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Santander UK Group Holdings PLC

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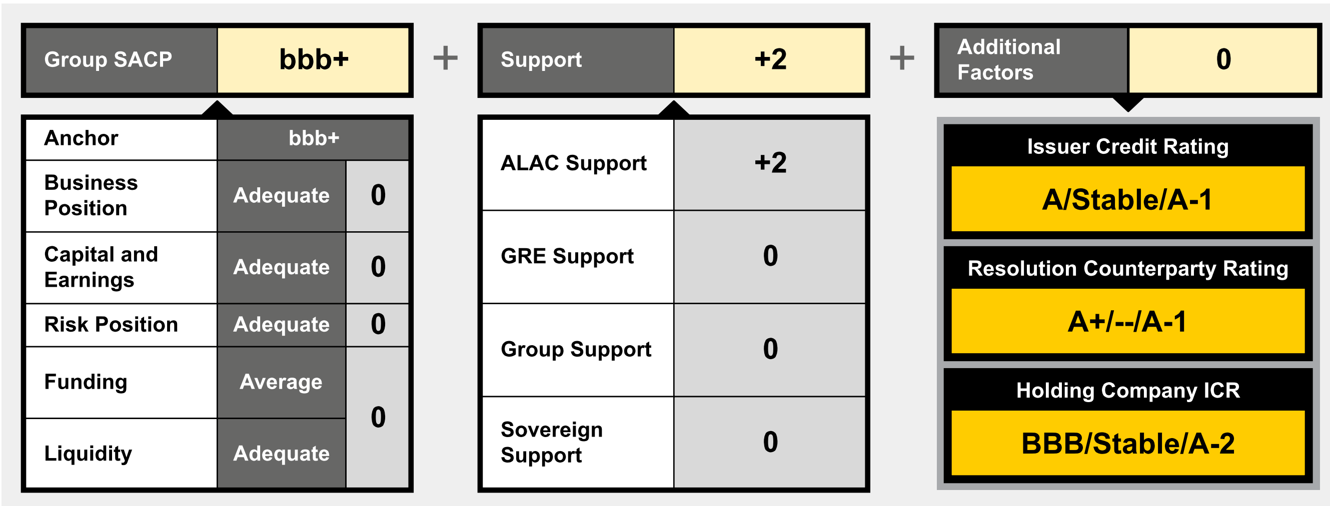
Santander UK Group Holdings PLC



ALAC--Additional loss absorbing capacity. ICR--Issuer credit rating. SACP--Stand-alone credit profile. The bank holding company ICR shown applies to Santander UK Group Holdings PLC, and is one notch below the group SACP. The ICR and the resolution counterparty rating shown apply to Santander UK Group Holdings PLC's core bank operating subsidiary, Santander UK PLC.

Credit Highlights

Issuer Credit Rating
BBB/Stable/A-2

Overview

Key strengths	Key risks
Good position in U.K. retail banking.	Residual pandemic risks and low interest rates will continue to weigh on profitability.
Conservative loan book profile compared with peers.	Net interest margin (NIM) and investment pressures will persist, although the weakening cost-to-income ratio trajectory is showing signs of stabilization.
Solid capitalization by our measures.	Lower revenue and business diversification than its larger U.K. competitors.

Santander UK Group Holdings' (Santander UK) asset quality remains robust thanks to sufficient provisioning throughout 2020. Given the material credit provisions in 2020, Santander UK's asset quality has remained strong, with the group having suffered low credit losses aided by fiscal and monetary support intervention. We believe that that the bank's capitalization, funding, and liquidity profiles are in line with those of domestic U.K. peers; as such, we expect Santander UK will maintain a healthy balance sheet.

Santander UK's transformation program will constrain earnings in the short term, but materially benefit the bank in the medium term. We acknowledge a renewed focus on efficiency exhibited by significant deposit repricing, further branche closures, and headquarter relocation. Operating expenses were up 16% year on year at March 31, 2021, reflecting transformation program costs of £142 million. However, adjusted operating expenses showed further progress falling by 3%, and we expect to see further progress in coming years.

Santander UK has a concentrated business model focused on the mortgage market. The bank's financial performance was underpinned by a better-than-expected mortgage market in 2020, given the support measures introduced by the government. We believe this may constrain Santander UK's performance if the mortgage market performs worse than expected in 2021 and 2022. Consequently, we believe that while its retail banking franchise is successful these benefits are offset by its lower business and revenue diversification when compared with peers.

Outlook

Santander UK Group Holdings PLC

The stable outlook reflects our view that the bank will incur a materially lower impairment charge for 2021 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 point of entry approach to resolution. This means that we believe the U.K. subgroup is more likely to support itself through bailing in its subordinated debt instruments for loss absorption and recapitalization, rather than rely on group support.

We could lower the ratings over our two-year horizon if we observe a weak economic recovery that compromises the underlying performance we anticipate. In that scenario, we would consider management's ability to leverage balance sheet strength and flexibility to further conserve capital and weather potentially negative economic conditions.

We could revise the outlook to positive if Santander UK were to strengthen its presence in sub-scale banking markets, such as commercial banking.

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 out 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 8% threshold, which would most likely be due to higher risk-weighted asset (RWA) inflation beyond our current expectations.

Key Metrics

Santander UK Group Holdings PLC--Key Ratios And Forecasts				
	--Fiscal year ended Dec. 31 --			
(%)	**2019a**	**2020a**	**2021f**	**2022f**
Growth in operating revenue	(8.2)	(5.1)	(1.0)-(0.7)	0.3-0.4
Growth in customer loans	2.9	2.5	0.0-0.1	1.8-2.2
Growth in total assets	(0.3)	3.7	0.3-0.4	1.4-2.1
Net interest income/average earning assets (NIM)	1.3	1.4	1.3-1.4	1.3-1.4
Cost to income ratio	62.7	64.7	63.0-66.2	60.3-63.4
Return on equity	3.6	1.6	4.0-4.4	5.9-6.5
Return on assets	0.2	0.1	0.2-0.3	0.2-0.3
New loan loss provisions/average customer loans	0.1	0.3	0.0-0.1	0.0-0.1
Gross nonperforming assets/customer loans	1.7	2.0	2.0-2.3	2.0-2.3
Net charge-offs/average customer loans	0.2	0.2	0.2-0.3	0.2-0.3
Risk-adjusted capital ratio	9.5	9.7	9.5-9.7	9.5-9.7

All figures are S&P Global Ratings-adjusted. a--Actual. f--Forecast.

Anchor: 'bbb+' For Banks Operating In the U.K.

We view the economic risk trend for the U.K., as it affects its domestic banking sector, as stable. We expect the strong economic rebound to continue through 2022, which in turn should provide a significant tailwind to U.K. banks' asset quality. We are mindful of residual pandemic-related risks and potential imbalances that could arise if the current robust levels of house price inflation and mortgage credit growth continue unabated. However, on balance, we think these concerns are sufficiently mitigated. We could improve our economic risk assessment if we gain confidence in the sustainability of U.K. economic performance and that the relatively high private sector leverage will not lead to new asset-quality concerns.

The industry risk trend is stable as we incorporate the strong institutional framework and robust funding profile. However, pre-provision earnings appear set to remain constrained by the ongoing low rate environment, despite some yield curve steepening. If we believe that medium-term earnings prospects are structurally impaired, including regulatory pressures that constrain noninterest income growth, then we could consider lowering our industry risk assessment.

