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Santander UK Group Holdings PLC

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Santander UK Group Holdings PLC

UGCP	bbb+
Anchor	bbb+	
Business Position	Adequate	0
Capital and Earnings	Adequate	0
Risk Position	Adequate	0
Funding	Average	0
Liquidity	Adequate	

\+

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

\+

Additional Factors	0

Issuer Credit Rating
A/Stable/A-1
Resolution Counterparty Rating
A+/--/A-1
Holding Company ICR
BBB/Stable/A-2

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

Major Rating Factors

Issuer Credit Rating
BBB/Stable/A-2

Strengths:

- Good position in U.K. retail banking.
- Conservative risk profile, including a relatively cautious pace of credit growth.
- Solid capitalization by our measures.

Weaknesses:

- Cost-income ratio is weakening, in part due to net interest margin pressure and ongoing investment in the bank.
- Lower revenue diversification than its larger U.K. competitors.
- Market shares and franchise in business and commercial banking will continue to lag behind direct peers.

Outlook

Santander UK Group Holdings PLC

The stable outlook reflects our view that the bank will steadily expand its market position in U.K. retail banking over our two-year outlook horizon, while maintaining its supportive risk appetite and capitalization. It also reflects our view that Banco Santander will continue to provide ongoing group support, despite the uncertainty for extraordinary group support in a severe stress scenario given its multiple point of entry approach to resolution.

We would most likely only raise the ratings if we revised upward the unsupported group credit profile (UGCP). This could occur, in particular, if we believed Santander UK's risk-adjusted capital (RAC) ratio was comfortably and consistently above our 10% threshold for a higher capital assessment.

We could lower the ratings if we revised downward the UGCP. At this time, we see limited downward pressures on Santander UK's credit characteristics. However, we could lower the ratings if asset quality significantly deteriorated due to a weakening in the external environment, or if we perceived a step change in risk appetite.

Santander UK PLC

The stable outlook on the main operating subsidiary reflects our view of the UGCP as described above. It also assumes that its additional loss-absorbing capacity (ALAC) buffer will remain supportive of the issuer credit rating by remaining comfortably above our 8% threshold.

We would most likely raise or lower the ratings if the UGCP strengthened or deteriorated, or if we expected the ALAC ratio to fall below 8%, which would most likely be due to material credit growth or capital distributions beyond our current expectations.

Rationale

As Santander UK is one of the six largest financial institutions focused on the U.K. banking market, we believe the bank's good position in U.K. retail banking, and conservative risk profile underpin its creditworthiness at the current rating level. However, the bank's franchise and market shares in business and commercial banking will continue to lag behind some of Santander UK's closest peers, which leads to higher revenue concentrations.

Owing to net interest margin pressure and the ongoing need to invest in the bank, we believe Santander UK would have to do well to achieve its stated medium-term goals of a return on tangible equity (RoTE) of 10%-12% (from a reported 9% in 2018) and a cost-income ratio of below 50% (a reported 56% in 2018). Santander UK is not alone in this respect owing to the demanding operating environment for U.K. banks, including the prolonged low-interest-rate environment, increasing competitive dynamics, and a series of regulatory and associated cost initiatives. Our view of Santander UK's earnings outlook therefore constrains upside potential for the ratings. We believe that balance sheet metrics--specifically capitalization, the funding and liquidity profiles, and asset quality--are broadly in line with those of domestic U.K. peers and we expect Santander UK will maintain its healthy profile.

Our 'A' rating on Santander UK PLC includes two notches of uplift for its ALAC. The bank's ALAC buffers do not positively affect the rating on Santander UK Group Holdings PLC. The 'BBB' rating on the nonoperating holding company (NOHC) is one notch lower than the 'bbb+' UGCP, reflecting the structural subordination of holding company creditors.

We consider Santander UK a core subsidiary of Banco Santander due to its material contribution to group earnings and relative medium-term earnings stability. However, we capture the benefits of being part of a large, diversified global bank within the UGCP, rather than potential group support notches, owing to the broader group's multiple point of entry approach to bank resolution.

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. While economic growth will remain lackluster, and may well decline in a disruptive Brexit scenario, the steady strengthening of U.K. banks' balance sheets over the past decade, and the reduction of pockets of risks/legacy assets at the large and diversified banks, means that the sector as a whole is now much more resilient to a tougher operating environment. An orderly Brexit with a transitional arrangement is still our base case. However, the risk of a disorderly Brexit has increased. If such an scenario materializes, or becomes likely, we would consider a negative action on the BICRA economic risk trend or score if we saw a severe economic shock looming.

We view the U.K. banking industry risk trend as stable. The domestic reform agenda is well advanced and banks have clarity on their future regulatory environment. We assume that past changes in regulatory structures will now continue to support market discipline, constrain risk appetites, curb adventurous management strategies, encourage a better conduct and compliance agenda, and still enable the banking industry to yield adequate profitability. We see limited downside to our industry risk assessment in our base case, though implicit in our assessment is the expectation that the industry continue on its path toward consistent statutory profitability and a return to earnings above the cost of capital.

