MOODY'S
INVESTORS SERVICE

CREDIT OPINION
14 February 2024

Update

Send Your Feedback

Santander UK Group Holdings plc

Update following rating action

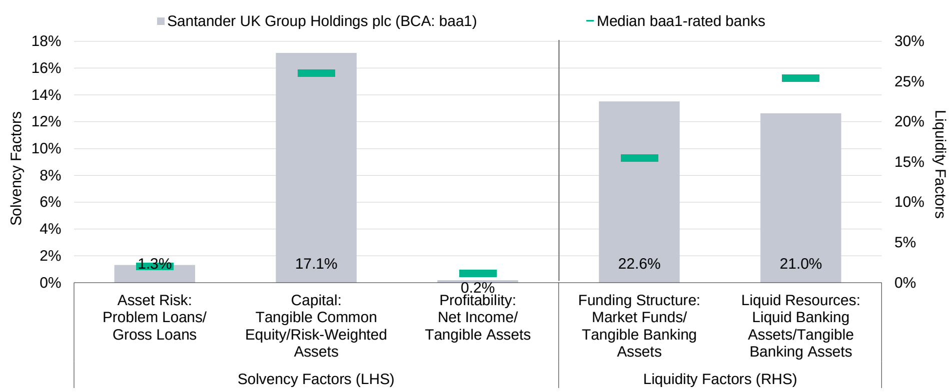
Summary
On 9 February 2024, we affirmed all ratings of Santander UK Group Holdings plc (SanUK Group, the holding company), Santander UK plc (SanUK, the bank) and Santander Financial Services (SFS), with the exception of SanUK Group's and SanUK's dated subordinated debt ratings, which were downgraded to Baa2 from Baa1.

The affirmation of SanUK Group's senior unsecured debt at Baa1 reflects its notional BCA of baa1; the instrument's moderate Advanced Loss Given Failure (LGF) analysis, resulting in no uplift and low probability of support from the Government of Untied Kingdom (Aa3 stable), providing no uplift.

The affirmation of the notional BCA of baa1 reflects the bank's low stock of problem loans, solid capitalisation and profitability, and modest business diversification in line with mortgage-focused peers, reflected in a one notch negative qualitative adjustment in our scorecard.

The downgrade of SanUK Group's and SanUK's dated subordinated debt reflects a lower current and anticipated volume of instruments junior to it in the group's liability structure, as assessed under Moody's Advanced LGF.

Exhibit 1
Rating Scorecard
Key financial ratios as at 30 June 2023



We assign a BCA to SanUK based on the consolidated financials of SanUK Group. The chart above shows the financial ratios of SanUK Group.
Source: Moody's Investors Service

RATINGS
Santander UK Group Holdings plc

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

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

Contacts

Alessandro Roccati +44.20.7772.1603
Senior Vice President
alessandro.roccati@moodys.com

Laurie Mayers +44.20.7772.5582
Associate Managing Director
laurie.mayers@moodys.com

Christopher Tucker +44.20.7772.1357
Sr Ratings Associate
christopher.tucker@moodys.com

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

Credit strengths

» Low asset risk, driven by largely retail mortgage loan book

» High capitalisation

» Solid profitability, benefiting from wide deposit margins and low credit impairments

Credit challenges

» Lower than peers' leverage ratio

» Expected deterioration in credit quality as inflation and cost of living pressures bite

» Competition in the mortgage market pressuring margins

Outlook

The outlook on SanUK's long-term deposit, issuer rating and senior unsecured debt ratings is stable, reflecting an expectation of continued moderate asset risk, a solid capital position, and ample liquidity which will continue to moderate wholesale funding exposures.

Factors that could lead to an upgrade of the ratings

SanUK Group's ratings could be upgraded following an upgrade of SanUK's BCA or an increase in the stock of bail-in-able liabilities. SanUK's long-term deposit, issuer rating and senior unsecured debt ratings could be upgraded if both the BCA is upgraded due to an improvement in the financial profile and the Advanced LGF notching increases due to a significant increase in the stock of more junior bail-in-able liabilities; this is because a BCA upgrade or additional Advance LGF notch would be neutralized by a decrease of the government support to zero notches from the current one notch. The BCA could be upgraded if there is an improvement in asset quality metrics, profitability or capital position, a reduction of its reliance on market funding or if the bank were able to increase the level of diversification of its business.

Factors that could lead to a downgrade of the ratings

SanUK Group's senior unsecured debt ratings and SanUK's long-term deposit, issuer rating and senior unsecured debt ratings could be downgraded if the BCA is downgraded, or if there is a significant decline in the stock of bail-in-able liabilities, or if the UK sovereign debt rating is downgraded. The BCA could be downgraded if there is a deterioration in asset quality metrics, a material weakening in profitability or a deterioration in the bank's funding and liquidity positions.