Business Position: Ongoing Investment In The Franchise

Our assessment of Santander UK's business position as adequate reflects the strength of its retail banking franchise, offset by its lower business and revenue diversification compared with its closest domestic peers.

We think that Santander UK's relatively high earnings concentration and exposure to the leveraged U.K. household sector make it harder to achieve a higher business position assessment, notwithstanding the benefits of being part of a large, diversified global bank. Moreover, unlike for some peers, Santander UK's inherent franchise strengths do not appear to be manifesting materially improved earnings metrics. For example, its cost-to-income ratio deteriorated every financial year since 2017; however, the first quarter of 2021 has seen an improved cost-to-income ratio. A greater focus on cost efficiency, including through noteworthy deposit repricing, has complemented the inherent stability of Santander UK's retail franchise and its bias toward the typically stable performance of U.K. residential property lending.

Key peers are Lloyds Banking Group PLC (Lloyds; group SACP: 'a-'), Nationwide Building Society (NBS; 'a-'), Natwest Group PLC ('bbb+'), and the U.K. ring-fenced banks, principally, of Barclays PLC ('bbb+') and HSBC Holdings PLC ('a'), Barclays Bank UK PLC and HSBC UK Bank PLC, respectively. A lower rated, and less diverse U.K. peer is Virgin Money UK PLC ('bbb'). Outside of the U.K., other retail-focused peers are ABN AMRO Bank N.V.('bbb+'), Credit Mutuel Group ('a'), Danske Bank A/S ('a-') and Nykredit Realkredit A/S ('a-').

In line with other U.K. banks, Santander UK has outperformed our expectations throughout the pandemic as government and central bank support measures have limited deterioration in asset quality and boosted mortgage market activity as new business mortgages margins have expanded. Santander UK has been notably more aggressive in driving efficiency gains in the past year, executing deposit repricing and structural reorganization to better deploy trapped liquidity (see "Santander Financial Services PLC Assigned ‘A-/A-2’ Ratings; Outlook Negative," published May 12, 2021).

Santander UK is one of the U.K.'s leading banks by deposits and mortgage loan balances. Indicative of its scale, Santander UK states that it has about 14 million active customers. We note that the steady increase of Santander UK's share of the U.K. retail current account market appears to have plateaued, with modest net switching losses in recent years-—likely indicative of more aggressive repricing.

Santander UK consists of three main divisions,and its regulatory RWA composition remained broadly stable in 2020 versus 2019:

- Retail Banking, including business banking with turnover up to £6.5 million; 68% of regulatory RWAs, up from 65% in 2019.
- Corporate & Commercial Banking, which covers businesses with annual turnover of £6.5 million-£500 million; remained at 18% of regulatory RWA, decreasing 1% since 2019.
- Corporate & Investment Banking (CIB), which covers corporate clients with an annual turnover of over £500 million; 5% of regulatory RWA. We are aware that the CIB book will be transferred to Banco Santander London Branch in first-half 2021 as a way to improve the customer experience.
- The balance of RWA (9%) is held in the corporate center.

While ring-fencing developments altered some of the comparative metrics, the following is indicative of Santander UK's more limited diversification (though it is more diverse than NBS):

- At Dec. 31, 2020, retail banking was a reported 88% of total operating income (2019: 84%); for Lloyds and Natwest this metric is typically in the 50%-60% range.

- At Dec. 31, 2020, net interest income was a reported 87% of total operating income (2019: 79%); for Lloyds and Natwest this metric is typically in the 60%-70% range.

We expect Santander UK will begin to focus on diversifying its income streams away from retail banking activities as the post-pandemic recovery gains momentum.

While commercial real estate (CRE) lending exposures may represent a residual risk from the pandemic, Santander UK's commercial banking franchise has significantly reduced its exposure in recent years to £4.7 billion in 2020 from £5.1 billion in 2019. In particular, we see evidence of Santander UK leveraging the group's international franchises by targeting more internationally focused U.K. companies. We expect this strategic shift will continue even though the related income expansion may lag the investment.

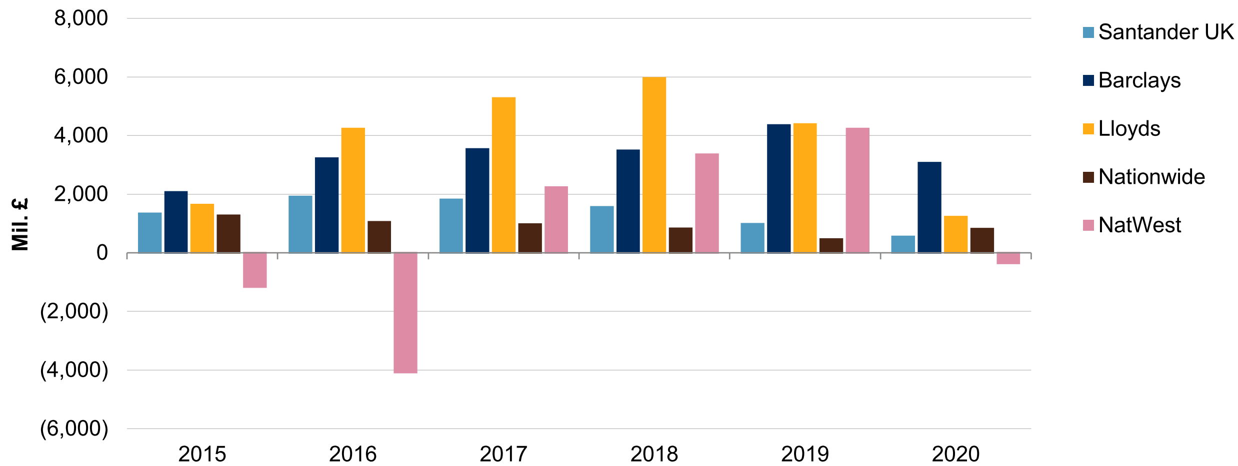
The combined impact of Santander UK's business banking and corporate banking strategies, and ring-fencing, means that total business line and income diversity has not fundamentally altered in recent years; mortgages, savings, and other retail products will therefore continue to be the key driver of earnings performance.

Relative to the larger U.K. banking groups, we acknowledge that Santander UK has generally demonstrated greater earnings and business stability over the past several years (see chart 1). This mainly reflects its more modest conduct and litigation charges and its lesser need to restructure. That said, in 2020 the bank experienced a material decrease in profit before tax of 43.7% versus the previous year. We believe this will be a low point as the bank has significantly provisioned against COVID-19 potential credit losses and, provided the recovery is sustained, we see potential for partial provision write-backs, as seen with other U.K. peers.

We expect to see the return of U.K. mortgage market competition of the next two years as risk appetite improves, which will likely pressure income growth. Moreover, we believe that Santander UK's larger peers are now better positioned to compete than they have been, especially in light of recent ring-fencing requirements that have increased funding available for the larger U.K. banks' retail operations, and the resolution of their key legacy litigation matters.

Chart 1

Santander UK's Statutory Profit Before Tax Versus Selected Peers'



As of Dec. 31, 2020, except for Nationwide whose financial year end is April 4 (i.e 2020=April 4, 2021).
Source: Company accounts.

The management team is likely to evolve following the announced departure of the Santander UK CEO Nathan Bostock that is planned for the end of 2021.