Table 1

Santander UK Group Holdings PLC Key Figures

	--Year-ended Dec. 31--				
(Mil. £)	**2018**	**2017**	**2016**	**2015**	**2014**
Adjusted assets	287,567	313,018	300,825	279,178	273,790
Customer loans (gross)	202,952	208,838	204,821	202,699	193,046
Adjusted common equity	11,027	11,456	11,058	10,866	10,603
Operating revenues	4,543	4,864	4,676	4,577	4,468
Noninterest expenses	2,563	2,595	2,558	2,580	2,574
Core earnings	1,122	1,256	1,270	1,257	1,300

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 in improving earnings metrics. For example, its cost-income ratio is deteriorating. Much improved efficiency could be one indication that Santander UK's business position is more favourable, and a credit strength under most operating conditions. If consummated, this credit strength would complement 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; UGCP: 'a-'), Nationwide Building Society (NBS; 'a'), The Royal Bank of Scotland Group plc (RBS; '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 CYBG PLC ('bbb'). Outside of the U.K., other retail-focused peers are ABN AMRO Bank N.V.('a-'), Credit Mutuel Group ('a-'), Danske Bank A/S ('a-') and Nykredit Realkredit A/S ('a-').

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 15 million active customers. We estimate that Santander UK's share of the U.K. residential mortgage stock at end-2018 stood at about 11%. We note that Santander UK's share of the U.K. retail current account market continues to steadily increase, such that it now ranks close to HSBC.

As of year-end 2018, Santander UK had completed the relevant business transfers in order to comply with the ring-fencing requirements in the U.K. During 2018, it transferred £1.4 billion of customer loans, £21.5 billion of other assets, and £20.7 billion of liabilities, mainly related to derivatives business, principally to Banco Santander's London branch.

Santander UK is managed via three main divisions:

- Retail Banking, including business banking with turnover up to £6.5 million; 59% of regulatory risk-weighted assets (RWA) at Dec. 31, 2018, up from 51% the year before.
- Corporate & Commercial Banking, which covers businesses with annual turnover of £6.5 million to £500 million; 22% of regulatory RWA (22%; but reduced in absolute terms in 2018).
- Corporate & Investment Banking (CIB), which covers corporate clients with an annual turnover of over £500 million; 9% of regulatory RWA (21%).
- The balance of RWA (11%) is held in the corporate centre.

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):

- In 2018, retail banking was a reported 82% of total income; for Lloyds and RBS this metric is typically in the 50%-60% range.
- In 2018, net interest income was a reported 79% of total income; for Lloyds and RBS this metric is typically in the 60%-70% range.

We note that in January 2019, the bank withdrew its bid for a Capability and Innovation Fund pool, which is one part of the RBS State Aid Alternative Remedies Package. We understand the decision reflects Santander UK's preference for flexibility and, unlike some smaller peers, its greater ability to focus on expanding its existing business banking franchise. The latter includes still participating in the Incentivized Switching Scheme, which is the other part of the remedies package that launched in February 2019.

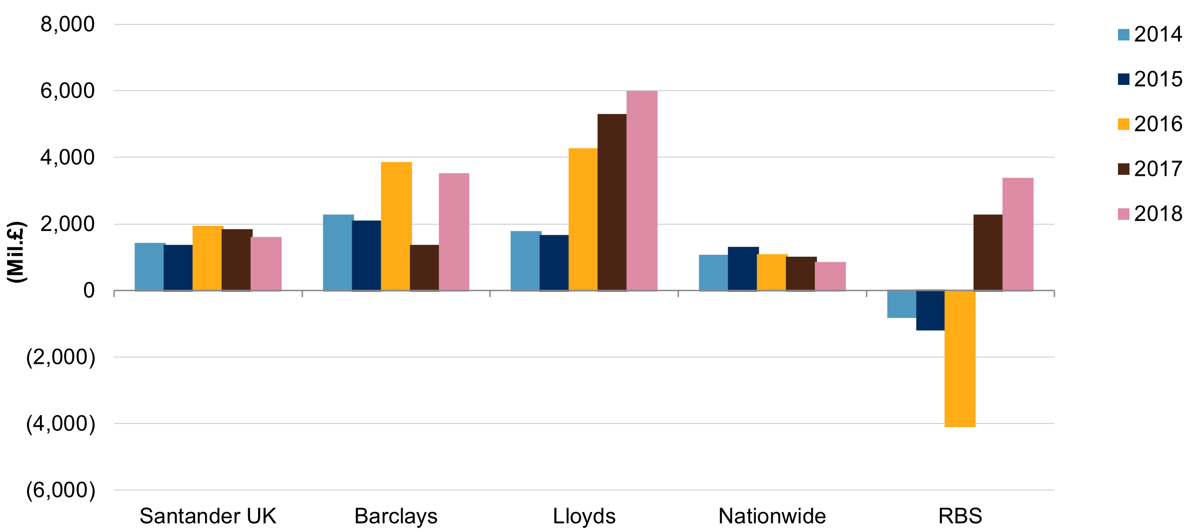
Santander UK's commercial banking franchise is evolving, with the focus on commercial real estate (CRE) lending having significantly reduced in recent years. In particular we see evidence of Santander UK leveraging the group's international franchises by targeting more internationally focussed U.K. companies. 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 (chart 1). This mainly reflects its more modest conduct and litigation charges and its lesser need to restructure. As reflected by a decline in earnings, this was less the case in 2018, which may be indicative of performance in future years. U.K. mortgage market competition has increased in recent years, which has pressured 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 new 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'



Source: Company accounts. Year-end December, except for Nationwide whose fiscal year end is April 4 (fiscal 2018 ends April 4, 2019).

The management team is relatively stable and we don't consider its overall strategy or return targets overly aggressive. Indeed, consistent with the public statements of its parent and the parent's reticence to allocate more capital towards the U.K., we believe that the management continues to display the conservative stance that it adopted post the 2016 EU Referendum.

