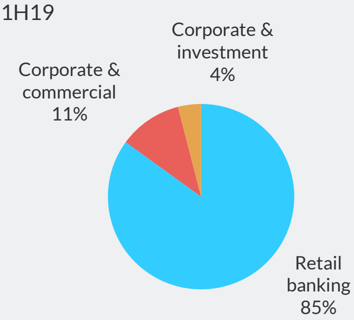
SGH's risk appetite is conservative underpinned by a lower appetite for more cyclical segments of the retail and corporate banking sector. This is reflected in consistently stable asset quality and lower earnings volatility compared to peers'. Growth has been restrained in recent years (average loan growth of just 0.2% a year between 2016 and 1H19 (annualised)).

Lending is focused on low-risk prime, owner-occupied mortgages with low loan-to-value (LTV) ratios while exposure to higher-risk sectors, such as BTL, commercial real estate (CRE) and unsecured consumer credit, is lower than similarly rated peers.

SGH's CRE exposure (in absolute terms) is being managed down steadily (end-1H19: GBP5.8 billion; end-2018: GBP6.2 billion; end-2017: GBP7.9 billion) in light of an uncertain operating environment and a focus on risk-adjusted returns. BTL volumes are increasing (end-1H19: GBP8.9 billion; end-2018: GBP8.3 billion) although they represent a modest share of the

Income Breakdown

1H19



Source: Fitch Ratings, SGH

mortgage book (6%) and are conservatively underwritten (average LTV of 65% in 1H19) with a focus on non-professional landlords with small property portfolios.

Lending to SME and corporate clients is supported by the use of covenants (financial and non-financial) to support a customer's creditworthiness. Most loans to large corporates are unsecured although they are typically to good-quality borrowers with larger exposures reported regularly to the board risk committee.

Auto finance loans (4%) are provided through Santander Consumer (UK) plc, part of SGH's retail banking segment, which offers a range of products for the purchase of new and used vehicles. Residual value risk is the main risk for auto finance. Personal contract purchase (about 45% of the auto finance portfolio) contracts are underwritten based on 85% of the indexed value of the vehicle, providing a cushion should residual values decline.

Appetite for unsecured consumer credit is more limited relative to peers (end-1H19: 3% of customer loans) split between personal loans, credit cards and overdrafts. Credit cards are typically issued to good quality customers who tend to use them for transactional ease rather than as a loan. The unsecured portfolio is performing well supported by internal, credit reference agency and application data as part of the underwriting process.

Reduced Market Risk Exposure Following Ring-Fence Transfers

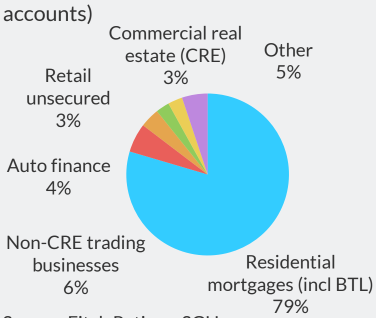
Following the implementation of ring-fencing rules, SGH's exposure to market risk has reduced significantly and represented just 0.4% of RWAs at end-3Q19.

Net interest margin sensitivity to a downward shift in the yield curve is manageable and has reduced recently, partly driven by balance-sheet management actions to manage the net structural position.

SGH operates mainly in British pounds, so it does not have significant foreign-exchange (FX) exposures. The only exception is wholesale funding raised in foreign currencies — primarily the US dollar and the euro. Funding raised in foreign currencies is converted into pounds through currency swaps in order to mitigate this FX risk.

Loan Book Split

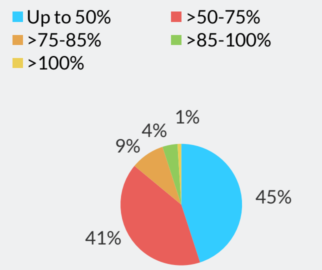
End-1H19 (GBP200.6bn based on SGH accounts)