We believe management will remain broadly conservative during this transition period and focus on infrastructure digitalization and ongoing cost initiatives. Indeed, consistent with the public statements of its parent and the parent's reticence to allocate more capital toward the U.K., we believe that management's conservative stance first adopted post the 2016 EU Referendum may prove relatively supportive of asset quality during the current economic downturn.

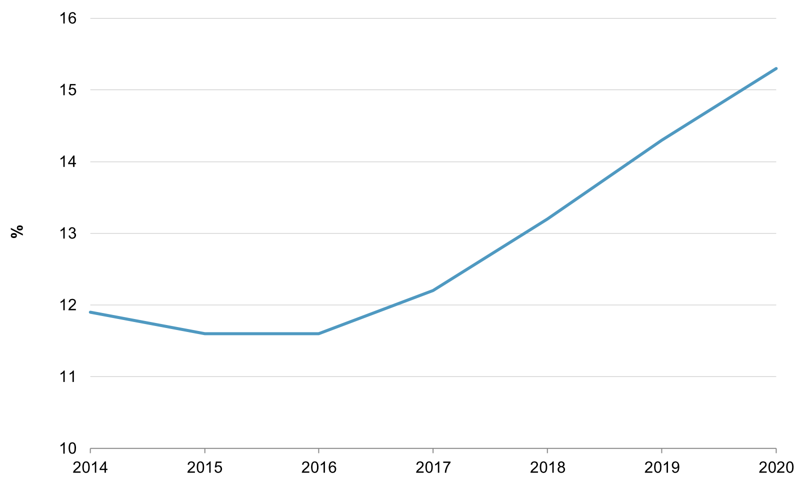
Key elements of management's updated strategic transformation program include improving returns in its corporate and commercial division, achieving enhanced efficiency, and capital discipline. In March 2021, Santander UK announced an update to their 'Transformation programme' that included 111 further branch closures in response to customers' preference for digital products such as mobile or online banking. While such strategic decisions constrain earnings in the short term, we believe that the pandemic has highlighted further efficiency gains, such as additional real estate rationalization opportunities that will improve profitability in the medium term.

Capital And Earnings: A Higher Assessment Might Require Reduced Distributions To The Parent

Santander UK's regulatory capitalization has gradually strengthened in recent years, and today is broadly in line with that of its domestic peers (see chart 2). Santander UK reported a regulatory Common Equity Tier 1 (CET1) ratio of 15.3% at March 31, 2021, and a U.K. leverage ratio of 5.2%.

Chart 2

Santander UK's CET1 Ratio Continues To Strengthen



As of Dec. 31, 2021. CET--Common equity tier 1. Source: Company accounts.

By our measures, we calculate Santander UK's risk-adjusted capital (RAC) ratio to be 9.6% as of Dec. 31, 2020, and we project that it will typically remain at 9.5%-10.0% through end-2023. While Santander UK may be reasonably close to the 10% threshold that could lead to a stronger assessment, we are not confident the bank will maintain the ratio comfortably and consistently above that level, not least given its status as a subsidiary of a larger banking group.

The base-case RAC ratio projection incorporates our expectations of:

- Pre-provision operating income stabilizing in 2021, reflecting trends in NIM pressure from retail banking competition and standard variable rate mortgage product attrition (SVR), and higher operating costs from investments to deliver strategic priorities and improve efficiency. We assume that pre-provision operating income growth will begin to improve in 2022 as the benefits of management actions and economic recovery are realized.
- Total loan growth remaining stable in 2021 before a return to growth of 2% as the economy recovers in 2022.
- The loan loss rate declining materially to below 10 basis points (bps) in 2021 and stabilize between 5 bps-10 bps in 2022 (it was a reported 30 bps in 2020).
- Ongoing restructuring costs and digitalization investments continuing to weigh on statutory earnings in 2021 and 2022.
- The dividend policy to distribute earnings continuing in 2021 (following a £103 million interim dividend paid in December 2020). We see potential for an additional distribution of a special dividend once the transfer of the CIB book to Banco Santander London Branch is complete. Furthermore, if Santander UK makes strong progress in managing regulatory RWA moves.
- S&P Global Ratings' RWAs remaining stable in 2021 before increasingly modestly in 2022 as corporate and retail

exposure gradually rebuild post-pandemic.

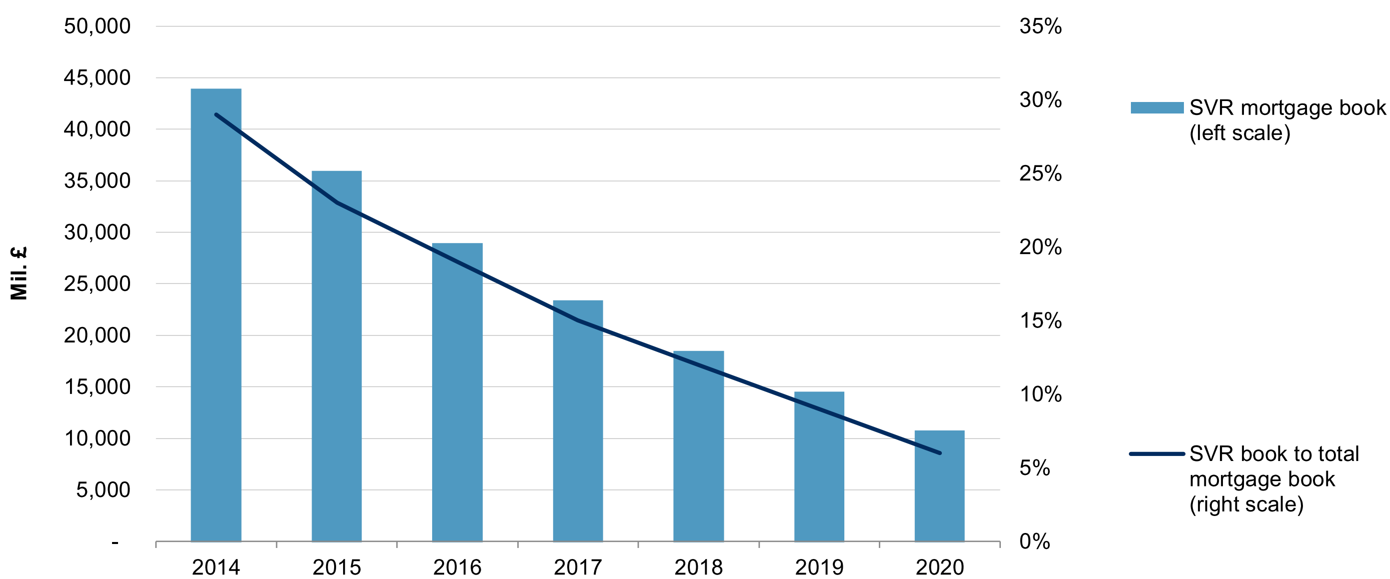
We expect the quality of capital will remain a neutral credit factor. Adjusted common equity was 83% of total adjusted capital (TAC) at end-2020, similar to that of many peers.

At March 31, 2021, Santander UK reported adjusted profit before tax of £422 million, a 154% increase compared with the first quarter of 2020. Within this, the reported adjusted net interest margin increased to 1.81% from 1.55%, the adjusted cost-to-income ratio was 55% and non-interest income fell 45% versus first-quarter 2020 due to lower retail banking and transaction fees as a result of overdraft regulatory changes. Santander UK stated that standard variable rate balances reduced to £10.7 billion as of Dec. 31, 2020 (2019: £14.1 billion).