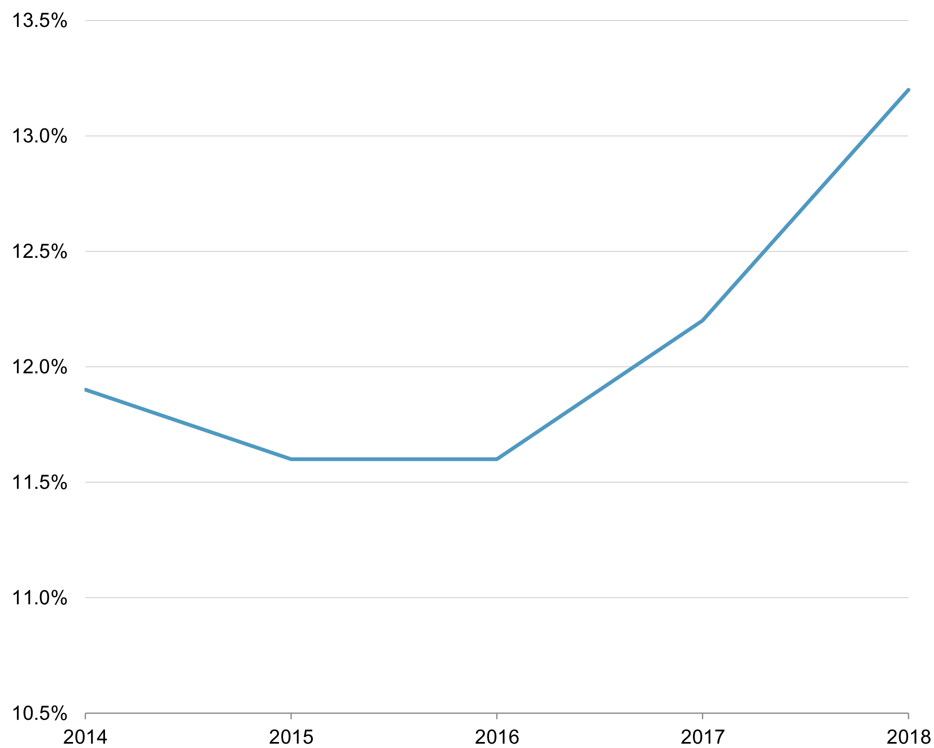
Key elements of management's updated strategy in 2019 include improving returns in its corporate and commercial division, achieving enhanced efficiency and capital discipline. The management has not outlined full details of its strategic transformation plan but indicative of the efficiency focus, Santander UK has announced the closure of 140 branches this year. Like peers, Santander UK is investing heavily in its digital capability; while this investment may constrain earnings growth in the short-term, we view this as necessary to compete, satisfy customer demands, and deliver simpler and more resilient technology platforms, in an increasingly demanding U.K. competitive and regulatory environment.

Capital and earnings: A higher assessment might require reduced distributions to the parent

Santander UK's regulatory capitalization has gradually strengthened over 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 13.3% at March 31, 2019 and a UK leverage ratio of 4.5%.

Chart 2

Santander UK CET1 Ratios



By our measures, we calculate Santander UK's risk-adjusted capital (RAC) ratio to be 9.4% as of Dec. 31, 2018, and we project that it will typically remain at 9.25%-9.75% through end-2021. This implies that Santander UK may be reasonably close to the 10% threshold that could lead to a stronger assessment. However, we are not confident that the ratio will be maintained 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 to decline in 2019, and to a lesser extent in 2020, reflecting net interest margin 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 recover strongly in 2021 as the benefits of management actions become apparent.
- We assume only 1% total loan growth in both 2019 and 2020 respectively, below our forecast for systemwide credit growth, before growing a bit more strongly in 2021.
- The loan loss rate to rise by about 5 basis points (bps) in each year (it was a reported 7 bps in 2018). Nevertheless, we have tailored these levels to be better than our base-case loan loss rate for the U.K. industry.

- We think that restructuring costs and additional conduct-related provisions may continue to weigh on statutory earnings in both 2019 and 2020.
- A dividend policy to distribute one-half of earnings, and possible additional distributions if Santander UK makes strong progress in managing regulatory RWAs moves.
- S&P Global Ratings' RWAs expected to remain stable in 2019 and 2020, helped by a reduction in higher risk-weighted CRE and other corporate loans, before increasing more in line with loan book growth in 2021.

We expect the quality of capital will remain a neutral credit factor. Adjusted common equity was 84% of total adjusted capital (TAC) at end-2018, similar to that of many peers.

In the first quarter of 2019, Santander UK reported adjusted profit before tax of £352 million, a 13% reduction compared to the prior year (when adjusted for ring-fencing perimeter changes). Within this the reported banking net interest margin fell by 5 bps from the fourth quarter of 2018 to 1.72%, the reported cost-income ratio was 60% and transformation charges booked were £77 million. We believe these figures are indicative of Santander UK's likely reporting trends for the remainder of 2019.

Santander UK stated that SVR balances reduced by a further £1.6 billion in the first quarter of 2019, which is a continuation of the longer term trend as customers refinance to lower rate fixed rate products (see chart 3).