Source: Fitch Ratings, SGH

Mortgage Stock LTVs

End-1H19



Source: Fitch Ratings, SGH

Summary Financials and Key Ratios

	30 Jun 19 6 months - interim (GBPm) reviewed - unqualified	31 Dec 18 year end (GBPm) audited - unqualified	31 Dec 17 year end (GBPm) audited - unqualified	31 Dec 16 year end (GBPm) audited - unqualified
Summary income statement				
Net interest and dividend income	1,671.0	3,606.0	3,803.0	3,582.0
Net fees and commissions	335.0	749.0	807.0	770.0
Other operating income	111.0	188.0	302.0	324.0
Total operating income	2,117.0	4,543.0	4,912.0	4,676.0
Operating costs	1,403.0	2,823.0	2,786.0	2,670.0
Pre-impairment operating profit	714.0	1,720.0	2,126.0	2,006.0
Loan and other impairment charges	69.0	153.0	203.0	67.0
Operating profit	645.0	1,567.0	1,923.0	1,939.0
Other non-operating items (net)	-70.0	n.a.	-109.0	-25.0
Tax	164.0	446.0	560.0	597.0
Net income	411.0	1,121.0	1,254.0	1,317.0
Other comprehensive income	-2.0	399.0	-322.0	-185.0
Fitch comprehensive income	409.0	1,520.0	932.0	1,132.0
Summary balance sheet				
Gross loans	203,556.0	202,439.0	200,350.0	200,722.0
- Of which impaired	2,472.0	2,491.0	1,300.0	1,400.0
Loan-loss allowances	830.0	820.0	1,018.0	989.0
Net loans	202,726.0	201,619.0	199,332.0	199,733.0
Interbank	2,966.0	3,515.0	3,466.0	2,890.0
Derivatives	5,498.0	5,321.0	19,942.0	26,569.0
Other securities and earning assets	44,400.0	47,882.0	52,949.0	51,164.0
Total earning assets	255,590.0	258,337.0	275,689.0	280,356.0
Cash and due from banks	25,967.0	24,180.0	32,771.0	17,107.0
Other assets	8,715.0	6,864.0	6,300.0	5,678.0
Total assets	290,272.0	289,381.0	314,760.0	303,141.0
Liabilities				
Customer deposits	176,344.0	173,692.0	177,421.0	172,224.0
Interbank and other short-term funding	34,500.0	33,975.0	44,105.0	38,227.0
Other long-term funding	54,042.0	56,032.0	49,401.0	43,126.0
Trading liabilities and derivatives	3,666.0	5,770.0	23,622.0	29,120.0
Total funding	268,552.0	269,469.0	294,549.0	282,697.0
Other liabilities	4,990.0	3,348.0	3,663.0	4,014.0
Preferential shares and hybrid capital	2,620.0	2,634.0	2,636.0	2,140.0
Total equity	14,110.0	13,930.0	13,912.0	14,290.0
Total liabilities and equity	290,272.0	289,381.0	314,760.0	303,141.0
Ratios (annualised as appropriate)				
Profitability				
Operating profit/RWAs	1.7	2.0	2.2	2.2

Summary Financials and Key Ratios (Cont.)

	30 Jun 19 6 months - interim (GBPm) reviewed - unqualified	31 Dec 18 year end (GBPm) audited - unqualified	31 Dec 17 year end (GBPm) audited - unqualified	31 Dec 16 year end (GBPm) audited - unqualified
Net interest income/average earning assets	1.4	1.5	1.5	1.5
Non-interest expense/gross revenue	66.3	62.1	56.7	57.1
Net income/average equity	5.6	7.5	8.7	9.2
Asset quality				
Impaired loans ratio	1.2	1.2	0.7	0.7
Growth in gross loans	0.6	1.0	-0.2	0.8
Loan loss allowances/impaired loans	33.6	32.9	78.3	70.6
Loan impairment charges/average gross loans	0.1	0.1	0.1	0.0
Capitalisation				
Fitch Core Capital ratio	16.4	15.4	14.0	13.7
TCE ratio	4.3	4.2	3.9	4.0
CET1 ratio	13.8	13.2	12.2	11.6
Basel leverage ratio	4.1	4.1	4.0	3.8
Net impaired loans/Fitch Core Capital	13.3	13.8	2.3	3.4
Funding & liquidity				
Loans/customer deposits	115.4	116.6	112.9	116.6
LCR	155.0	164.0	120.0	139.0
Customer deposits/funding	65.5	64.2	63.5	65.9
NSFR	n.a.	n.a.	n.a.	n.a.

Source: Fitch Ratings

Key Financial Metrics – Latest Developments

Notes on Charts

Peer charts show indicative quantitative ranges and, where applicable, implied scores for Fitch's core financial metrics corresponding with 'aa' scored operating environments. Peer average includes: Lloyds Banking Group (VR: 'a'), Nationwide Building Society (NBS; 'a'), The Royal Bank of Scotland Group plc ('a'). Where disclosure allows, we have used 9M19 data, otherwise it is 1H19. The 1H19 and 9M19 data for NBS in the charts are for the year to 4 April 2019. All other data for NBS are at year-end (i.e. its 2018 results are for the year ended 4 April 2018).

