FitchRatings

Banks
Bank Holding Companies
United Kingdom

Santander UK Group Holdings plc

Update

Key Rating Drivers

UK Retail and Commercial Bank: Santander UK Group Holdings plc's (SGH) ratings are based on the group's stable and low-risk business model, solid retail banking franchise, conservative risk appetite, low levels of impaired loans though recent credit cycles, adequate capitalisation and stable funding and liquidity profile. They also reflect a less diversified business mix than larger UK peers, with a relatively small non-retail franchise and limited income from fee-generating business lines, which weakens the group's profitability.

Healthy Asset Quality: SGH has observed little deterioration in asset quality to date, with a low 1.4% Stage 3 loans ratio at end-1H21. Fitch Ratings expects the ratio to increase, possibly to 2% or 3% by end-2022, based on the agency's latest forecasts for UK unemployment and GDP growth, and this would remain consistent with our current assessment of asset quality.

Resilient Profitability Expected: Lower loan impairment charges over the next two years combined with the group's ongoing cost reduction programme should support the recovery and resilience of SGH's operating profit. We expect the ratio of operating profit/risk-weighted assets to remain over 1% on average over the rating horizon.

Adequate Capitalisation: The group's common equity Tier 1 (CET1) capital ratio is expected to remain adequate on a fully-loaded basis in 2021 and 2022. Capitalisation will face some downward pressures due to regulatory effects, including the expected reversal of software intangibles treatment in 2021.

Stable Deposit Base: SGH's funding benefits from a solid and granular retail deposit base. The group has proven access to wholesale funding markets and also benefits from the potential for ordinary support from its parent, Banco Santander, S.A. (A-/Stable). Liquidity is prudently managed.

Standalone Strength Drives Ratings: In Fitch's view, SGH's parent, Banco Santander, has a strong propensity to support its UK subsidiaries given their strategic importance as well as the high reputational risk of a default. However, because Fitch's assessment results in a 'BBB+' Long-Term Issuer Default Rating (IDR) based on institutional support, SGH's IDRs are driven by its stand-alone credit profile, as reflected in its Viability Rating (VR).

Rating Sensitivities

Slower than Expected Recovery: The ratings are primarily sensitive to changes in the VR, which could be downgraded in the event of an unexpected severe setback to the economic outlook or if the financial repercussions of rising unemployment and pandemic-related economic disruptions are worse than our assumptions. A downgrade could be triggered if the Stage 3 loans ratio was expected to increase above 3% without a clear path to reduction, or if the group was unable to execute strategic targets.

Limited Upside Potential: The most likely trigger for an upgrade would be a significant increase in the diversity of its business model without significantly increasing its risk appetite and while maintaining solid capitalisation and funding.

Ratings

Foreign Currency	
Long-Term IDR	A
Short-Term IDR	F1
Viability Rating	a
Support Rating	2
Sovereign Risk	
Long-Term Foreign- and Local-Currency IDR	AA-
Country Ceiling	AAA
Outlooks	
Long-Term IDR	Stable
Sovereign Long-Term Foreign- and Local-Currency IDR	Stable

Applicable Criteria

Bank Rating Criteria (February 2020)

Related Research

Fitch Revises Santander UK Group Holdings' Outlook to Stable; Affirms at 'A' (July 2021)

Global Economic Outlook (June 2021)

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Related Issuer Ratings

Rating level	Santander UK plc	Santander Financial Services plc
Long-Term IDR	A+/Stable	A+/Stable
Short-Term IDR	F1	F1
Viability Rating	a	
Support Rating	2	1
Derivative Counterparty Rating (DCR)	A+(dcr)	

Source: Fitch Ratings

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 Santander UK plc (San UK) and Santander Financial Services plc (SFS). It acts as the UK sub-group's issuing entity for loss-absorbing capital, facilitating a single point of entry resolution approach, which is the approach preferred by the UK Prudential Regulation Authority.

The Long-Term IDR of SGH's main operating bank, San UK, is notched up once from its VR. This is because senior creditors of San UK benefit from a buffer of qualifying junior debt and eligible holding company (SGH) senior debt which could be bailed-in to protect San UK's senior debt from default in the event of failure.

The IDRs of SFS are based on support from SGH. They reflect Fitch's view that SGH has a strong ability and propensity to support SFS given this subsidiary's role within the group as well as its small size relative to SGH.

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

Debt Ratings

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

The ratings of all subordinated debt and hybrid securities issued by SGH and San UK are notched down from their VRs.

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

Legacy Tier 1 securities issued by San UK are rated four notches below San UK's VR to reflect higher 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.