Chart 3

Importance Of Standard Variable Rate Mortgage Book Has Reduced

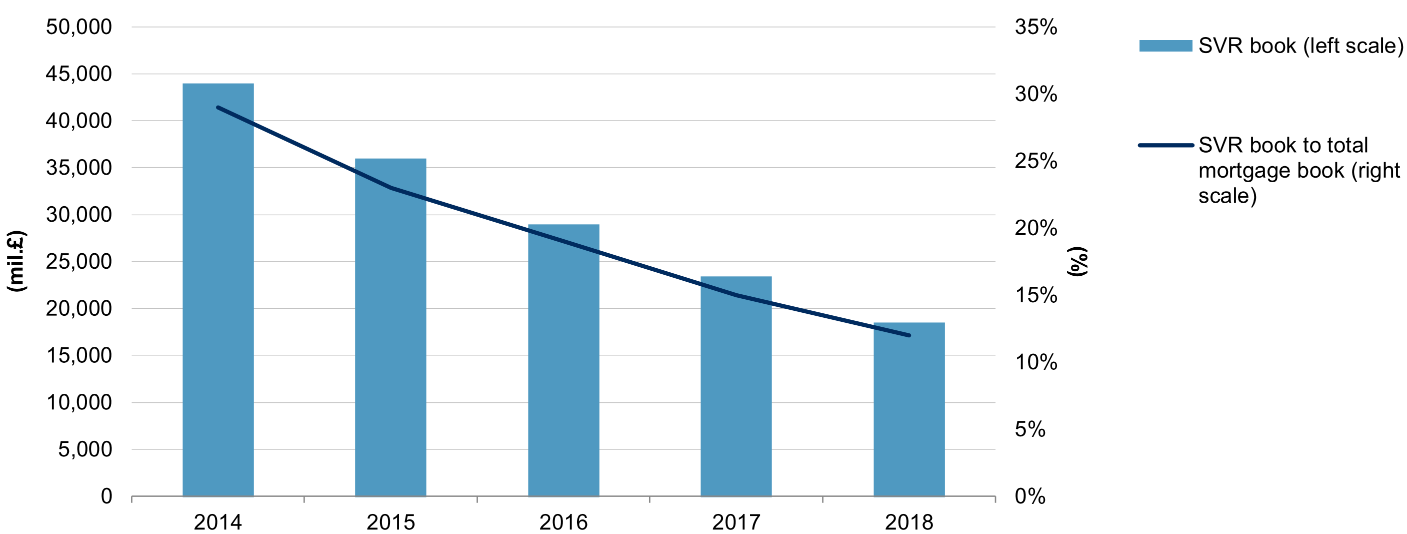
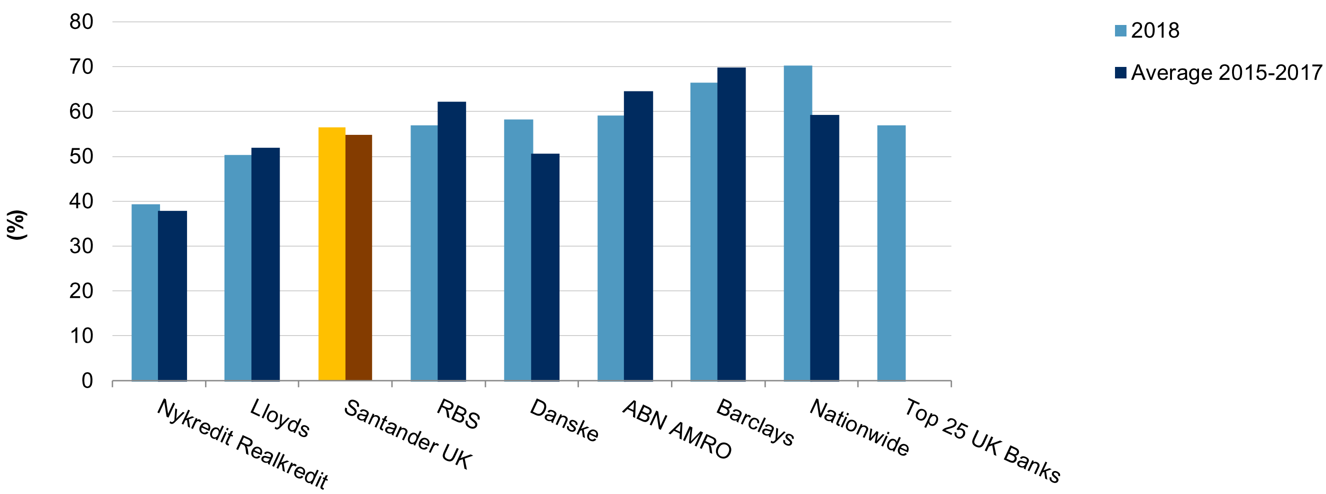


Chart 4

Santander UK and Peers Cost-To-Income Ratio



Source: S&P Global Ratings database. Year-end December; Nationwide's financial year-end is April 4.

Table 2

Santander UK Group Holdings PLC Capital And Earnings

	--Year-ended Dec. 31--				
(%)	**2018**	**2017**	**2016**	**2015**	**2014**
Tier 1 capital ratio	16.2	15.0	14.0	14.1	14.0
S&P Global Ratings' RAC ratio before diversification	9.4	9.3	8.6	8.9	N/A
S&P Global Ratings' RAC ratio after diversification	8.9	8.9	8.2	9.4	N/A
Adjusted common equity/total adjusted capital	84.3	84.8	87.6	87.5	92.7
Double leverage	100.7	100.0	100.0	100.0	100.0
Net interest income/operating revenues	79.4	78.2	76.6	78.1	76.9
Fee income/operating revenues	16.5	16.6	16.5	15.6	16.5
Market-sensitive income/operating revenues	2.8	3.6	4.6	5.4	5.7
Noninterest expenses/operating revenues	56.4	53.4	54.7	56.4	57.6
Preprovision operating income/average assets	0.7	0.7	0.7	0.7	0.7
Core earnings/average managed assets	0.4	0.4	0.4	0.5	0.5

N/A--Not applicable.