Asset Quality Holding Up Well

Asset quality continues to perform well with low levels of arrears, reflecting benign economic conditions and a low proportion of more highly cyclical exposures, such as unsecured consumer credit and CRE, compared to peers. Impaired loans (Stage 3 loans including undrawn Stage 3 exposures) were a modest 1.2% of customer loans (plus undrawn Stage 3 exposures) at end-3Q19 while credit losses were a low 9bp of gross loans. Stage 2 exposures have remained stable, accounting for 5.8% of gross loans at end-1H19 (end-2018: 5.9%) with Stage 2 expected credit losses falling slightly due to more favourable forecasts of house prices and a decline in average LTVs in the period.

In Fitch's view, SGH's mortgage book, which forms the bulk of lending (79% of total loans), is well positioned to withstand a possible moderate sustained fall in UK property prices given low average LTVs (end-1H19: 40% weighted average indexed LTV) and a moderate exposure to more cyclical BTL mortgages. Additionally, low mortgage interest rates and a stable labour market, should continue to support owner-occupiers' ability to service their debts.

Coverage of impaired loans is in line with domestic peers at around 34% at end-1H19, albeit modest by international standards reflecting the low-risk nature of SGH's lending and a highly collateralised loan book and exposing the bank to possible asset price declines.

Operating Profitability Is under Pressure

SGH's operating profit/RWAs ratio fell to 1.7% in 9M19 (2018: 2.0%) reflecting pressure on earnings from increased investment costs and strong competition in the mortgage market. Non-operating costs further suffered from increased PPI provisions. Fitch expects earnings to remain under pressure although they should benefit from the non-recurrence of ring-fencing set-up costs and low funding costs.

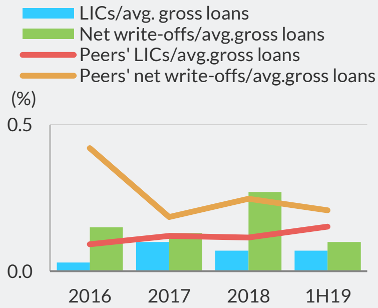
Revenue fell by 9% in 9M19 yoy driven by lower net interest income (down 9% yoy) reflecting pressure on asset yields from increased mortgage market competition, further attrition of higher-yielding back book mortgages, and subdued loan growth reflecting an uncertain macro-economic environment. Other income fell 12%, largely due to ring-fencing changes at the start of 2019. The decline in revenues was reduced by higher income from SGH's auto finance business.

Loan impairment charges (LICs) remain at cyclical lows, but are likely to rise towards normalised levels over the medium term. They absorbed 13% of pre-impairment operating profit in 9M19 (2018: 9%) and Fitch believes these will increase if the UK economic environment deteriorates and affordability pressures on highly indebted UK household increase. Nonetheless, we expect them to be manageable given SGH's prudent underwriting standards and the largely secured nature of its loan book.

In 3Q19, SGH announced a significant additional PPI provision of GBP99 million, which reflects an increase in new complaint volumes ahead of the August 2019 deadline for submitting claims. Fitch expects exceptional costs to decline now that the deadline for new PPI complaints has passed.

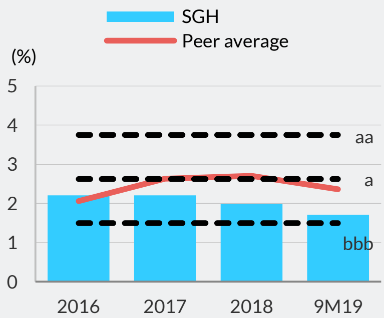
Cost efficiency (cost/income-ratio: 65% in 9M19) is higher than peers and has increased steadily over the past couple of years due to margin compression and increased costs, largely related to the group's investment programme. We expect SGH's cost/income ratio to remain elevated in the near term until the majority of investments are complete.

Loan Impairment Charges



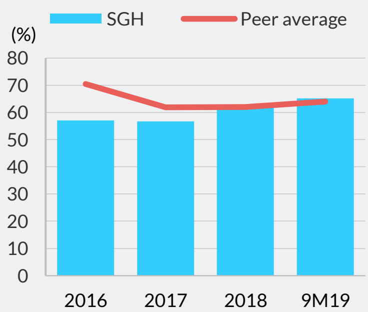
Source: Fitch Ratings, Banks

Operating Profit/RWAs



Source: Fitch Ratings, Banks

Cost/Income



Source: Fitch Ratings, Banks

Capitalisation Commensurate with Risk Profile

SGH's fully loaded CET1 ratio improved in 9M19 to 13.9% (end-2018: 13.2%), supported by sound internal capital generation, muted loan growth and reduced RWAs following the business transfer to its parent, offsetting adverse market-driven pension movements in 3Q. SGH reported a 4.3% Basel leverage ratio at end-3Q19 (end-2018: 4.1%), adequately above minimum regulatory requirements but at the lower end of the peer group.

