

CREDIT OPINION

15 October 2021

Update

 Rate this Research

RATINGS

Santander UK Group Holdings plc

Domicile	London, United Kingdom
Long Term CRR	Not Assigned
Long Term Debt	Baa1
Type	Senior Unsecured - Fgn Curr
Outlook	Stable
Long Term Deposit	Not Assigned

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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EMEA	44-20-7772-5454

Santander UK Group Holdings plc

Update post semiannual results

Summary

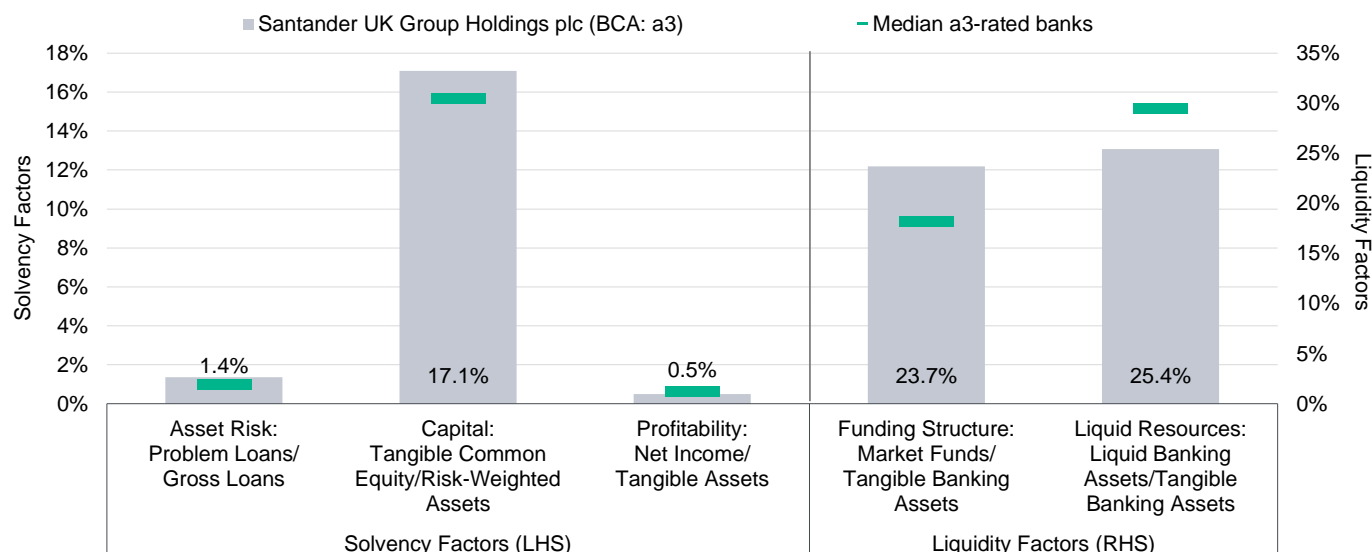
The A1 long-term deposit and senior debt ratings of [Santander UK plc](#) (Santander UK) incorporate: (1) the bank's standalone creditworthiness, reflected in its baa1 Baseline Credit Assessment (BCA); (2) limited financial and operational connections to its parent, [Banco Santander S.A.](#) (Banco Santander, A2/A2 stable, baa1), which shields Santander UK from a potential deterioration in its parent's creditworthiness; (3) very low loss-given-failure, which provides two notches of uplift under our Advanced Loss Given Failure (LGF) analysis; and (4) our assessment of a moderate probability of support from the [Government of United Kingdom](#) (Aa3 stable), which provides one additional notch to the ratings.

The Baa1 senior unsecured debt ratings of the group holding company [Santander UK Group Holdings plc](#) (Santander UK Group) incorporate: 1) its notional BCA of baa1 2) the instrument's high loss-given-failure, resulting in a rating one notch negative adjustment; and 3) low probability of government support, which does not provide any uplift.