The bank experienced improving performance in the first quarter of 2021 as pandemic restrictions eased. Adjusted NIM improve by 26 bps year on year as income increased and costs continued to decrease. Only £5 million of credit impairment losses were reported, indicative of the prudently high provisions taken throughout 2020 and a lack of asset-quality deterioration.

Chart 3

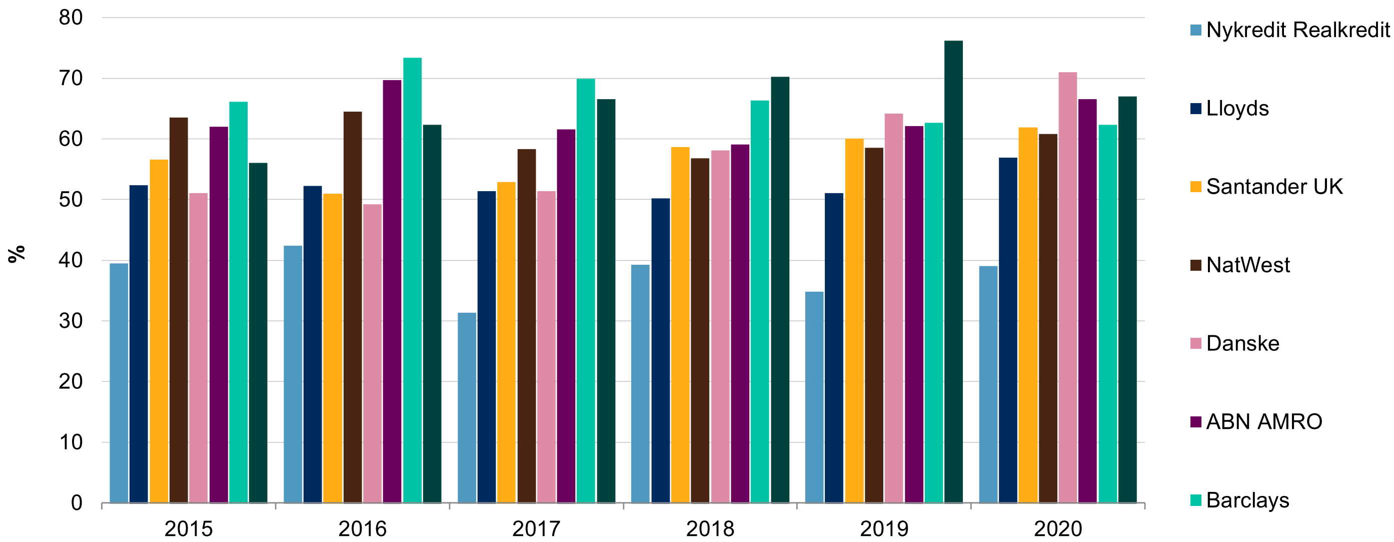
Santander UK's SVR Mortgage Book Declining As A Proportion Of Total Mortgage Book



SVR--Standard variable rate. Source: Full-year company accounts.

Chart 4

Santander UK's Cost-To-Income Ratio Versus Peers'



As of Dec. 31, 2020, except for Nationwide whose financial year end is April 4 (i.e 2020=April 4, 2021).
Source: S&P Global Ratings' database.

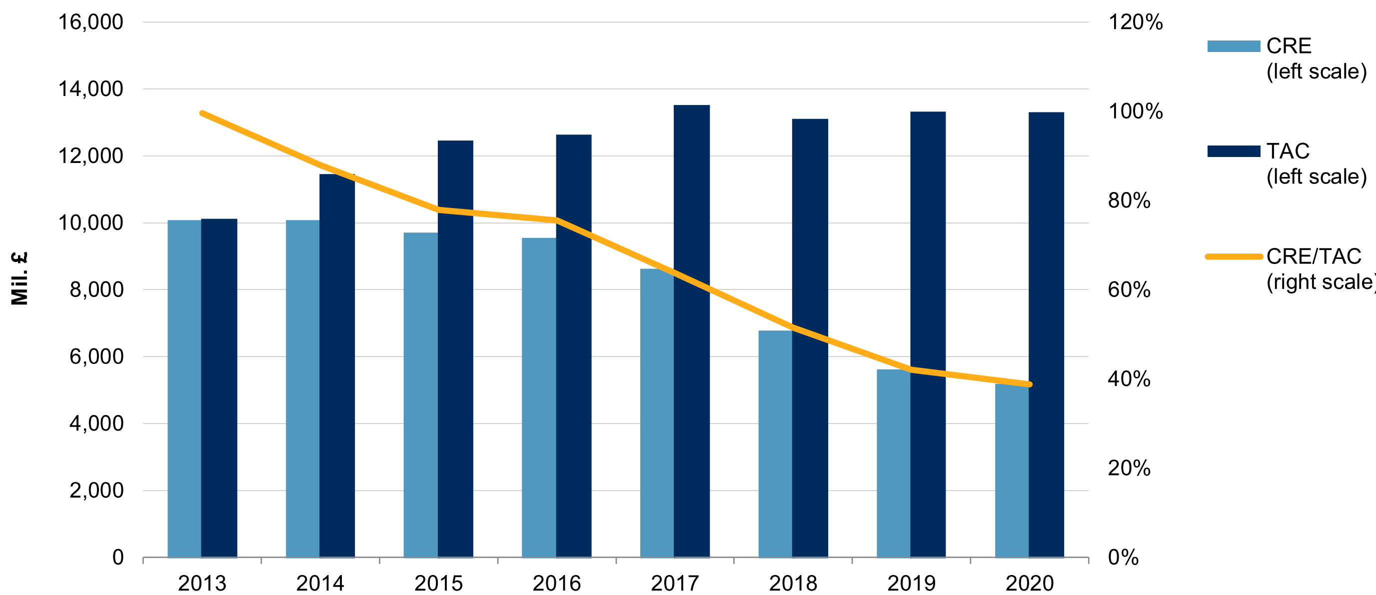
Risk Position: Solid Mortgage Book And Controlled Growth In Other Segments

Our assessment of Santander UK's risk position reflects our view that the bank's capital and earnings adequately capture the bank's exposure to, and capacity to absorb, unexpected losses. Risk is primarily of a credit nature, with minimal market risk, reflecting the small scale of Santander UK's financial market operations. Overall, we consider that the profile and credit quality of Santander UK's loan book is broadly in line with that of peers. We would need to observe a greater differential in asset-quality measures to consider a stronger assessment.

We note Santander UK's relatively cautious approach to credit growth. In particular, total retail loan growth has been slower than the market in recent times, and we are not expecting a large shift in this respect. Further evidence of recent caution is the reduction in the absolute size of the bank's CRE exposure, which had been a negative outlier (see chart 5). One of the side effects of expanding a commercial banking franchise is that it tends to be biased toward property, and not all clients will have primary relationships with the bank, which affects returns. The weighting of CRE to TAC was 39% at Dec. 31, 2020, having been at a high level of 100% at end-2013 (see chart 5). Santander UK states that CRE loans further reduced by £0.4 billion in 2020.