Management is targeting a medium-term CET1 ratio of above 12%, insuring that buffers over minimum regulatory requirements remain sound. Our assessment of capitalisation also considers possible capital injections, if required, from SGH's ultimate parent, Banco Santander. SGH typically repatriates around half of its recurring profits annually to its Spanish parent although we believe that this would be reduced in case of stress.

Granular Core Retail Deposit Base

SGH's funding profile is a relative strength for the rating, due to a solid and granular core retail deposit base, proven access to the long-term wholesale funding markers and robust contingency funding plans, including access to funding from the Bank of England, if required. SGH's end-3Q19 loans/deposits ratio of 115% was at the higher end of its peer group.

Funding costs are comparable with peers supported by a large proportion of current account funding and access to cheap funding via the Bank of England's Term Funding Scheme (TFS; GBP10.8 billion of outstanding funding) and Funding for Lending Schemes (GBP1.0 billion). The bank has until 2022 to repay its TFS funding in full which we expect it to replace with a mixture of deposit and wholesale funding. Maturities are well spread and should be manageable given the proven access to the long-term wholesale markets.

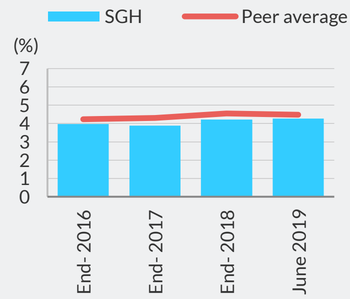
Liquidity is well managed and supported by a large pool of high quality liquid assets (GBP53.7 billion; 25% of end-1H19 customer deposits and short-term funding) with the group maintaining high levels of liquidity due to Brexit uncertainty including the pre-funding of maturing balances ahead of schedule. Regulatory ratios are healthy with a liquidity coverage ratio at end-3Q19 of 148%.

Strong Progress towards Meeting End-State MREL

SGH is subject to an indicative MREL requirement, as stated by the Bank of England, of 26.9% of RWAs by 2022 and has been required by the regulator to meet interim MREL requirements since 1 January 2019 as a subsidiary of a global systemically important bank. The UK approach requires the use of structural subordination, involving the issuance of external MREL-eligible instruments through SGH. This approach is intended to allow the group to downstream internal loss absorbing capital to its operating subsidiaries so that the bank can meet its requirements.

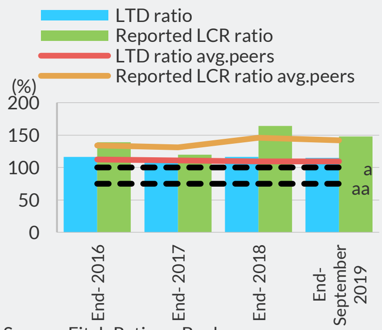
SGH has made good progress, issuing GBP9.3 billion of senior holdco issuance in up to 1H19 (12% of end-1H19 RWAs), the majority of which has been down-streamed in a subordinated manner to San UK. The bank is intending to hold an MREL recapitalisation management buffer greater than the amount of MREL that will become ineligible over the following six months. The bank expects to meet its MREL requirement by replacing San UK's maturing senior debt with new senior debt issued by SGH.

Tangible Leverage[a]



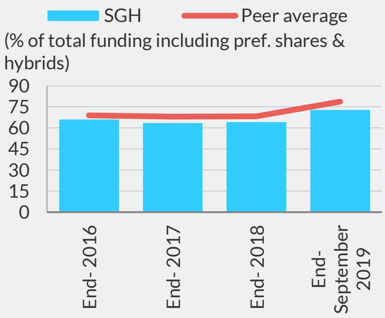
[a] Tangible equity/tangible assets
Source: Fitch Ratings, Banks