We align the ratings of the group's non-ring-fenced bank [Santander Financial Services plc](#) (SFS) with those of Santander UK, reflecting the predominance of Santander UK.

Santander UK's a3 BCA reflects: 1) low stock of problem loans; 2) good risk-weighted capitalisation; 3) low earnings volatility, which mitigates medium-term pressures on profitability; 4) a lower than peers leverage ratio, and 5) modest business diversification in line with mortgage-focused peers, reflected in one notch negative qualitative adjustment in our scorecard.

Exhibit 1

Rating Scorecard - Key financial ratios as at 30 June 2021

We assign a BCA to Santander UK based on the consolidated financials of Santander UK Group. The chart above shows the financial ratios of Santander UK Group.

Source: Moody's Investors Service

Credit strengths

- » Track record of low stock of problem loans
- » Good risk-weighted capitalisation
- » Future profitability to benefit from net interest margin increase and lower credit provision

Credit challenges

- » Lower than peers leverage ratio
- » Medium-term pressures on profitability due to low interest rates

Outlook

The outlook on Santander UK's long-term deposit and senior unsecured debt ratings is stable, reflecting our view that the combined solvency and liquidity metrics will on a forward-looking basis remain in line with our assessment, as its asset quality and profitability stabilize.

Factors that could lead to an upgrade of the ratings

Santander UK's and Santander UK Holdings Group's ratings could be upgraded following an upgrade of Santander UK's BCA, supported by improved profitability, lower level of problem loans and reduced reliance on its moderate market funding. The BCA could also be upgraded if the bank were able to increase the level of diversification of its business.

Factors that could lead to a downgrade of the ratings

Santander UK's ratings could be downgraded following a downgrade of Santander UK's BCA driven by a significant deterioration in the bank's asset-quality metrics, a material weakening in profitability or a deterioration in the bank's funding and liquidity position, including a further reduction in the quantity or quality of its liquidity buffer. Santander UK Group's senior holdco debt rating could be downgraded following a downgrade of Santander UK's BCA or following a material reduction in the volume of bail-in-able debt.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

Key indicators

Exhibit 2

Santander UK Group Holdings plc (Consolidated Financials) [1]

	06-21 ²	12-20 ²	12-19 ²	12-18 ²	12-17 ²	CAGR/Avg. ³
Total Assets (GBP Billion)	291.8	295.6	285.2	286.0	295.3	(0.3) ⁴
Total Assets (USD Billion)	403.1	404.0	377.9	364.3	399.4	0.3 ⁴
Tangible Common Equity (GBP Billion)	12.5	11.4	13.8	13.7	13.8	(2.8) ⁴
Tangible Common Equity (USD Billion)	17.2	15.6	18.2	17.5	18.6	(2.2) ⁴
Problem Loans / Gross Loans (%)	1.4	1.4	1.1	1.2	1.3	1.3 ⁵
Tangible Common Equity / Risk Weighted Assets (%)	17.1	15.7	18.8	17.5	15.8	17.0 ⁶
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	21.3	22.7	15.6	17.1	17.7	18.9 ⁵
Net Interest Margin (%)	1.3	1.1	1.2	1.3	1.3	1.2 ⁵
PPI / Average RWA (%)	2.5	1.9	2.3	2.3	2.8	2.3 ⁶
Net Income / Tangible Assets (%)	0.6	0.5	0.5	0.5	0.5	0.5 ⁵
Cost / Income Ratio (%)	56.9	64.4	59.5	56.6	50.7	57.6 ⁵
Market Funds / Tangible Banking Assets (%)	21.9	23.7	25.6	27.8	28.7	25.5 ⁵
Liquid Banking Assets / Tangible Banking Assets (%)	23.2	25.4	24.3	24.9	28.9	25.4 ⁵
Gross Loans / Due to Customers (%)	109.3	107.8	113.4	113.3	109.4	110.6 ⁵

[...] Further to the publication of our revised methodology in July 2021, for issuers that have "high trigger" additional Tier 1 instruments outstanding, not all ratios included in this report reflect the change in treatment of these instruments. [1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel III - fully loaded or transitional phase-in; IFRS.