Chart 5

Santander UK's Commercial Real Estate Exposure To Total Adjusted Capital

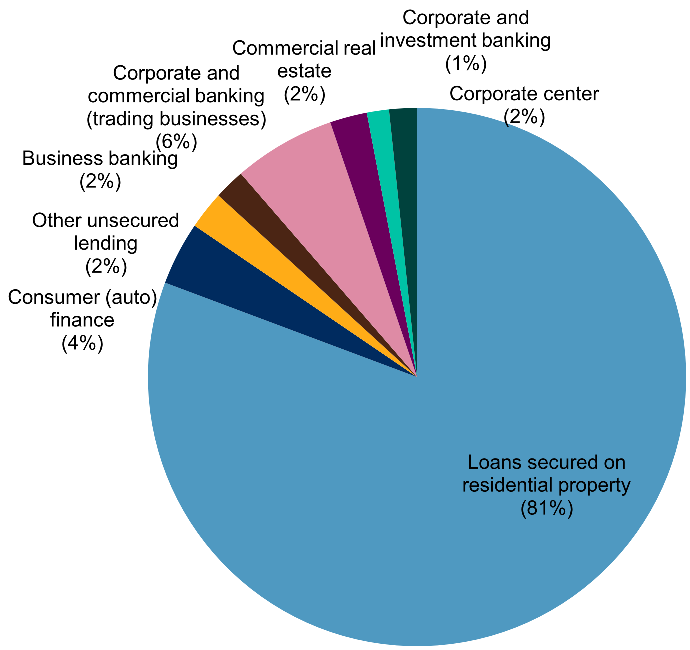


CRE--Commercial real estate. TAC--Total adjusted capital. Source: As reported and S&P Global Ratings' database.

Santander UK's total loan book remains heavily biased toward residential mortgages, which constituted a reported 81% of the gross customer loan book at March 31, 2021. Conversely, relative to U.K. peers, Santander UK's loan book exposure to consumer credit is relatively modest (see chart 6). A material part (£8 billion) of Santander UK's consumer credit book is auto finance, which can be particularly volatile during periods of recession--that said, we note that about 93% of such customer loans are secured.

Chart 6

Santander UK's Gross Customer Loans By Sector At December 31, 2020



Excludes amounts due from fellow Banco Santander subsidiaries and joint ventures. Source: Company accounts.

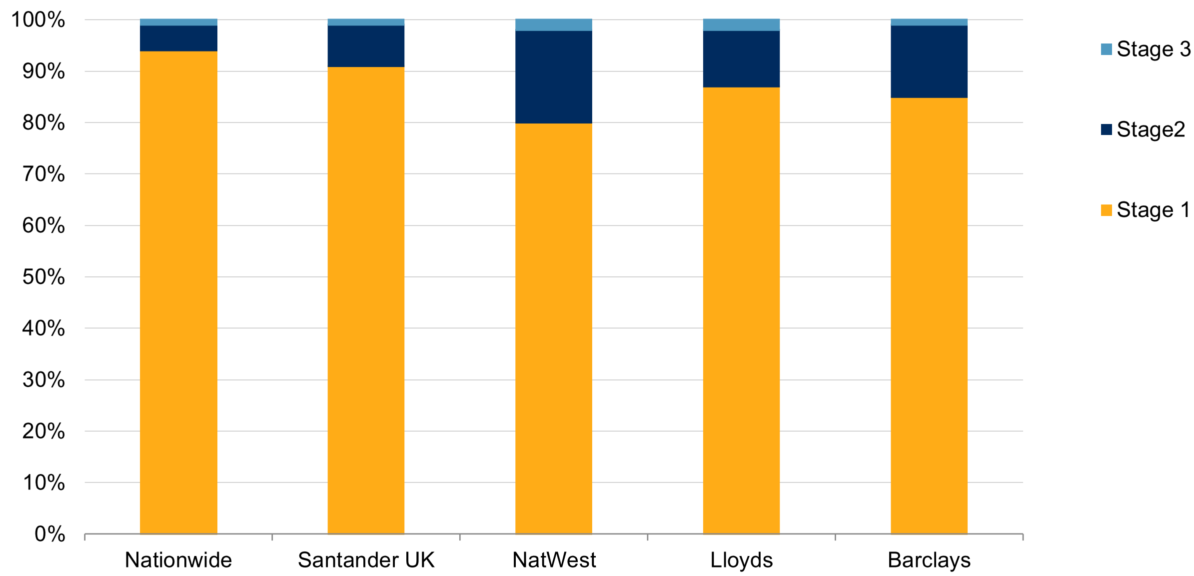
We believe that Santander UK's mortgage underwriting record compares satisfactorily with its U.K. peers'. We also note that buy-to-let mortgages, although increasing in terms of new lending, still represent only 7% of the mortgage stock, well below the industry stock figure of about 16%.

Santander UK reports that less than 1% of the mortgage book showed negative equity at Dec. 31, 2020, with a further 4% having an indexed loan-to-value (LTV) ratio of 85%-100% (reported bank average is 64%). We consider these figures to be fairly typical for U.K. mortgage lenders. Furthermore, the proportion of interest only mortgages continues to reduce.

The stock of nonperforming and problematic loans remains low. Santander UK reported that Stage 3 loans were £3 billion or 1.46% of gross loans at March 31, 2021. A broader analysis of asset quality also captures Stage 2 loans. For Santander UK, total Stage 2 loans are relatively low, partly owing to its mortgage book bias. At March 31, 2021, £18.1 billion customer loans were defined as Stage 2, which supports our view that Santander UK's credit risk compares well. Total Stage 2 and Stage 3 loans to total loans was 9.86% at March 31, 2021, which is lower than that of many U.K. peers (see chart 7).

Chart 7

Santander UK's Loan Breakdown By Stage Versus Peers'



As of Dec. 31, 2020. Data for Nationwide is as of April 30, 2021. Source: Company accounts and S&P Global Ratings.

The 8% RAC adjustment after diversification mainly reflects the concentration on the U.K. market. We note, for example, that London and the South East regions represented a reported 57% of the mortgage stock, which compares with just under 30% of the U.K. population (though the average LTV profile is favorable and loans above £1 million are limited). The RAC framework does not capture the nontrading market risk of Santander UK's large defined-benefit pension fund exposure. The fair value of post-retirement scheme assets was £14 billion at year-end 2020.

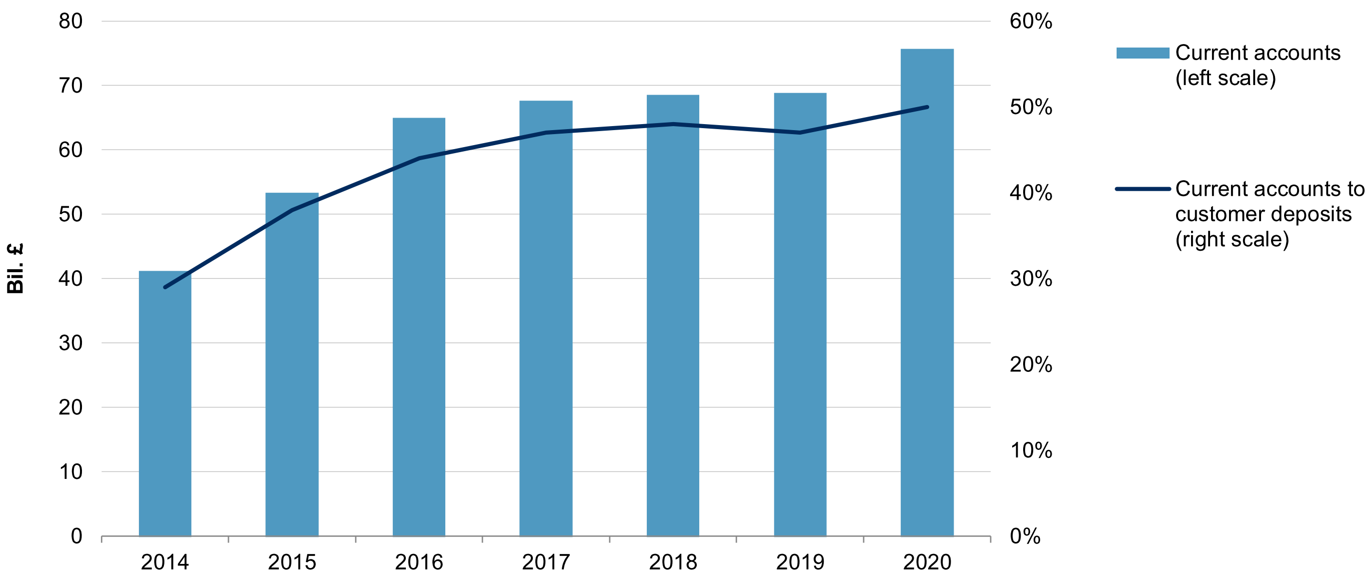
Funding And Liquidity: Granular Deposit Franchise And Access To Diversified Funding Sources