Debt Rating Classes

Debt level	Rating
Santander UK Group Holdings plc	
Senior unsecured	A/F1
Subordinated Tier 2	BBB+
Additional Tier 1	BBB-
Santander UK plc	
Senior unsecured	A+/F1
Subordinated Tier 2	BBB+
Legacy upper Tier 2	BBB
Non-innovative Tier 1	BBB-
Santander Financial Services plc	
Senior unsecured	F1

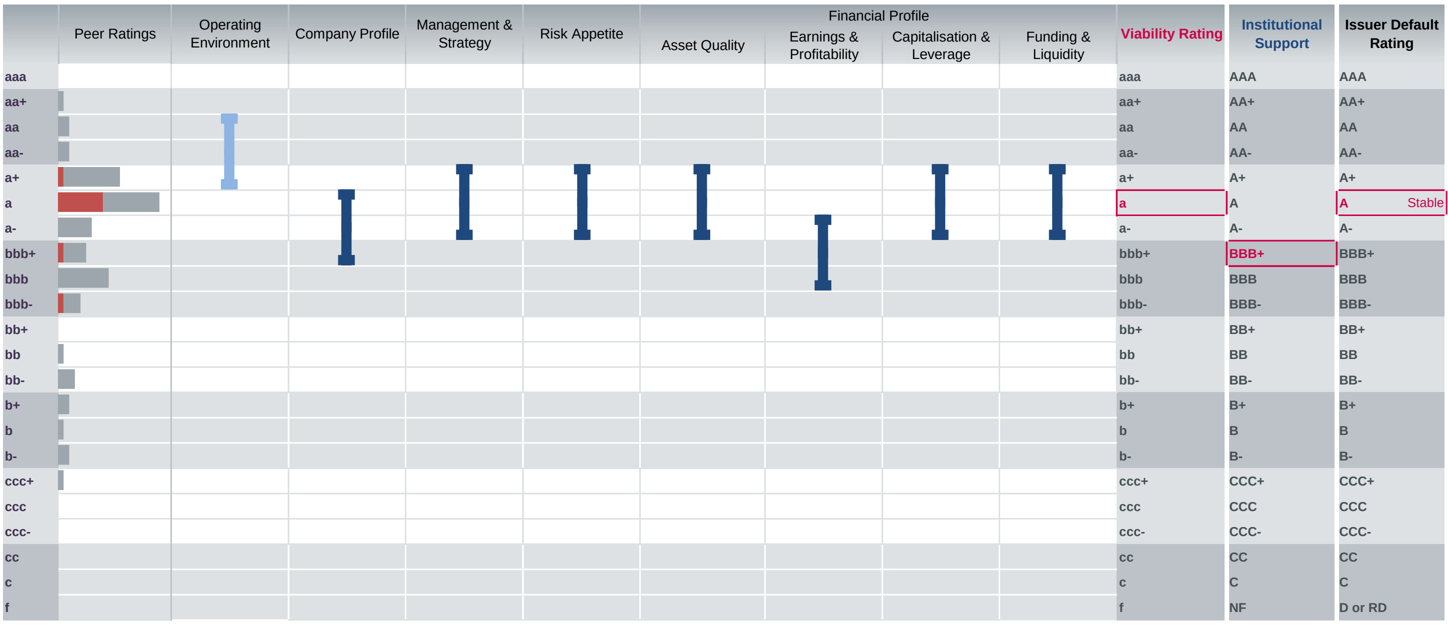
Source: Fitch Ratings

Ratings Navigator

Santander UK Group Holdings plc

ESG Relevance:

Banks Ratings Navigator



Significant Changes

UK Sovereign Rating Outlook Revised to Stable

On 18 June 2021 Fitch revised the Outlook on the UK's 'AA-' sovereign rating to Stable from Negative. The revision reflects macroeconomic, labour market and fiscal outturns since the start of 2021 which have shown the UK economy and public finances to be more resilient to the impact of the pandemic than Fitch had expected.

Outlook Revised to Stable from Negative

We have revised the Outlooks on the IDRs of SGH and its subsidiaries to Stable from Negative. This is because we believe the challenges for the UK economy from the coronavirus pandemic have subsided sufficiently to remove the negative outlook on the UK operating environment score.

Businesses have adapted better to working within economic restrictions, and the greater resilience of private consumption and investment have resulted in an upward revision of Fitch's real GDP growth forecast for 2020 and 2021 to minus 9.8% and (plus) 6.6%, respectively, with growth moderating to 5.0% in 2022. We expect the unemployment rate to average just 5.4% in 2021, supported by the extension of income and job-support schemes and the continuation of fiscal and pandemic-related loan support to businesses.

We have also revised the trends to stable from negative on our assessments of management and strategy, asset quality and earnings. The group has continued to progress with its cost-reduction programme after a short pause in its branch closures and redundancies due to the coronavirus pandemic. While net cost savings of GBP200 million by FY22 may be delayed slightly, we expect them to continue to mitigate profitability pressure. In addition, risks to asset quality have decreased since the start of the pandemic, due to a more-resilient-than expected economy as well as the strong performance of the housing market.

UK Housing Market Outlook

The UK residential mortgage market performed better than expected in 2020 and 1H21. Mortgage delinquencies remain at cyclically low levels, supported by tighter underwriting standards over the past decade, continued low interest rates and a strongly performing UK labour market. They are currently being supported by the government's job retention scheme and payment holidays, both of which are to remain in place until September.