[3] May include rounding differences because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of periods for the latest accounting regime. [6] Simple average of Basel III periods.

Sources: Moody's Investors Service and company filings

Profile

Santander UK is a retail and commercial bank that operates exclusively in the UK. It is a large subsidiary of Banco Santander, accounting for around 20% of the group's assets at the end of 2020. In the UK, Santander UK is the third-largest residential mortgage provider and is the fifth-largest current account provider.

As part of the implementation of the ring-fencing legislation in the UK, in 2018, Santander UK transferred its small corporate and investment banking division to the London branch of Banco Santander, and its branches in the Crown Dependencies to its sister company SFS, which became the non-ring-fenced bank of Santander UK Group. At present, in addition to the branches in the Crown Dependencies, SFS retains a small portfolio of legacy assets.

Detailed credit considerations

We assign a BCA to Santander UK based on the consolidated financials of Santander UK Group. The financial data in the following sections are sourced from Santander UK Group's consolidated financial statements, unless otherwise stated.

Concentration of revenue in UK residential mortgages

Santander UK's baa1 BCA incorporates a negative qualitative adjustment to reflect its modest business diversification, due to the high proportion of retail loans in Santander UK's loan book: 82% of Santander UK's portfolio consists of residential mortgages (followed by corporate loans, 12%, consumer loans, 4%, credit cards and unsecured personal loans, 2%) at end-June 2021.

We apply the same one-notch negative qualitative adjustment to other UK banks with similar business models, in particular the building societies.

Low stock of problem loans

The assigned a1 Asset Risk score reflects our expectation that problem loans will broadly stabilize at current level, following an improvement of the operating environment in the UK.

Santander UK's loan book has a low risk profile, largely comprising residential mortgages (83% of the total loan book), with a relatively low average loan-to-value ratio of 42% at end of June 2021. Buy-to-let mortgages are low, representing just 8% of the loan book. Lending to corporate and small and medium-sized enterprises at 12% of total loans is relatively low compared with that of its peers, although the bank aims to gradually increase its market share. Consumer finance lending is small when compared with other large UK banks, representing 6% of total lending (4% auto finance and 2% unsecured lending). The remainder of Santander UK's loan book (1%) is largely composed of legacy assets and portfolios in run-off booked under the bank's corporate centre.

At the end of June 2021, Stage 3 loans remained in line with year end 2020 at 1.4% while Stage 2 loans decreased to 7.0% of loans from 8.1% at end- 2020. We expect Stage 3 loans to broadly stabilize at current level.

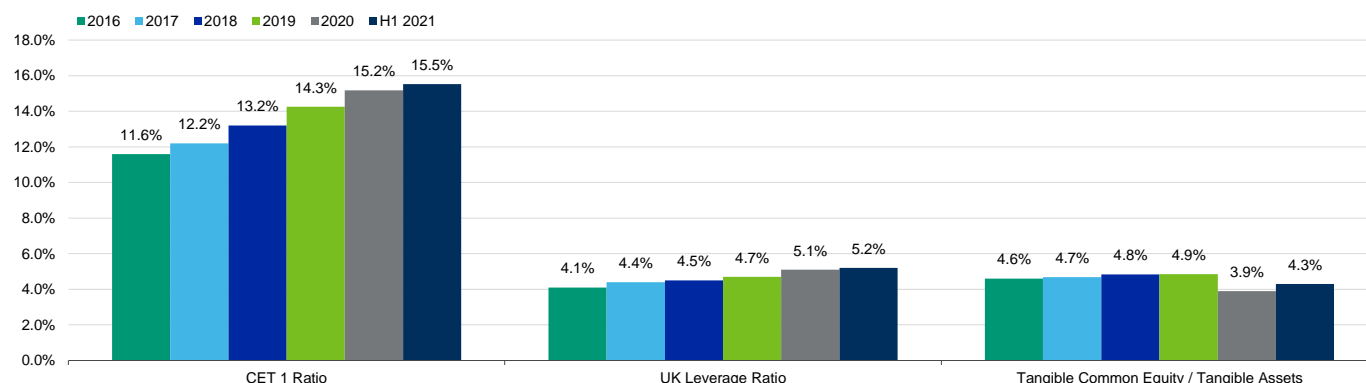
Good risk-weighted capitalisation, but weaker than peers leverage ratio