Table 3

Santander UK Group Holdings PLC RACF [Risk-Adjusted Capital Framework] Data

(Mil. £)	Exposure*	Basel III RWA	Average Basel III RW(%)	S&P Global RWA	Average S&P Global Ratings' RW (%)
Credit risk					
Government & central banks	39,800	--	--	549	1
Institutions and CCPs	8,662	1,563	18	1,954	23

Table 3

Santander UK Group Holdings PLC RACF [Risk-Adjusted Capital Framework] Data (cont.)					
Corporate	35,600	24,400	69	35,339	99
Retail	184,400	37,600	20	79,047	43
Of which mortgage	166,700	37,600	23	60,896	37
Securitization§	5,870	608	10	1,400	24
Other assets†	10,967	5,550	51	11,405	104
Total credit risk	285,298	69,720	24	129,693	45
Credit valuation adjustment					
Total credit valuation adjustment	--	1,250	--	--	--
Market Risk					
Equity in the banking book	200	600	300	1,500	750
Trading book market risk	--	--	--	--	--
Total market risk	--	600	--	1,500	--
Operational risk					
Total operational risk	--	7,500	--	8,565	--
	Exposure	**Basel III RWA**	**Average Basel II RW (%)**	**S&P Global Ratings' RWA**	**% of S&P Global Ratings' RWA**
Diversification adjustments					
RWA before diversification	--	79,070	--	139,757	100
Total Diversification/ Concentration Adjustments	--	--	--	6,647	5
RWA after diversification	--	79,070	--	146,404	105
		Tier 1 capital	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		12,746	16.1	13,082	9.4
Capital ratio after adjustments‡		12,746	16.2	13,082	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 2018', S&P Global Ratings.

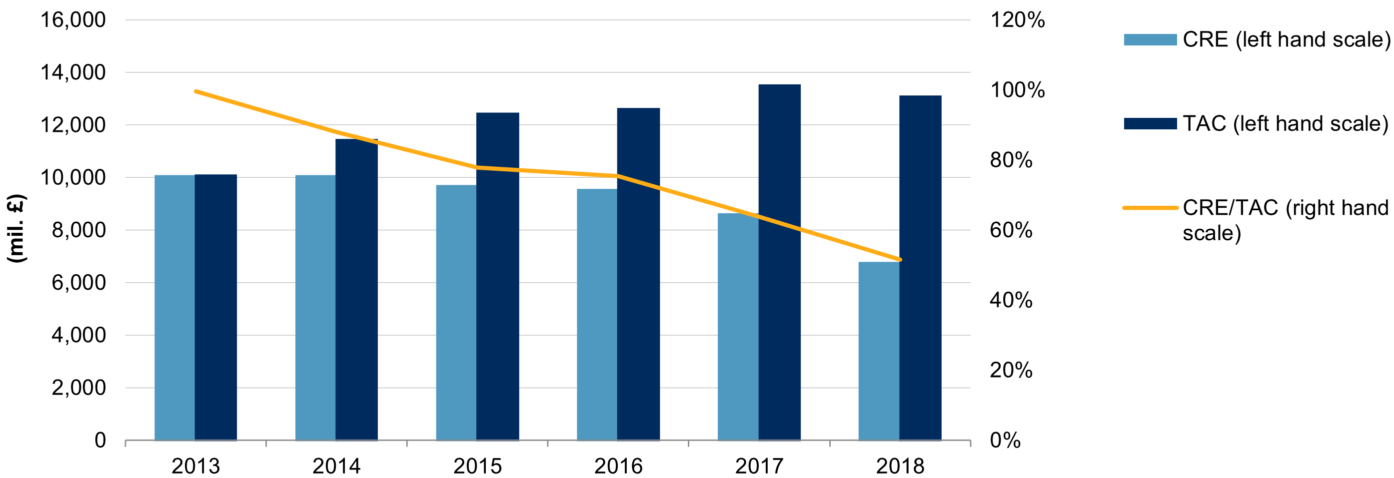
Risk position: Solid mortgage book and controlled growth in other segments

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 52% at Dec. 31, 2018, having been at a high level of 100% at end-2013. Santander UK states that CRE loans further reduced by £0.3 billion in the first quarter of 2019.

Chart 5

Santander UK's Commercial Real Estate (CRE) Exposure To Total Adjusted Capital (TAC)

