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Research Update:

German Credit Institution Santander Consumer Bank Assigned 'BBB+/A-2' Ratings; Outlook Stable

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Research Update:

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Overview

- Santander Consumer Bank AG (SCB) has a sound market position in consumer finance and operates in a favorable economic environment in Germany.
- SCB has strong capitalization, a granular loan portfolio, and a diversified funding profile.
- We are assigning our 'BBB+/A-2' long- and short-term ratings to SCB.
- The stable outlook reflects our view that SCB's status as a core subsidiary of Spain-based Santander Consumer Finance is unlikely to change over the next 18-24 months.

Rating Action

On March 30, 2017, S&P Global Ratings assigned its 'BBB+/A-2' long- and short-term counterparty credit ratings to Germany-based Santander Consumer Bank AG (SCB). The outlook is stable.

Rationale

The 'BBB+' long-term rating on SCB reflects our 'a-' anchor for German domestic banks and the bank's high market share and concentration in the German consumer finance niche. The rating also reflects our forecast of a risk-adjusted capital (RAC) ratio between 10.5%-11% over the next 12-24 months. In addition, the ratings reflect the concentration of SCB's loan book on consumer finance, which lacks the diversification of universal bank peers. We also take into account the bank's diversified funding profile dominated by retail deposits and its comfortable liquidity position. Based on these factors, we view SCB's stand-alone credit profile (SACP) at 'bbb+'.

Furthermore, in our view SCB is a core subsidiary of its intermediate parent, Spain-based Santander Consumer Finance S.A. (SCF; BBB+/Stable/A-2) and contributes about 40% to the lending volume of SCF. We expect SCB's strategy will remain aligned with that of Banco Santander Group's consumer finance strategy. The group support does not result in an uplift currently SCB's SACP being at the same rating level as our issuer credit rating on SCF.

SCB enjoys a strong domestic market share of about 13% in the niche auto loan and consumer finance market. SCB's consumer finance division has one of the most cost-efficient operations among its peers. These factors only partly offset SCB's fairly concentrated business model. Moreover, margin pressure in Germany's highly competitive consumer finance market appears to limit SCB's growth potential as it aims to maintain risk-adjusted profitability.

Our forecast RAC ratio in the range of 10.5%-11% by year-end 2018 underpins our view of SCB's solid capitalization. Given that SCB usually upstreams all of its profits to SCF and has historically been managed with a capital position just above the minimum requirements, we expect that future medium-term parental capital injections will be limited. Based on a current common equity Tier 1 ratio of 13.2% as of year-end 2016, coupled with the bank's ambition to expand its lending business over the next years, we expect a deterioration of our RAC ratio from our estimate of 11.5% for end-2016. We believe SCB's earnings generation, as a potential first line of defense in case of increasing credit losses, will remain strong, thanks to stable high-margin lending. We estimate an earnings buffer, which measures the capacity for a bank's earnings to cover normalized losses, of 150 basis points (bps)-180bps.

SCB faces concentration risk in its loan book because it is heavily weighted toward consumer finance exposures. In our view, the credit quality of such exposures is inherently more volatile and losses in a stress environment might be higher than for secured retail banking products like mortgages. However, we note SCB's track record of limited losses compared with those of its pure consumer finance peers, demonstrating a more conservative approach to risk. The current economic environment in Germany results in very favorable risk metrics, with a nonperforming loan ratio of 2.1% and cost of risk of 31bps in 2016. We anticipate that these metrics have likely bottomed out and that cost of risk will likely normalize to 50bps-100bps over the medium term.

Overall, we assess SCB's funding profile neutrally. The stable funding ratio, S&P Global Ratings' measure of available long-term funding relative to long-term funding needs, was 80% in 2016, relatively weaker than we see among local peers. Often the ratio is comfortably in excess of 100%. However, we expect this ratio to improve in the medium term with the issuance of covered bonds and senior notes, and we also note the bank's de minimis use of short-term wholesale funding sources. We believe granular retail deposits, which currently cover 61% of the funding base, will remain the main funding source for SCB. While asset-backed securities (ABS) have historically been an important funding vehicle for SCB, the bank has recently retained most of them on its own books as available collateral for opportunistic funding from the European Central Bank (ECB). In our view SCB has sufficient and highly diversified sources to replace ECB funding in the medium term.

SCB's liquidity is adequate, in our view, based on the bank's negligible reliance on short-term wholesale funding. Our liquidity ratio (broad liquid assets to short-term wholesale funding) was comfortable at 2.7x in 2016. We also consider the potential benefits and stability provided by SCB's membership to Banco Santander Group, although no committed facilities exist to our knowledge.

Outlook

The stable outlook on SCB mirrors the stable outlook on SCF and reflects our view that material changes to SCB's strategy and financial profile are unlikely over the next 18-24 months. Furthermore, we believe that SCB's core group status within SCF is unlikely to change during that period. Given that it is a core group member, our rating on SCB will likely move in tandem with that on SCF.

Downside scenario

As long as SCB continues to be a core member of SCF, any deterioration in SCB's SACP would be offset by uplift for extraordinary group support. We could nevertheless lower the rating on SCB if we were to lower the rating on SCF. This could be triggered by a similar action on the Banco Santander Group or the Spanish sovereign, or if we believed the group's commitment to the consumer finance business had weakened. In addition, a weakening of SCB's importance within the Banco Santander Group's consumer finance business could lead us to lower the rating, although we view this as remote over the next 24 months.

Upside scenario

Conversely, a positive rating action on SCF would result in a similar action on SCB. An upgrade of SCF would be triggered by a similar action on both the Banco Santander Group and the sovereign, or by our revision of SCF's status within the group to core.

An improvement in SCB's stand-alone creditworthiness would be unlikely to result in an upgrade of SCB. However, an upgrade could follow if we were to assess SCB as insulated from SCF, or if we anticipated a distinct resolution strategy for SCB, independent from the rest of the group.

Ratings Score Snapshot

Issuer Credit Rating	BBB+/Stable/A-2
SACP	bbb+
Anchor	a-
Business Position	Moderate (-1)
Capital and Earnings	Strong (+1)
Risk Position	Moderate (-1)
Funding and Liquidity	Average and Adequate (0)
Support	0
ALAC Support	0
GRE Support	0
Group Support	0

Sovereign Support	0
Additional Factors	0

Related Criteria

- 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: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 09, 2011
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 09, 2011
- Criteria - Financial Institutions - Banks: Bank Capital Methodology And Assumptions, Dec. 06, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Financial Institutions - Banks: Commercial Paper I: Banks, March 23, 2004

Related Research

- Outlook On Banco Santander 'A-' Long-Term Rating Revised To Positive On Expected Sizable ALAC Buffer; Ratings Affirmed, Feb. 9, 2017
- Banco Santander S.A., Dec. 23, 2016
- Santander Consumer Finance S.A., Dec. 20, 2016
- Banking Industry Country Risk Assessment: Germany, Sept. 7, 2016

Ratings List

New Rating

Santander Consumer Bank AG	
Counterparty Credit Rating	BBB+/Stable/A-2

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.