The assigned a1 Capital score is two notches below the aa2 Macro-Adjusted score, reflecting an expected decrease of capital levels and its weaker than peers leverage ratio.

Regulatory capital is currently solid: the Common Equity Tier 1 (CET1) capital ratio was 15.5% at end-June 2021 (15.2% at YE 2020), 550 basis points above it's the Maximum Distributable Amount (MDA). The CET1 ratio has been improving (it was 14.3% at end-2019 and 13.2% at end-2018), reflecting stable retained earnings and a material decrease in risk-weighted assets, driven by a reduction in the exposure towards commercial real estate companies, together with ring-fencing transfers and securitisations. The Tangible Common Equity ratio at June-end 2021 was 17.1% and excludes high-trigger AT1 instruments, which previously accounted for around 290 basis points.

The leverage ratio calculated according to the UK Prudential Regulation Authority's recommendations (the so-called UK leverage ratio) was 5.2% at the end of June 2021, above requirements . However, our leverage ratio was 4.3% at end-June 2021, lower than most peers.

Exhibit 3

Santander UK's increase in CET1 ratio mainly reflects lower risk-weighted assets**Santander UK's main capital ratios**

Regulatory ratios on a fully loaded basis.

Source: Moody's Investors Service, company reports

Future profitability to benefit from net interest margin increase and lower credit provision

The assigned ba1 Profitability score is two notches below the baa2 Macro-Adjusted score.

Santander UK's profitability has been relatively stable in recent years and before the Coronavirus-led crisis, due to its concentration in residential mortgages and a smaller than-peers impact from legacy issues such as payment protection insurance (PPI) redress.

In 2020, Santander UK reported £438 million profit after tax, a decrease of 38% from the prior year, largely due to higher credit impairment and charges and lower revenue. Net interest income increased 4% during the year, benefiting from the repricing of customer deposits, which offset the negative impact from lower rates. However, fee income dropped 40% during the same period. Operating costs decreased, Higher credit provisions mostly reflected change in macroeconomic scenario assumptions following the coronavirus outbreak. The reduction in retail transaction and banking fees was largely due to the implementation of regulatory changes to overdrafts.

In the first half of 2021, Santander UK reported a profit after tax of £571 million, a 410% increase compared to the same period the prior year. Revenue increased 18% yoy, driven by a 27% increase in net interest income, largely supported by the repricing actions on the deposits to offset the base rate cuts and SVR loan book attrition. Banking net interest margin was 1.87% at the end of June 2021, up from 1.53% at the end of June 2020. The bank released credit provisions of £70 million, compared to £364 million credit provision and impairment charges in the same period the previous year. Operating costs of £1.3 billion were 10% higher yoy, due to transformation programme additional costs.

We expect profitability to improve going forward, as the net interest margin increase will support net interest income and revenue and the bank will likely report lower credit provisions, benefiting from write-backs on the statistical credit provisions recorded in 2020, at the onset of the coronavirus pandemic. Longer-term, higher competition in the mortgage market will affect pricing on new mortgage lending and will increase pressure on revenue. Further cost savings, driven by the transformation programme will partially mitigate these pressures.

Stable retail funding profile

The baa1 Funding Structure score is in line with their respective Macro-Adjusted scores.