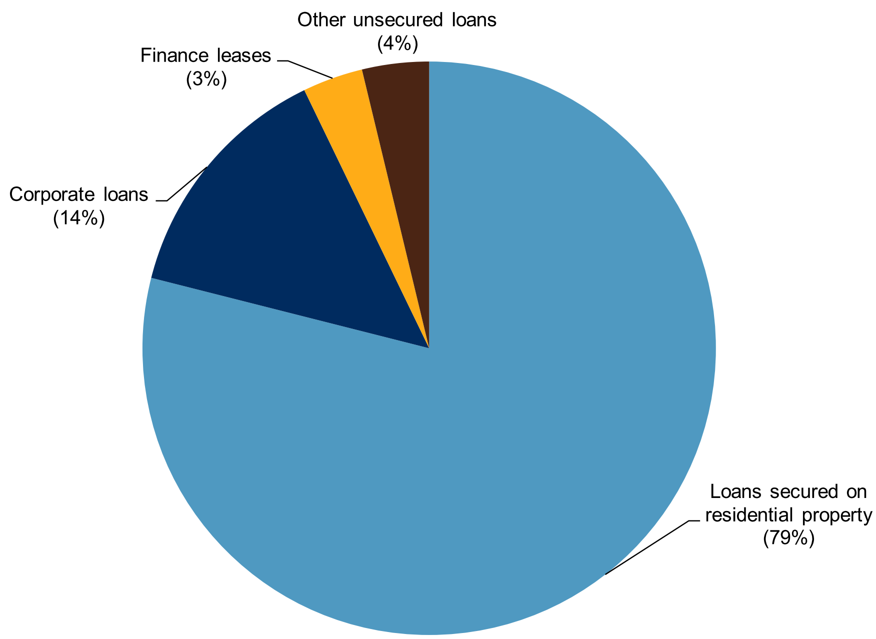


Source: As reported and S&P Global Ratings database.

Santander UK's total loan book remains heavily biased toward residential mortgages, which constituted a reported 79% of the gross customer loan book at Dec. 31, 2018. Conversely, relative to U.K. peers, Santander UK's loan book exposure to consumer credit is relatively modest (see chart 6.)

Chart 6

Santander UK's Gross Customer Loans By Sector At Dec. 31, 2018



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

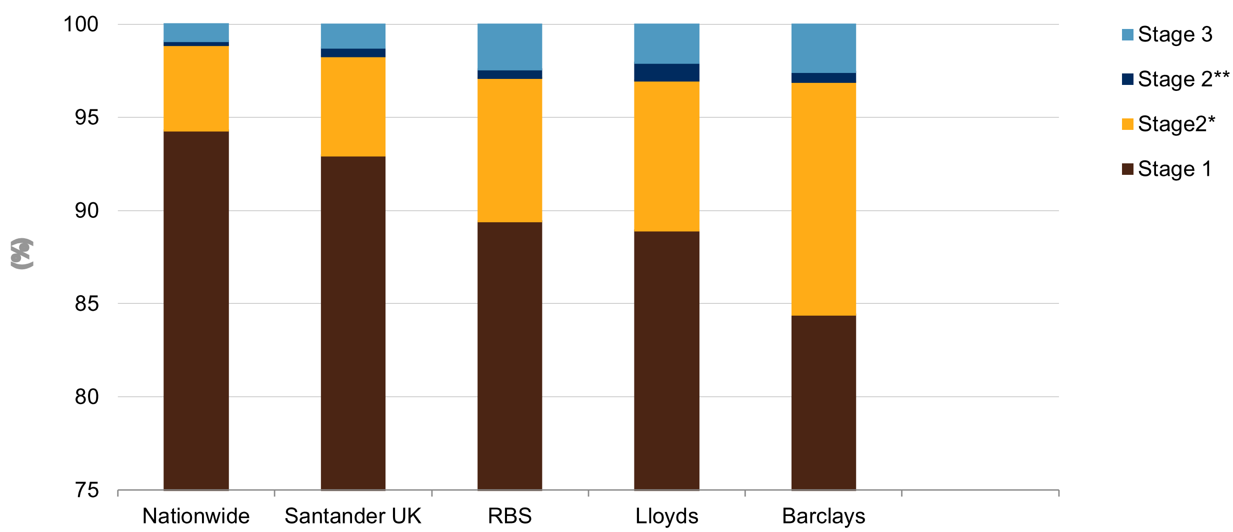
We believe that Santander UK's mortgage underwriting record compares satisfactorily with its U.K. peers'. We also note that buy-to-let mortgages, although increasing in terms of new lending, still represent only 5% of the mortgage stock, well below the industry stock figure of about 16%. This partly explains why mortgage asset quality appears to be a little worse than that reported by some peers, because current buy-to-let industry arrears are less than one-half owner-occupier mortgages.

Santander UK reports that only 1% of the mortgage book showed negative equity at Dec. 31, 2018, with a further 4% having an indexed loan-to-value ratio of 85%-100%. 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 £2 billion or 1.2% of gross loans at Dec. 31, 2018. 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. Only 0.5% of total loans were defined as Stage 2 and past 30 days due, which supports our view that Santander UK's credit risk compares well. Total Stage 2 and Stage 3 loans to total loans was 7% at Dec. 31, 2018, which is lower than many U.K. peers (see chart 7). Santander UK's coverage metrics appear to be lower than peers as the expected credit loss (ECL) allowance represents 13.8% of Stage 3 loans, or 4.5% coverage of Stage 2 and Stage 3 loans.

Chart 7

Santander UK and Peers Loan Breakdown By Stage



As of December 31, 2018. Data for Nationwide is as of April 4, 2019. Stage 2* not past due or <= 30 days past due. Stage 2** >30 days past due.

The 5% 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 56% of the mortgage stock, which compares to 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 postretirement scheme assets was £11.5 billion at year end-2018.