Santander UK's large deposit base is supported by a suite of well-managed and diverse wholesale funding activities, and we believe that our key funding metrics are broadly in line with the U.K. bank averages. The bank adequately manages its liquidity and is able to withstand an extended period of market or idiosyncratic stress. Santander UK has no structural reliance on group funding and is self-supporting from a liquidity standpoint.

At year-end 2020, and post the impact of ring-fencing, Santander UK stated that its loan-to-deposit ratio was 110%. To put this into context, the median for the top-25 U.K. banks (by revenue) was 109% at end-2020. We don't expect Santander UK's metric will weaken, unlike some smaller U.K. lenders. Indicative of the quality of its deposit franchise, current accounts now represent a reported 50% of customer deposits (see chart 8). As of first quarter 2021, the reported liquidity coverage ratio (LCR) decreased by 13 percentage points from end-2020 to 137% as the bank reduced its wholesale funding balances within the quarter.

Chart 8

Important And Stable Role Of Current Accounts In The Funding Base (Retail Banking Division)



Source: Full year company accounts.

Our stable funding ratio of 108.6% at Dec. 31, 2020, is also broadly in line with the average of 115% for the top-25 U.K. banks.

The bank will replace all funding level maturities in 2021 with a term funding scheme (TFSME) with additional incentives for small and midsized entities. In first-quarter 2021, Santander repaid £1.5 billion of the term funding scheme leaving £4.8 billion outstanding.

The liquidity position is satisfactory given the bank's restrained use of short-term wholesale funding (14.3% at Dec. 31, 2020), its stock of liquid assets, and its ability to further monetize its mortgage book. We believe that the continued strong capacity of the unencumbered mortgage book could generate additional liquidity if needed. Our measure of broad liquid assets to short-term wholesale funding was a comfortable 1.6x at year-end 2020.

Support: Two Notches Of ALAC Support

Our ALAC ratio was 9.7% at year-end 2020. We expect our ALAC measure will remain above our 8% threshold on an ongoing basis since we believe it contains a well-defined bail-in process under which authorities would permit nonviable systemically important banks to continue critical functions as going concerns following a bail in of eligible liabilities. Therefore, we factor in two notches of uplift to the long-term rating on Santander UK PLC.

In our view, Santander UK has high systemic importance in the U.K., primarily due to its very strong position in the U.K. retail banking market. We regard the prospect of extraordinary government support for U.K. banks as uncertain in view of the country's well-advanced and effective resolution regime. As a result, systemic banks are not eligible for notching uplift for possible future U.K. government support.

We include all of the consolidated Santander UK group's junior instruments in our ALAC assessment, because we believe they have the capacity to absorb losses without triggering a default on Santander UK PLC's senior obligations. We also include senior unsecured issuance by the nonoperating holding company (NOHC).

Summary Of ALAC Calculation As Of Dec. 31, 2020

		Bil. £	**% of S&P Global Ratings' RWAs**
A	Adjusted common equity	11,045	
B	Hybrids in TAC	2,241	
C (A+B)	Total adjusted common equity	13,286	9.7
D	TAC in excess of our 7% threshold	3,666	2.7
E	ALAC-eligible instruments	9,698	7.1
	of which NOHC senior	7,479	
	of which dated subordinated	1,398	
	of which minimal equity content hybrids	1,012	
	of which other*	(191)	
F (=D+E)	ALAC buffer	13,364	9.7
	S&P Global Ratings' RWA	137,428	

*Principally instruments maturing within 12-24 months in excess of 0.5% of S&P Global Ratings RWAs. ALAC--Additional loss-absorbing capacity. TAC--Total adjusted capital. NOHC--Nonoperating holding company. RWAs--Risk-weighted assets. Source: S&P Global Ratings' database.

Environmental, Social, And Governance Factors

Although Santander UK 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 banking industry accelerates so do risks relating to cyber security, operational resilience, and financial crime. The group has outlined a four-pillar sustainability strategy that covers social and environmental aspects. In 2020, the group has originated £1.27 billion of debt to finance renewable energy projects, which marks the bank's firm commitment to meet the goals of the UN and transition to a low carbon footprint.

We see ESG credit factors for the Santander UK group as being consistent with domestic peers. The ring-fenced bank and the non-ring-fenced bank both have strong governance arrangements including independent board members.

Group Status: Highly Strategic Subsidiary Of Banco Santander

We consider Santander UK a highly strategic subsidiary of Banco Santander. Despite the Spanish parent being rated at the same level as Santander UK PLC, we continue to incorporate ALAC support into the ratings on the U.K. subgroup where applicable, rather than group support. This is because of the broader group's multiple point of entry approach to bank resolution, which means that we view the U.K. subgroup as more likely to self-support through bailing in its subordinated debt instruments for loss absorption and recapitalization, rather than relying on group support. While we understand that Banco Santander may provide support to Santander UK in certain circumstances, we do not envisage this to be the case in all scenarios--it is especially uncertain in the extreme scenario whereby the U.K. subgroup needs to be resolved, given the severity of the associated stress.

Group Structure, Rated Subsidiaries, And Hybrids

Holding company rating

We regard Santander UK Group Holdings as an intermediate NOHC. The ratings on Santander UK Group Holdings PLC are based on our view of the group SACP. We do not include notches of uplift for ALAC support in the ratings on NOHCs, because we do not believe that their senior obligations would continue to receive full and timely payment in a resolution scenario.

We rate the NOHC one notch below the group SACP to reflect our view that NOHC creditors are structurally subordinated to those of operating company creditors.