Being primarily a retail bank, customer deposits are Santander UK's main source of funding, accounting for about 70% of total funding at end-2020. Santander UK has replaced more price-sensitive deposit customers with current accounts, which are generally more stable and usually have more than one product with the bank. The bank's loan-to-deposit ratio was 108% at the end of June 2021, a level higher than most of its peers.

Wholesale funding reliance is moderate and broadly stable, representing 24% of tangible banking assets at end-2020. We expect the bank will replace its cheap central bank Term Funding Scheme (TFS) facility with the new Term Funding Scheme introduced by the Bank of England in March 2020 (TFSME); additional MREL issuance to meet 2022 requirements are relatively small, likely to be offset by maturing non-MREL funding.

Santander UK has a good stock of liquid assets, representing 25% of the bank's tangible banking assets as of December 2020. The bank reported a strong 150% liquidity coverage ratio as of the end of 2020. The liquidity coverage ratio-eligible liquidity pool was £51.5 billion as of the same date, covering 2.4 times the wholesale funds with a residual maturity of less than one year.

We assign a baa1 liquidity score, one notch lower than the initial a3 score. Santander UK has a good stock of liquid assets, representing 25% of the bank's tangible banking assets at end-2020. The bank reported an 144% liquidity coverage ratio (LCR) at end-June 2021, below the 150% at end 2020. The eligible liquidity pool was £47 billion as of the same date, covering 2.8x wholesale funds with a residual maturity of less than one year.

ESG Considerations

In line with our general view for the banking sector, Santander UK has a low exposure to Environmental risks and moderate exposure to Social risks. See our [Environmental risks heatmap](#) and [Social risks heatmap](#) for further information.

Our assessment of moderate Social risk for Santander UK also takes into account the bank's exposure to the coronavirus-induced economic shock.

Governance is highly relevant for Santander UK, as it is to all banks. Corporate governance weaknesses can lead to a deterioration in a company's credit quality, while governance strengths can benefit its credit profile. Governance risks are largely internal rather than externally driven, and for Santander UK we do not have any particular governance concern. Nonetheless, corporate governance remains a key credit consideration and requires ongoing monitoring.

Support and structural considerations

Affiliate support

We expect a high probability of support coming from Banco Santander, based on the size of Santander UK within the group and reputational risk to its parent. Our assumptions do not lead to any uplift, because the BCA of Santander UK is in line with that of Banco Santander.

Loss Given Failure (LGF) analysis

Santander UK is subject to the UK implementation of the EU Bank Recovery and Resolution Directive, which we consider to be an operational resolution regime. Our analysis assumes residual tangible common equity of 3%, post-failure losses of 8% of tangible banking assets, a 25% run-off in junior wholesale deposits and a 5% run-off in preferred deposits, and it assigns a 25% probability to deposits being preferred to senior unsecured debt. These assumptions are in line with our standard assumptions. We also assume the proportion of deposits considered junior at 10%, relative to our standard assumption of 26%, because of the more retail, and small and medium-sized enterprise-oriented depositor base.

Our LGF analysis indicates that Santander UK's junior deposits and senior debt are likely to face very low loss-given-failure because of the loss absorption provided by limited subordinated debt and the volume of deposits and senior debt. This results in a two-notch uplift from the bank's BCA. For the senior unsecured debt of the holding company Santander UK Group, our LGF analysis shows moderate loss-given-failure, resulting from the combination of its own limited volume of debt and the amount of debt subordinated to it. This results in ratings in line with Santander UK Group's BCA.

The Additional Tier 1 high-trigger contingent convertible perpetual preferred securities issued by Santander UK Group are rated Ba1 (hyb) following the update of the methodology.

Government support

We expect a moderate probability of government support for Santander UK's deposits and senior debt, reflecting the bank's high market share for deposits and residential mortgages in the UK. This results in one notch of uplift to the long-term deposit and senior unsecured ratings.

For junior securities, and for the senior debt of the holding company, we believe that potential government support is low, and these ratings do not include any related uplift.