Table 4

Santander UK Group Holdings PLC Risk Position					
	--Year-ended Dec. 31--				
(%)	**2018**	**2017**	**2016**	**2015**	**2014**
Growth in customer loans	(2.8)	2.0	1.0	5.0	2.4
Total diversification adjustment/S&P Global Ratings' RWA before diversification	4.8	4.5	4.7	(4.9)	N/A
Total managed assets/adjusted common equity (x)	26.2	27.5	27.4	25.9	26.0
New loan loss provisions/average customer loans	0.1	0.1	0.0	0.0	0.1
Net charge-offs/average customer loans	0.2	0.1	0.1	0.2	0.2
Gross nonperforming assets/customer loans + other real estate owned	1.8	1.9	2.1	3.2	4.0
Loan loss reserves/gross nonperforming assets	20.7	23.6	22.5	17.6	18.7

N/A--Not applicable.

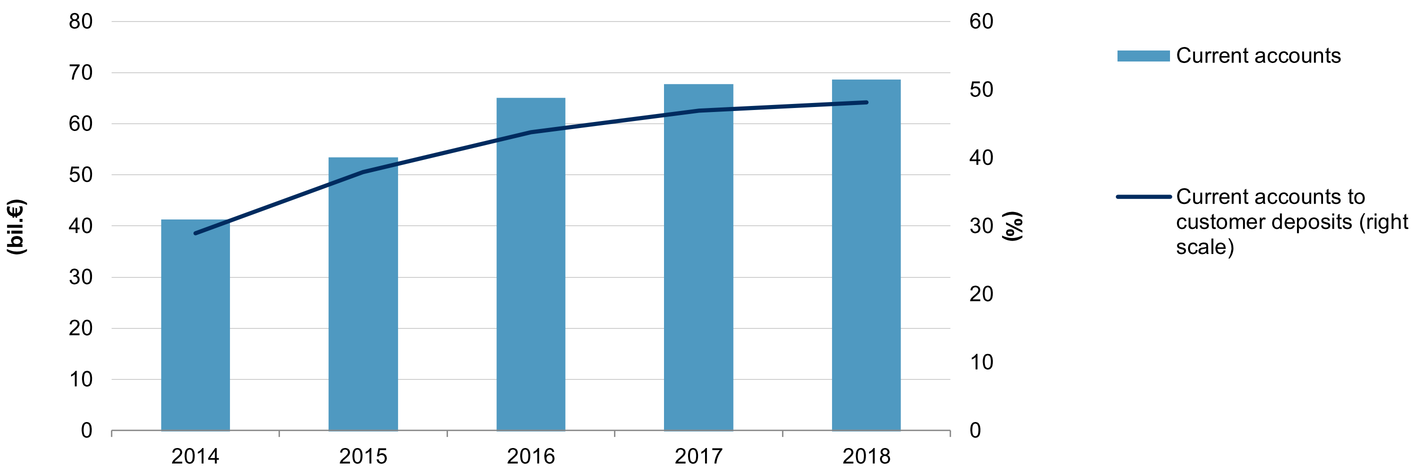
Funding and liquidity: Granular deposit franchise and access to diversified funding sources

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 position 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 2018, and post the impact of ring fencing, Santander UK stated that its loan-deposit ratio was 116%. To put this into context the median for the top-25 U.K. banks (by revenues) was 111% at end-2018. We do not 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 48% of customer deposits (see chart 8).

Chart 8

Customer Accounts To Customer Deposits



Our stable funding ratio of 108% at Dec.31, 2018 is also broadly in line with the average of 112% for the top-25 U.K. banks.

The bank remains one of the larger issuers of residential mortgage-backed securities and covered bonds in the U.K, representing 9% of its funding (£23.4 billion as of end-2018). It also means that asset encumbrance tends to be higher at Santander UK than at other U.K. banks. However, we observe that the encumbrance has reduced significantly in recent years, and it further reduced in 2018 to £47 billion having been as high as £74 billion back in 2014, for example.

The liquidity position is satisfactory given the bank's restrained use of short-term wholesale funding, 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 2018. The bank states that its liquidity coverage ratio (LCR) ratio as of March, 2019 was 142% (end-2018: 164%), with the decrease being a result of the new ring-fence structure (liquidity is managed separately for the ring-fenced bank, and the small non-ring fenced bank with effect from Jan. 1, 2019).

Table 5

Santander UK Group Holdings PLC Funding And Liquidity

	--Year-ended Dec. 31--				
(%)	**2018**	**2017**	**2016**	**2015**	**2014**
Core deposits/funding base	64.7	63.8	66.5	67.8	65.2
Customer loans (net)/customer deposits	116.4	117.5	118.0	123.4	124.4
Long-term funding ratio	87.7	82.2	87.0	87.9	87.5
Stable funding ratio	108.2	105.9	106.3	102.0	103.1
Short-term wholesale funding/funding base	13.0	18.7	13.7	12.8	13.1
Broad liquid assets/short-term wholesale funding (x)	1.6	1.3	1.5	1.3	1.3
Net broad liquid assets/short-term customer deposits	12.2	9.8	10.4	6.3	7.0
Short-term wholesale funding/total wholesale funding	35.9	50.5	40.0	39.0	37.4
Narrow liquid assets/3-month wholesale funding (x)	N/A	1.7	2.0	1.7	1.9

N/A--Not applicable.

Support: Two notches of ALAC support

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.

However, we view the U.K. resolution regime as effective under our ALAC criteria because, among other factors, 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, based on our view that its ALAC ratio is likely to be consistently above our 8% threshold.

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 NOHC. On this basis, we calculate that ALAC was 11.4% of S&P Global Ratings RWAs at year-end 2018 (see table 6), up from 8.9% the year before reflecting significant issuance of NOHC senior obligations. We expect our ALAC measure will remain comfortably above our 8% threshold on an ongoing basis.

