FITCH PUBLISHES GERMANY'S SANTANDER CONSUMER BANK AG'S 'A-' IDR; OUTLOOK STABLE

Fitch Ratings-Frankfurt/London-30 March 2017: Fitch Ratings has published Santander Consumer Bank AG's (SCB AG) Long-Term Issuer Default Rating (IDR) of 'A-' and Short-Term IDR of 'F2'. The Outlook on the Long-Term IDR is Stable. Fitch has also published SCB AG's Viability Rating (VR) of 'a-'. A full list of rating actions is at the end of this rating action commentary.

KEY RATING DRIVERS
IDRS, VR AND SUPPORT RATING
SCB AG's IDRs are driven by both its intrinsic strength reflected in its VR, and our view that if needed, it would benefit from strong support from its ultimate parent, Banco Santander, S.A. (Santander, A-/Stable/F2/a-). SCB AG is Santander's main operating subsidiary in Germany.

SCB AG is deeply integrated within the operations of its intermediate parent Santander Consumer Finance, S.A. (SCF, A-/Stable/F2/bbb+). However, Fitch has assigned a separate VR to SCB AG, because in our view, its standalone franchise and business model would enable it to maintain a viable profile if it had to operate as an independent bank rather than as a subsidiary of Santander.

The VR reflects SCB AG's solid business model and franchise in Germany. We believe that the bank's strong pricing power in consumer finance results in adequate risk pricing through the credit cycle. It also provides considerable flexibility to mitigate the earnings pressure on retail funding that arises from the low interest-rate environment.

Our assessment of SCB AG's business model also reflects our expectation that its mortgage and SME lending businesses will continue to gradually increase, benefiting revenue diversification, but eroding the bank's return on unweighted average assets. We expect that consumer finance will continue to dominate the bank's business and drive its strong performance and resilient financial profile. As a result, we forecast profitability to remain strong in the foreseeable future, even if Germany's operating environment starts to deteriorate slightly.

SCB AG's funding consists primarily of retail deposits, and liquidity is robust. Funding is fully independent from Santander and has been significantly diversified since 2014 by scaling up origination of retained auto and consumer ABS, which the bank notably used to access the European Central Bank's (ECB) targeted longer-term refinancing operations (TLTRO) in 2016. Its large pool of unencumbered ECB-eligible secured loans provides funding flexibility. Further moderate diversification will be achieved in the medium term by issuing mortgage Pfandbriefe. We believe that SCB AG's high asset margins and established franchise in the vast German retail deposit market, despite its low market share, would enable the bank to collect sufficient deposits by raising deposit remuneration if additional liquidity needs arose.

SCB AG's capitalisation is robust but needs to be assessed in the context of a control and profit transfer agreement (CPTA) that obliges SCB AG to transfer its entire net income to its immediate parent, Santander Consumer Holding GmbH (SCH), a German-based holding company. This could create a reliance on capital injections from Santander, should SCB AG resume significant loan growth.

In addition to these standalone characteristics, SCB AG's IDRs reflect our view that Santander has a high propensity to provide both ordinary and extraordinary support if needed, given the shared brand name and SCB AG's deep integration within SCF and ultimately Santander's organisation and systems. SCB AG accounts for the largest share (about 40%) of SCF's consolidated loan portfolio, and Santander publicly defines consumer finance as one of its 10 core markets. In addition, several capital injections from Santander in recent years to support SCB AG's organic and external growth support our view that Santander's willingness to support its subsidiary is strong.

Beside this strong propensity, SCB AG's Support Rating reflects Santander's strong ability to provide support directly or via SCF if needed. We assess this ability through Santander and SCF's Long-Term IDRs as well as SCB AG's modest size relative to Santander's. Therefore, we equalise SCB AG's IDRs with those of Santander and SCF.

The CPTA prevents SCB AG from generating internal capital despite its strong performance. In light of SCH's limited resources, this is likely to make SCB AG reliant on capital reinjections from Santander/SCF to compensate potential large annual losses or to support significant loan growth. Therefore, SCB AG's IDRs are likely to be capped by those of Santander.

DCR AND DEPOSIT RATINGS
Due to its retail deposits and ABS driven funding mix, SCB AG's buffer of junior and vanilla senior debt is very small (about 2% of risk-weighted assets) and does not provide material incremental probability of default protection to derivative counterparties or depositors or provide comfort that recoveries in a default scenario would be above average. Therefore, the bank's DCR and Deposit Ratings are equalised with its IDRs.

RATING SENSITIVITIES
IDRS, VR AND SUPPORT RATING
A downgrade of SCB AG's IDRs and Support Rating could be driven either by a downgrade of Santander/SCF's IDRs or by Fitch's perception that propensity of institutional support is weakening. The latter could be signalled, for example, by the sale of a significant stake in SCB AG or if we otherwise believed that Santander no longer viewed SCB AG as a core entity.

An upgrade of SCB AG's IDRs would require an upgrade of Santander/SCF's Long-Term IDRs accompanied by either a continued very strong propensity to support SCB AG or an upgrade of SCB AG's VR. An upgrade of SCB AG's VR would require major revenue diversification, most likely from growth in mortgage and SME lending, while containing the resulting margin dilution. An upgrade would also require sustainable strengthening of SCB AG's capital and liquidity buffers.

A downgrade of the VR could result from excessive growth, a failure to maintain an adequate risk-return profile in mortgage and SME lending, or unexpectedly strong margin pressure in consumer finance. Severe deterioration of German households' creditworthiness triggering significant asset quality pressure in consumer finance and sharp capital erosion due to insufficient reinjections from Santander could also increase pressure on SCB AG's VR.

DCR AND DEPOSIT RATINGS
SCB AG's DCR and Deposit Ratings are primarily sensitive to changes in its IDRs. In addition, we could notch the DCR and Deposit Ratings above the IDRs if the bank increases its qualifying junior and vanilla senior debt buffers to an extent sufficient to restore viability and prevent a default on its derivative obligations and deposits after a failure.

The DCR and Deposit Ratings are also sensitive to future changes to Germany's resolution regime, which may alter the hierarchy of the various instruments in resolution, although this is not our expectation.

The rating actions are as follows:

Long-Term IDR published at 'A-'; Outlook Stable
Short-Term IDR published at 'F2'
Viability Rating published at 'a-'
Support Rating published at '1'
Derivative Counterparty Rating published at 'A-(dcr)'
Deposit Ratings published at 'A-'/'F2'

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Additional information is available on www.fitchratings.com

Applicable Criteria
Global Bank Rating Criteria (pub. 25 Nov 2016)
https://www.fitchratings.com/site/re/891051