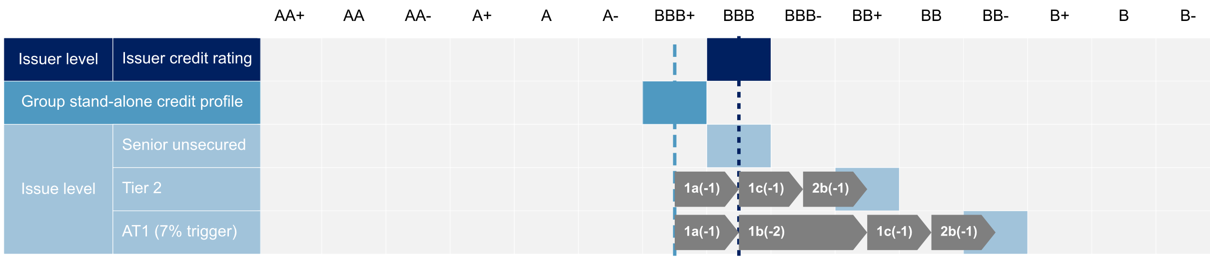
The group structure is relatively straightforward, mainly comprising the ring-fenced bank. We rate the non-ring fenced bank, Santander Financial Services PLC (SFS), one notch below the group credit profile (GCP) because we believe it is a highly strategic subsidiary and consider it tactically important rather than integral to the group. SFS principally conducts the business of the Jersey and Isle of Man branches, holds a small number of legacy business positions, and a mortgage portfolio.

Hybrid issue ratings

We rate hybrid instruments according to their respective features (see charts 9 and 10). We do not apply Step 2a notch for additional tier-1 instruments given our confidence that Santander UK's CET1 ratio will continue to sustainably exceed the 14.0% necessary to meet the 700 bps buffer in-excess of instrument trigger. The CET1 ratio was 15.3% at March 31, 2021, and we expect it will remain in excess of 14% beyond our two-year outlook horizon, notwithstanding dividend payments to its parent, given that the bank's binding constraint is the U.K. leverage ratio. We expect the likely moderate CET1 headwinds of Basel 3 implementation, non-implemented Capital Requirements Regulation (CRR2) items, and eventual U.K. countercyclical buffer increases to be adequately absorbed by improving organic capital generation as deposit repricing and transformation program efforts continue to bear fruit.

Chart 9

Santander UK Group Holdings plc: NOHC Notching



Key to notching

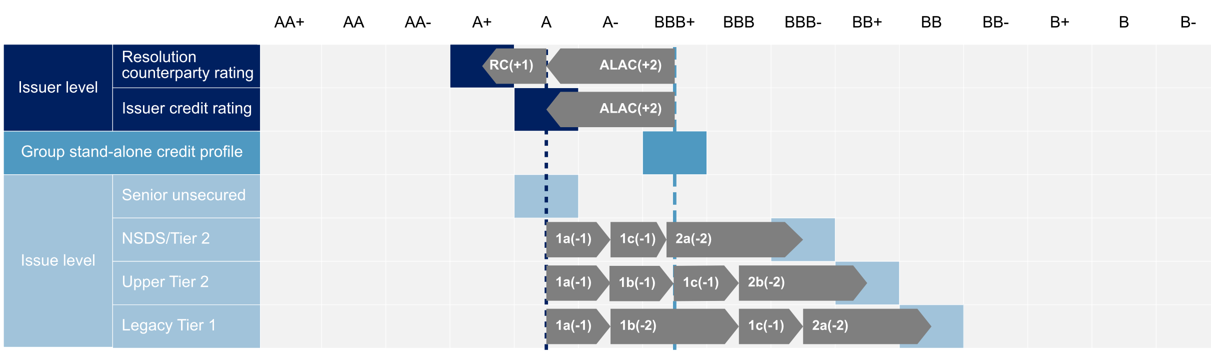
- Group stand-alone credit profile
- Issuer credit rating

1a	Contractual subordination
1b	Discretionary or mandatory nonpayment clause and whether the regulator classifies it as regulatory capital
1c	Mandatory contingent capital clause or equivalent
2a	Mandatory going-concern, regulatory capital-based trigger (either statutory or contractual)
2b	Other nonpayment or default risk not captured already

Note: The number-letter labels in the table above are in reference to the notching steps we apply to hybrid capital instruments, as detailed in table 3 of our "Hybrid Capital: Methodology And Assumptions" criteria, published on July 1, 2019.
The nonoperating holding company (NOHC) issuer credit rating and senior unsecured debt ratings are notched from the group stand-alone credit profile (SACP) under our criteria. Since ALAC notching does not benefit NOHCs, for simplicity the diagram above is stylized to show the positioning of these ratings with reference to the group SACP.
AT1--Additional Tier 1.

Chart 10

Santander UK plc: Notching



Key to notching

- Group stand-alone credit profile
- Issuer credit rating

RC	Resolution counterpartyliabilities (senior secured debt)
ALAC	Additional loss-absorbing capacity buffer
1a	Contractual subordination
1b	Discretionary or mandatory nonpayment clause and whether the regulator classifies it as regulatory capital
1c	Mandatory contingent capital clause or equivalent
2a	Mandatory going-concern, regulatory capital-based trigger (either statutory or contractual)
2b	Other nonpayment or default risk not captured already

Note: The number-letter labels in the table above are in reference to the notching steps we apply to hybrid capital instruments, as detailed in table 3 of our "Hybrid Capital: Methodology And Assumptions" criteria, published on July 1, 2019.
NDSD--Non-deferrable subordinated debt.

Resolution Counterparty Ratings

We set 'A+/A-1' resolution counterparty ratings (RCR) on Santander UK PLC one notch above its long-term issuer credit rating. The RCRs also reflect our jurisdiction assessment for the U.K.

An RCR is a forward-looking opinion of the relative default risk of certain senior liabilities that may be protected from default through an effective bail-in resolution process for the issuing financial institutions. RCRs apply to issuers in jurisdictions where we assess the resolution regime to be effective and we consider the issuer likely to be subject to a resolution that entails a bail-in if it reaches nonviability.

Key Statistics

Table 1

Santander UK Group Holdings PLC--Key Figures

	--Year ended Dec. 31--				
(Mil. £)	**2020**	**2019**	**2018**	**2017**	**2016**
Adjusted assets	297,415	286,712	287,567	313,018	300,825
Customer loans (gross)	214,094	208,879	202,952	208,838	204,821
Adjusted common equity	11,045	11,055	11,027	11,456	11,058
Operating revenues	3,958	4,170	4,543	4,864	4,676
Noninterest expenses	2,561	2,613	2,632	2,595	2,558
Core earnings	418	794	1,073	1,256	1,270

Table 2

Santander UK Group Holdings PLC--Business Position

	--Year ended Dec. 31--				
(%)	**2020**	**2019**	**2018**	**2017**	**2016**
Total revenues from business line (mil. £)	3,958	4,170	4,543	4,912	4,795
Commercial banking/total revenues from business line	14.7	14.7	18.2	9.5	10.2
Retail banking/total revenues from business line	87.9	85.7	82.9	79.7	77.9
Commercial & retail banking/total revenues from business line	102.6	100.4	101.0	89.3	88.1
Trading and sales income/total revenues from business line	N/A	N/A	N/A	8.9	8.4
Other revenues/total revenues from business line	(2.6)	(0.4)	(1.0)	1.8	3.6
Investment banking/total revenues from business line	N/A	N/A	N/A	8.9	8.4
Return on average common equity	1.6	3.6	6.5	7.5	8.1

Data as of Dec. 31, 2020. N/A--Not applicable.