Counterparty Risk (CR) Assessments and Counterparty Risk Ratings (CRRs)

Santander UK's CR Assessments are Aa3(cr)/Prime-1(cr). The long-term CR Assessments, before government support, are three notches above the bank's standalone BCAs of baa1. The uplift results from the buffer against default provided to the operating obligations by substantial bail-in-able debt and deposits. A moderate probability of government support results in one additional notch of uplift.

Santander UK's CRRs are Aa3/Prime-1. The long-term CRRs, before government support, are three notches above the bank's BCAs of baa1. The uplift derives from the buffer against default provided to the operating obligations by substantial bail-in-able debt and deposits. A moderate probability of government support results in one additional notch of uplift. Although Santander UK is likely to have more than a nominal volume of CRR liabilities at failure, this has no impact on the CRRs because the significant level of subordination below the CRR liabilities at the banks already provides the maximum amount of uplift under our rating methodology.

About Moody's Bank Scorecard

Our scorecard is designed to capture, express and explain in summary form our Rating Committee's judgement. When read in conjunction with our research, a fulsome presentation of our judgement is expressed. As a result, the output of our scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating methodology and scorecard factors

Exhibit 4

Santander UK Group Holdings plc

Macro Factors							
Weighted Macro Profile		Strong +	100%				
Factor	Historic Ratio	Initial Score	Expected Trend	Assigned Score	Key driver #1	Key driver #2	
Solvency							
Asset Risk							
Problem Loans / Gross Loans	1.4%	aa3	↔	a1	Expected trend		
Capital							
Tangible Common Equity / Risk Weighted Assets (Basel III - fully loaded)	17.1%	aa2	↔	a1	Expected trend	Nominal leverage	
Profitability							
Net Income / Tangible Assets	0.5%	baa2	↔	ba1	Earnings quality		
Combined Solvency Score		a1		a2			
Liquidity							
Funding Structure							
Market Funds / Tangible Banking Assets	23.7%	baa1	↔	baa1	Market funding quality		
Liquid Resources							
Liquid Banking Assets / Tangible Banking Assets	25.4%	a3	↔	baa1	Expected trend		
Combined Liquidity Score		baa1		baa1			
Financial Profile				a3			
Qualitative Adjustments				Adjustment			
Business Diversification				-1			
Opacity and Complexity				0			
Corporate Behavior				0			
Total Qualitative Adjustments				-1			
Sovereign or Affiliate constraint				Aa3			
BCA Scorecard-indicated Outcome - Range				a3 - baa2			
Assigned BCA				baa1			
Affiliate Support notching				0			
Adjusted BCA				baa1			
Balance Sheet		in-scope (GBP Million)	% in-scope	at-failure (GBP Million)	% at-failure		
Other liabilities		69,239	23.6%	82,863	28.2%		
Deposits		194,632	66.2%	181,008	61.6%		
Preferred deposits		175,169	59.6%	166,410	56.6%		
Junior deposits		19,463	6.6%	14,597	5.0%		
Senior unsecured bank debt		8,212	2.8%	8,212	2.8%		
Dated subordinated bank debt		817	0.3%	817	0.3%		
Junior subordinated bank debt		452	0.2%	452	0.2%		
Preference shares (bank)		560	0.2%	560	0.2%		
Senior unsecured holding company debt		8,113	2.8%	8,113	2.8%		
Dated subordinated holding company debt		824	0.3%	824	0.3%		
Preference shares(holding company)		2,250	0.8%	2,250	0.8%		
Equity		8,817	3.0%	8,817	3.0%		
Total Tangible Banking Assets		293,916	100.0%	293,916	100.0%		