Santander UK states that its minimum requirement for own funds and eligible liabilities (MREL) position was 31.4% at March 31, 2019, including eligible operating company instruments. The Bank of England has now communicated to all relevant U.K. banks their non-binding indicative MREL requirements. Firms become subject to final requirements from Jan. 1, 2022. In Santander UK's case, this indicative figure is 27.0%, and the gross issuance required to achieve this target appears to be both manageable and supportive of our ALAC assessment.

Table 6

Summary Of ALAC Calculation As Of Dec. 31, 2018

		Bil. £	% of S&P Global Ratings' RWAs
A	Adjusted common equity	11,027	
B	Hybrids in TAC	2,055	
C (A+B)	Total adjusted common equity	13,082	9.4%
D	TAC in excess of our 7% threshold	3,299	2.4%
E	ALAC-eligible instruments	12,574	9.0%
	of which NOHC senior	9,265	
	of which dated subordinated	2,382	
	of which minimal equity content hybrids	1,200	
	of which other	9	
F (D+E)	ALAC buffer	15,873	11.4%
	S&P Global Ratings' RWA	139,757	

ALAC--Additional loss-absorbing capacity. TAC--Total adjusted capital. NOHC--Nonoperating holding company. RWAs--Risk-weighted assets. Source: S&P Global Ratings' database.

We could potentially rate Santander UK PLC above its parent Banco Santander (they are currently both rated at the same level) as a result of ALAC because we believe that:

- The subsidiary is clearly subject to a separate resolution process;
- The subsidiary will be able to continue operating without defaulting on its senior unsecured obligations in the event of a resolution of the parent; and
- Santander UK's ALAC cannot be used to recapitalize another part of the Banco Santander group.

Additional rating factors:

No additional factors affect the ratings.

Group status: Core subsidiary of Banco Santander

We consider Santander UK a core 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 U.K. subgroup's ratings 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 UK 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.

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 UGCP. 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 UGCP 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. In 2018 Abbey National Treasury Services PLC (ANTS) become a subsidiary of the NOHC (having previously been a subsidiary of Santander UK plc). ANTS holds a small number of legacy business positions and the business of the Jersey and Isle of Man branches.

Rating on hybrid instruments

We rate the nondeferrable subordinated debt issued by Santander UK PLC two notches below the UGCP, reflecting the debt's contractual subordination as a Tier 2 instrument and our view that the Bank Recovery and Resolution Directive (BRRD) creates the equivalent of a contractual write-down clause. We rate similar issuance by the NOHC a notch lower, reflecting our view of structural subordination.

We rate all legacy Additional Tier 1 (AT1) instruments four notches below the UGCP, reflecting:

- One notch because the notes are contractually subordinated;
- Two notches because the notes have AT1 regulatory capital status; and
- One notch because we consider that the BRRD creates the equivalent of a contractual write-down clause.

We rate the AT1 securities issued by the NOHC 'B+', six notches below the UGCP, reflecting:

- One notch because the notes are contractually subordinated;
- Two notches because the notes have regulatory capital status;
- One notch because we consider the notes have a contractual write-down clause;
- One notch because the instrument contains a going-concern write-down trigger (defined as CET1 falling below 7%), and we expect that the distance to the trigger will remain within a range of 301 bps-700 bps; and
- One notch because the NOHC issues the notes.

Resolution Counterparty Ratings

We set 'A+/A-1' resolution counterparty rating (RCR) on Santander UK PLC one notch above its long-term issuer credit rating. The RCR 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.

Related Criteria

- 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: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- 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: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Financial Institutions - Banks: Commercial Paper I: Banks, March 23, 2004

Related Research

- United Kingdom Ratings Affirmed At ‘AA/A-1+’; Outlook Remains Negative, April 26, 2019
- U.K Banks: Looking At The Facts Rather Than Received Wisdom, March 4, 2019
- The 2019 Outlook For U.K. Banks Hinges On Brexit, Jan. 10, 2019
- Banco Santander S.A., Dec. 27, 2018
- Banking Industry Country Risk Assessment: United Kingdom, Nov. 5, 2018
- Everyone Passed: Stress Tests Highlight Growing Resilience Of U.K. Banks, Nov. 29, 2018
- Rearranged And Ready: U.K. Banks Are On Track For Ring-Fencing, Aug. 15, 2018
- Our Credit Loss Estimates For U.K. Banks: 2018-2020, June 7, 2018

Ratings Detail (As Of June 14, 2019)*	
Santander UK Group Holdings PLC	
Issuer Credit Rating	BBB/Stable/A-2
Junior Subordinated	B+
Senior Unsecured	BBB
Short-Term Debt	A-2
Subordinated	BB+
Issuer Credit Ratings History	
10-Apr-2015	BBB/Stable/A-2

Ratings Detail (As Of June 14, 2019)*(cont.)	
Sovereign Rating	
United Kingdom	AA/Negative/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-1
Commercial Paper	
Foreign Currency	A-1
Senior Unsecured	A
Subordinated	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
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+

Ratings Detail (As Of June 14, 2019)*(cont.)	
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	A-2
Senior Subordinated	BBB+
Senior Unsecured	A-
Short-Term Debt	A-2
Subordinated	BBB
Santander Holdings U.S.A Inc.	
Issuer Credit Rating	BBB+/Stable/A-2
Preferred Stock	BB+
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 Unsecured	A
Short-Term Debt	A-1
Subordinated	BBB-
Sovereign Real Estate Investment Trust	
Preferred Stock	BB+

*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.