Table 3

Santander UK Group Holdings PLC--Capital And Earnings

	--Year ended Dec. 31--				
(%)	**2020**	**2019**	**2018**	**2017**	**2016**
Tier 1 capital ratio	18.6	17.9	16.2	15.0	14.0
S&P Global Ratings' RAC ratio before diversification	9.7	9.5	9.4	9.3	8.6
S&P Global Ratings' RAC ratio after diversification	8.9	8.8	8.9	8.9	8.2
Adjusted common equity/total adjusted capital	83.1	83.1	84.3	84.8	87.6
Double leverage	100.3	100.3	100.7	100.0	100.0
Net interest income/operating revenues	86.8	79.0	79.4	78.2	76.6
Fee income/operating revenues	9.7	16.5	16.5	16.6	16.5
Market-sensitive income/operating revenues	1.9	0.6	2.8	3.6	4.6
Cost-to-income ratio	64.7	62.7	57.9	53.4	54.7
Preprovision operating income/average assets	0.5	0.5	0.6	0.7	0.7
Core earnings/average managed assets	0.1	0.3	0.4	0.4	0.4

Data as of Dec. 31, 2020. 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	371	1
Of which regional governments and local authorities	0	0	0	0	0
Institutions and CCPs	4,665	500	11	832	18
Corporate	28,900	17,600	61	33,491	116
Retail	197,600	41,900	21	83,603	42
Of which mortgage	179,500	30,700	17	65,571	37
Securitization§	3,431	1,038	30	956	28
Other assets†	6,609	4,100	62	8,661	131
Total credit risk	296,705	65,138	22	127,914	43
Credit valuation adjustment					
Total credit valuation adjustment	--	300	--	0	--
Market risk					
Equity in the banking book	200	600	300	1,500	750
Trading book market risk	--	200	--	300	--
Total market risk	--	800	--	1,800	--
Operational risk					
Total operational risk	--	6,800	--	7,749	--

Table 4

Santander UK Group Holdings PLC--Risk-Adjusted Capital Framework Data (cont.)

	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	--	137,462	100
Total diversification/ concentration adjustments	--	--	--	11,538	8
RWA after diversification	--	73,038	--	149,000	108
		Tier 1 capital	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global Ratings RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		13,531	18.5	13,286	9.7
Capital ratio after adjustments‡		13,531	18.6	13,286	8.9

*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--				
(%)	**2020**	**2019**	**2018**	**2017**	**2016**
Growth in customer loans	2.5	2.9	(2.8)	2.0	1.0
Total diversification adjustment/S&P Global Ratings' RWA before diversification	8.4	7.2	4.8	4.5	4.7
Total managed assets/adjusted common equity (x)	27.1	26.1	26.2	27.5	27.4
New loan loss provisions/average customer loans	0.3	0.1	0.1	0.1	0.0
Net charge-offs/average customer loans	0.2	0.2	0.2	0.1	0.1
Gross nonperforming assets/customer loans + other real estate owned	2.0	1.7	1.8	1.9	2.1
Loan loss reserves/gross nonperforming assets	30.7	21.8	20.7	23.6	22.5

Data as of Dec. 31, 2020. RWA--Risk weighted assets.

Table 6

Santander UK Group Holdings PLC--Funding And Liquidity

	--Year ended Dec. 31--				
(%)	**2020**	**2019**	**2018**	**2017**	**2016**
Core deposits/funding base	69.5	66.5	64.7	63.8	66.5
Customer loans (net)/customer deposits	110.2	116.2	116.4	117.5	118.0
Long-term funding ratio	86.4	84.0	87.7	82.2	87.0
Stable funding ratio	108.6	102.6	108.2	105.9	106.3
Short-term wholesale funding/funding base	14.3	16.9	13.0	18.7	13.7
Broad liquid assets/short-term wholesale funding (x)	1.6	1.2	1.6	1.3	1.5
Net broad liquid assets/short-term customer deposits	12.5	4.6	12.2	9.8	10.4
Short-term wholesale funding/total wholesale funding	45.5	49.2	35.9	50.5	40.0

Table 6

Santander UK Group Holdings PLC--Funding And Liquidity (cont.)					
	--Year ended Dec. 31--				
(%)	**2020**	**2019**	**2018**	**2017**	**2016**
Narrow liquid assets/3-month wholesale funding (x)	N/A	N/A	N/A	1.7	2.0

Data as of Dec. 31, 2020. N/A--Not applicable.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Methodology For Assigning Financial Institution Resolution Counterparty Ratings, April 19, 2018
- 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
- Criteria | Financial Institutions | Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Criteria | Financial Institutions | Banks: Assessing Bank Branch Creditworthiness, Oct. 14, 2013
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- ARCHIVE | General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria | Financial Institutions | Banks: Commercial Paper I: Banks, March 23, 2004

Related Research

- Comparative Statistics On Top 25 U.K. Banks, June 28, 2021
- Various Rating Actions Taken On U.K. Banks On Recovering Economy, June 24, 2021
- Why The U.K.'s Worse Recession Should Turn Into A Stronger Recovery, May 12, 2021
- U.K. Banks' Poor 2020 Earnings Mask A Hint Of Optimism For Future Creditworthiness, March 9, 2021
- Banking Industry Country Risk Assessment: United Kingdom, Nov. 17, 2020
- U.K. Bank Regulator's Proposed Easing Of MDA Restrictions Should Be Ratings Neutral, Nov. 2, 2020
- Banco Santander S.A., Aug. 5, 2020

- Europe's AT1 Market Faces The COVID-19 Test: Bend, Not Break, April 22, 2020

Ratings Detail (As Of July 15, 2021)*	
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	
Banco Santander (Brasil) S.A.	
Issuer Credit Rating	BB-/Stable/B
Brazil National Scale	brAAA/Stable/brA-1+
Banco Santander-Chile S.A.	
Issuer Credit Rating	A-/Stable/A-2
Commercial Paper	
Foreign Currency	A-2
Senior Unsecured	A-
Banco Santander S.A.	
Issuer Credit Rating	A/Stable/A-1
Resolution Counterparty Rating	A+/--/A-1
Senior Subordinated	A-
Senior Unsecured	A
Short-Term Debt	A-1
Subordinated	BBB+
Banco Santander SA (London Branch)	
Certificate Of Deposit	
Local Currency	A-1
Banco Santander S.A. (New York Branch)	
Commercial Paper	
Local Currency	A-1
Banco Santander Totta S.A.	
Issuer Credit Rating	BBB/Stable/A-2
Resolution Counterparty Rating	BBB/--/A-2
Senior Unsecured	BBB
PSA Banque France	
Issuer Credit Rating	BBB+/Stable/A-2
Commercial Paper	A-2

Ratings Detail (As Of July 15, 2021)*(cont.)	
Senior Unsecured	BBB+
Santander Bank, N.A.	
Issuer Credit Rating	A-/Stable/A-2
Senior Unsecured	A-
Short-Term Debt	A-2
Subordinated	BBB+
Santander Consumer Bank AG	
Issuer Credit Rating	A-/Stable/A-2
Resolution Counterparty Rating	A/--/A-1
Commercial Paper	A-2
Senior Subordinated	BBB+
Senior Unsecured	A-
Santander Consumer Finance S.A.	
Issuer Credit Rating	A-/Stable/A-2
Resolution Counterparty Rating	A/--/A-1
Commercial Paper	
Local Currency	A-2
Senior Subordinated	BBB+
Senior Unsecured	A-
Short-Term Debt	A-2
Subordinated	BBB
Santander Financial Services PLC	
Issuer Credit Rating	A-/Stable/A-2
Resolution Counterparty Rating	A/--/A-1
Santander Holdings U.S.A Inc.	
Issuer Credit Rating	BBB+/Stable/A-2
Senior Unsecured	BBB+
Santander Totta SGPS, S.A.	
Senior Unsecured	BBB
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.