Debt Class	De Jure waterfall		De Facto waterfall		Notching		LGF	Assigned	Additional	Preliminary
	Instrument	Sub- volume + ordination	Instrument	Sub- volume + ordination	De Jure	De Facto	Notching Guidance vs. Adjusted BCA	LGF notching	Notching	Rating Assessment
Counterparty Risk Rating	15.2%	15.2%	15.2%	15.2%	3	3	3	3	0	a1
Counterparty Risk Assessment	15.2%	15.2%	15.2%	15.2%	3	3	3	3	0	a1 (cr)
Deposits	15.2%	7.4%	15.2%	10.2%	2	3	2	2	0	a2
Senior unsecured bank debt	15.2%	7.4%	10.2%	7.4%	2	1	2	2	0	a2
Senior unsecured holding company debt	7.4%	4.7%	7.4%	4.7%	0	0	0	0	0	baa1
Dated subordinated bank debt	4.7%	4.1%	4.7%	4.1%	0	0	0	0	0	baa1
Dated subordinated holding company debt	4.7%	4.1%	4.7%	4.1%	0	0	0	0	0	baa1
Junior subordinated bank debt	4.1%	4.0%	4.1%	4.0%	-1	-1	-1	-1	-1	baa3
Cumulative bank preference shares	4.0%	3.0%	4.0%	3.0%	-1	-1	-1	-1	-1	baa3
Non-cumulative bank preference shares	4.0%	3.0%	4.0%	3.0%	-1	-1	-1	-1	-2	ba1
Holding company non-cumulative preference shares	4.0%	3.0%	4.0%	3.0%	-1	-1	-1	-1	-2	ba1

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Rating	3	0	a1	1	Aa3	Aa3
Counterparty Risk Assessment	3	0	a1 (cr)	1	Aa3(cr)	
Deposits	2	0	a2	1	A1	A1
Senior unsecured bank debt	2	0	a2	1	A1	A1
Senior unsecured holding company debt	0	0	baa1	0	Baa1	Baa1
Dated subordinated bank debt	0	0	baa1	0	Baa1	Baa1
Dated subordinated holding company debt	0	0	baa1	0		Baa1
Junior subordinated bank debt	-1	-1	baa3	0	Baa3 (hyb)	Baa3 (hyb)
Cumulative bank preference shares	-1	-1	baa3	0	Baa3 (hyb)	
Non-cumulative bank preference shares	-1	-2	ba1	0	Ba1 (hyb)	
Holding company non-cumulative preference shares	-1	-2	ba1	0	Ba1 (hyb)	

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.

Source: Moody's Investors Service

Ratings

Exhibit 5

Category	Moody's Rating
SANTANDER UK GROUP HOLDINGS PLC	
Outlook	Stable
Baseline Credit Assessment	baa1
Adjusted Baseline Credit Assessment	baa1
Issuer Rating -Dom Curr	Baa1
Senior Unsecured	Baa1
Subordinate	Baa1
Pref. Stock Non-cumulative -Dom Curr	Ba1 (hyb)
Other Short Term	(P)P-2
SANTANDER FINANCIAL SERVICES PLC	
Outlook	Stable
Counterparty Risk Rating	Aa3/P-1
Bank Deposits	A1/P-1
Baseline Credit Assessment	baa1
Adjusted Baseline Credit Assessment	baa1
Counterparty Risk Assessment	Aa3(cr)/P-1(cr)
Issuer Rating	A1
ST Issuer Rating	P-1
SANTANDER UK PLC	
Outlook	Stable
Counterparty Risk Rating	Aa3/P-1
Bank Deposits	A1/P-1
Baseline Credit Assessment	baa1
Adjusted Baseline Credit Assessment	baa1
Counterparty Risk Assessment	Aa3(cr)/P-1(cr)
Issuer Rating	A1
Senior Unsecured	A1
Subordinate	Baa1
Jr Subordinate	Baa3 (hyb)
Pref. Stock -Dom Curr	Baa3 (hyb)
Pref. Stock Non-cumulative -Dom Curr	Ba1 (hyb)
Commercial Paper	P-1
Other Short Term	(P)P-1

Source: Moody's Investors Service

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