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

Summary Financials and Key Ratios

	6 Months - Interim USDm Unaudited	30 Jun 2021 6 Months - Interim GBPm Unaudited	31 Dec 2020 Year End GBPm Audited - Unqualified	31 Dec 2019 Year End GBPm Audited - Unqualified	31 Dec 2018 Year End GBPm Audited - Unqualified	31 Dec 2017 Year End GBPm Audited - Unqualified
Summary Income Statement						
Net interest and dividend income	2,673	1,928	3,437	3,295	3,606	3,803
Net fees and commissions	n.a.	n.a.	383	689	749	807
Other operating income	394	284	138	186	188	302
Total operating income	3,066	2,212	3,958	4,170	4,543	4,912
Operating costs	2,122	1,531	2,685	2,780	2,577	2,786
Pre-impairment operating profit	944	681	1,273	1,390	1,966	2,126
Loan and other impairment charges	-97	-70	645	220	153	203
Operating profit	1,041	751	628	1,170	1,813	1,923
Other non-operating items (net)	33	24	-76	-189	-246	-109
Tax	283	204	114	272	446	560
Net income	792	571	438	709	1,121	1,254
Other comprehensive income	n.a.	n.a.	-252	-336	399	-322
Fitch comprehensive income	792	571	186	373	1,520	932
Summary Balance Sheet						
Assets						
Gross loans	294,995	212,793	214,148	208,344	202,439	200,350
- of which impaired	4,020	2,900	2,896	2,289	2,491	1,300
Loan loss allowances	1,654	1,193	1,357	846	820	1,018
Net loans	293,341	211,600	212,791	207,498	201,619	199,332
Interbank	n.a.	n.a.	2,004	2,583	3,515	3,466
Derivatives	n.a.	n.a.	3,451	3,363	5,321	19,942
Other securities and earning assets	n.a.	n.a.	30,105	41,529	47,882	52,949
Total earning assets	293,341	211,600	248,351	254,973	258,337	275,689
Cash and due from banks	n.a.	n.a.	43,537	26,395	24,180	32,771
Other assets	111,181	80,200	7,176	7,120	6,864	6,300
Total assets	404,522	291,800	299,064	288,488	289,381	314,760
Liabilities						
Customer deposits	270,328	195,000	193,088	179,006	173,692	177,421
Interbank and other short-term funding	n.a.	n.a.	42,503	38,465	33,975	44,105
Other long-term funding	78,880	56,900	40,209	47,535	56,032	49,401
Trading liabilities and derivatives	n.a.	n.a.	3,354	3,422	5,770	23,622
Total funding	349,209	251,900	279,154	268,428	269,469	294,549
Other liabilities	31,746	22,900	3,321	3,375	3,348	3,663
Preference shares and hybrid capital	n.a.	n.a.	2,820	2,820	2,634	2,636
Total equity	23,567	17,000	13,769	13,865	13,930	13,912
Total liabilities and equity	404,522	291,800	299,064	288,488	289,381	314,760
Exchange rate		USD1 = GBP0.721345	USD1 = GBP0.745156	USD1 = GBP0.76211	USD1 = GBP0.78768	USD1 = GBP0.74011

Source: Fitch Ratings, Fitch Solutions, SGH

Summary Financials and Key Ratios

	30 Jun 2021	31 Dec 2020	31 Dec 2019	31 Dec 2018	31 Dec 2017
Ratios (annualised as appropriate)					
Profitability					
Operating profit/risk-weighted assets	2.1	0.9	1.6	2.3	2.2
Net interest income/average earning assets	1.7	1.5	1.4	1.5	1.5
Non-interest expense/gross revenue	69.2	67.8	66.7	56.7	56.7
Net income/average equity	7.4	2.9	4.8	7.5	8.7
Asset quality					
Impaired loans ratio	1.4	1.4	1.1	1.2	0.7
Growth in gross loans	-0.6	2.8	2.9	1.0	-0.2
Loan loss allowances/impaired loans	41.1	46.9	37.0	32.9	78.3
Loan impairment charges/average gross loans	-0.1	0.3	0.1	0.1	0.1
Capitalisation					
Common equity Tier 1 ratio	15.5	15.2	14.3	13.2	12.2
Tangible common equity/tangible assets	5.8	4.1	4.2	4.2	3.9
Basel leverage ratio	n.a.	n.a.	4.3	4.1	4.0
Net impaired loans/common equity Tier 1	15.1	13.9	13.8	16.1	2.7
Funding and liquidity					
Loans/customer deposits	109.1	110.9	116.4	116.6	112.9
Liquidity coverage ratio	144.0	150.0	142.0	164.0	120.0
Customer deposits/funding	77.4	69.0	66.4	64.2	63.5

Source: Fitch Ratings, Fitch Solutions, SGH

Institutional Support Assessment

SGH and Santander UK plc's Support Ratings of '2' reflect Fitch's view that their ultimate parent, Banco Santander S.A., has a strong propensity to provide support but that its ability to provide support is constrained by the subsidiaries' large size and by possible regulatory restrictions. The Support Rating indicates a 'BBB+' rating floor for SGH's Long-Term IDR. Our view of Banco Santander S.A.'s strong propensity to provide support is based on the strategic importance of the UK business to Banco Santander S.A. as well as 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			✓

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 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.

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.

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.