Liquidity Metrics



Source: Fitch Ratings, Banks

Customer Deposit Funding



Source: Fitch Ratings, Banks

Peer Comparison: Selected Data

Viability Rating	SGH a 30 Jun 19	SGH a 31 Dec 18	RBSG a 30 Jun 19	RBSG a 31 Dec 18	LBG a 30 Jun 19	LBG a 31 Dec 18	Nationwide a 04 Apr 19	Nationwide a 04 Apr 18
Structural indicators (GBPbn)								
Total assets	290	289	730	694	822	798	238	229
Total equity	14	14	42	42	44	44	12	11
Fitch Core Capital	12	12	33	33	29	29	11	10
Net income	0.4	1.1	2.5	2.1	2.2	4.4	0.6	0.7
Asset quality (%)								
Growth of gross loans	0.6	1.0	1.8	-5.7	-0.7	-0.7	4.0	2.3
Impaired loans/gross loans	1.2	1.2	2.3	2.5	2.2	2.1	0.9	0.5
Loss allowances/impaired loans	33.6	32.9	45.1	43.6	34.5	34.2	37.0	45.0
LICs/average gross loans	0.1	0.1	0.2	0.1	0.3	0.2	0.1	0.1
Earnings & profitability (%)								
Operating profit/RWAs	1.7	2.0	1.8	2.5	3.5	3.3	2.6	3.0
Return on equity	5.6	7.5	12.0	4.9	10.3	10.2	5.3	6.8
Cost/income	66.3	62.1	66.9	62.4	54.8	58.5	70.5	65.1
Capitalisation & leverage (%)								
FCC ratio	16.4	15.4	17.6	17.6	14.1	14.2	33.4	31.0
CET1 ratio	13.8	13.2	16.0	16.2	13.9	14.6	32.4	30.5
Net impaired loans/FCC	13.3	13.8	12.1	13.1	21.7	20.7	10.4	5.6
Basel leverage ratio	4.1	4.1	5.2	5.4	4.7	5.1	4.6	4.6
Funding & liquidity (%)								
Loans/deposits	115.4	116.6	86.8	86.0	106.4	107.5	129.7	129.8
Customer deposits/total funding	65.5	64.2	73.7	69.8	69.3	70.1	69.0	69.2
LCR	155	164	154	158	130	130	150	130

SGH: Santander UK Group Holdings plc ; RBSG: The Royal Bank of Scotland Group plc; LBG: Lloyds Banking Group; Nationwide: Nationwide Building Society
Source: Fitch Ratings, Banks

High Probability of Support from Banco Santander for UK Subsidiaries

SGH's and San UK's SRs of '2' reflect Fitch's view that their ultimate parent, Banco Santander, has a strong propensity to support both entities, but that its ability to provide support is constrained by the subsidiaries' large size relative to its own equity and by possible regulatory restrictions. The SR indicates a 'BBB+' long-term rating floor based on institutional support. Our view of the parent's strong propensity to support is primarily based on the strategic importance of the UK business to Banco Santander and the high reputational risk it would face in the case of a default by its UK subsidiaries.

Institutional Support			Value
Parent IDR			A-
Total Adjustments (notches)			-1
Institutional Support:			**BBB+**
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 ownership stake	✓		
Support track record		✓	
Subsidiary performance and prospects	✓		
Branding	✓		
Legal commitments			✓
Cross-default clauses			✓

Subsidiary Company – Santander Financial Services plc

SFS's IDRs are based on support and are equalised with those of SGH. SFS's SR of '1' reflects Fitch's view that SGH would have a strong ability and propensity to support SFS based on its role within the group and our expectation that support would be manageable for SGH given SFS's small relative size.

SFS became a direct subsidiary of SGH on 31 October 2018 as part of the Santander UK group's restructuring to comply with UK ring-fencing rules by 1 January 2019. Under the revised structure, San UK is within the ring-fence while SFS is outside the UK group's ring-fence perimeter and houses the group's branches in the Crown Dependencies (the Isle of Man and Jersey) and a small portfolio of residual assets.

Environmental, Social and Governance Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. ESG issues are credit neutral or have only a minimal credit impact on SGH, either due to their nature or the way in which they are being managed by SGH. For more information on our ESG Relevance Scores, visit www.fitchratings.com/esg.

FitchRatings **Santander UK Group Holdings plc**

Banks
Ratings Navigator

Credit-Relevant ESG Derivation

Santander UK Group Holdings plc has 5 ESG potential rating drivers

- 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.

			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	E Scale
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	Company Profile; Management & Strategy; Risk Appetite; Asset Quality	1

Social (S)

General Issues	S Score	Sector-Specific Issues	Reference	S Scale
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	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; Company Profile; Management & Strategy; Risk Appetite	4
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Company Profile; Management & Strategy	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	Company Profile; Financial Profile	1

Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference	G Scale
Management Strategy	3	Operational implementation of strategy	Management & Strategy	5
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	4
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Company Profile	3
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Management & Strategy	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 left-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 the [number of] general 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 and sub-sector ratings criteria and the General Issues and the Sector-Specific Issues have been informed with SASB's Materiality Map.

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.