Key indicators

Exhibit 2
Santander UK Group Holdings plc (Consolidated Financials) [1]

	06-23[2]	12-22[2]	12-21[2]	12-20[2]	12-19[2]	CAGR/Avg.[3]
Total Assets (GBP Billion)	284.3	292.2	293.7	295.6	285.2	(0.1)[4]
Total Assets (USD Billion)	361.5	351.5	396.4	404.0	377.9	(1.3)[4]
Tangible Common Equity (GBP Billion)	12.3	12.1	12.3	11.4	13.8	(3.1)[4]
Tangible Common Equity (USD Billion)	15.7	14.5	16.6	15.6	18.2	(4.2)[4]
Problem Loans / Gross Loans (%)	1.3	1.2	1.4	1.4	1.1	1.3[5]
Tangible Common Equity / Risk Weighted Assets (%)	17.1	17.2	18.0	15.7	18.8	17.4[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	21.1	20.3	22.4	22.7	15.6	20.4[5]
Net Interest Margin (%)	1.6	1.5	1.3	1.1	1.2	1.4[5]
PPI / Average RWA (%)	3.8	3.6	2.7	1.8	2.3	2.8[6]
Net Income / Tangible Assets (%)	0.8	-1.1	0.5	0.5	0.5	0.2[5]
Cost / Income Ratio (%)	47.9	48.8	55.6	64.3	59.5	55.2[5]
Market Funds / Tangible Banking Assets (%)	22.8	22.5	24.5	24.2	25.6	23.9[5]
Liquid Banking Assets / Tangible Banking Assets (%)	22.2	21.0	24.1	25.4	24.3	23.4[5]
Gross Loans / Due to Customers (%)	112.2	110.9	108.8	108.6	113.4	110.8[5]

[-] Further to the publication of our revised methodology in July 2021, only ratios from annual 2020 onwards included in this report reflect the change in analytical treatment of the "high-trigger" Additional Tier 1 instruments. [1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel III - fully loaded or transitional phase-in; IFRS. [3] May include rounding differences because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of periods for the latest accounting regime. [6] Simple average of Basel III periods.
Sources: Moody's Investors Service and company filings

Profile

SanUK is a retail and commercial bank that operates exclusively in the UK. It is a large subsidiary of Banco Santander S.A. (Spain) (A2/A2 stable, baa1[1]), accounting for around 18% of the group's assets at end-December 2023. In the UK, SanUK is the fourth-largest residential mortgage provider and is the fifth-largest current account provider.

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

Recent developments

On the 11 January 2024, the Financial Conduct Authority (FCA) announced that they would be reviewing historical motor finance commission arrangements and sales across several firms for the period 2007-2021. In 2021, the FCA banned certain commission models for car finance, which encouraged brokers to raise costs for consumers.

SanUK had c. £5.3 billion of UK Motor Finance loans outstanding at end-June 2023, equal to c. 3% of the total loan book.

Detailed credit considerations

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

Concentration of revenue in UK residential mortgages

SanUK's baa1 BCA incorporates a negative qualitative adjustment to reflect its modest business diversification, due to the high proportion of mortgages in SanUK Group's loan book: 85% of SanUK Group's portfolio consists of residential mortgages (followed by mid corporate and SME loans, 10%[2], consumer loans, 3%, credit cards and unsecured personal loans, 2%) at end-December 2023.

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

Asset risk supported by low stock of problem loans

The assigned a1 Asset Risk score reflects our expectation that problem loans will broadly stabilize at the current level or moderately deteriorate over the outlook period.

SanUK Group's loan book has a low risk profile, largely comprising residential mortgages, with a relatively low average loan-to-value ratio of 51%[3] at end-December 2023. Buy-to-let mortgages are low, representing 9% of the mortgage loan book. Lending to corporate and small and medium-sized enterprises at 10% of total loans is relatively low compared with that of its peers, although the bank aims to gradually increase its market share. Consumer finance lending is small when compared with other large UK banks, representing 3% of total lending. The remainder of SanUK's loan book is largely composed of legacy assets and portfolios in run-off booked under the bank's corporate centre (<1%).

Stage 3 loans increased to 1.5% of loans at end-2023 from 1.2% at end-2022 while Stage 2 loans increased to 11.1% of loans from 8.4% at end-2022. We expect Stage 3 loans to moderately increase relative to current levels.

High capitalisation, but weaker than some peers' leverage ratio

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

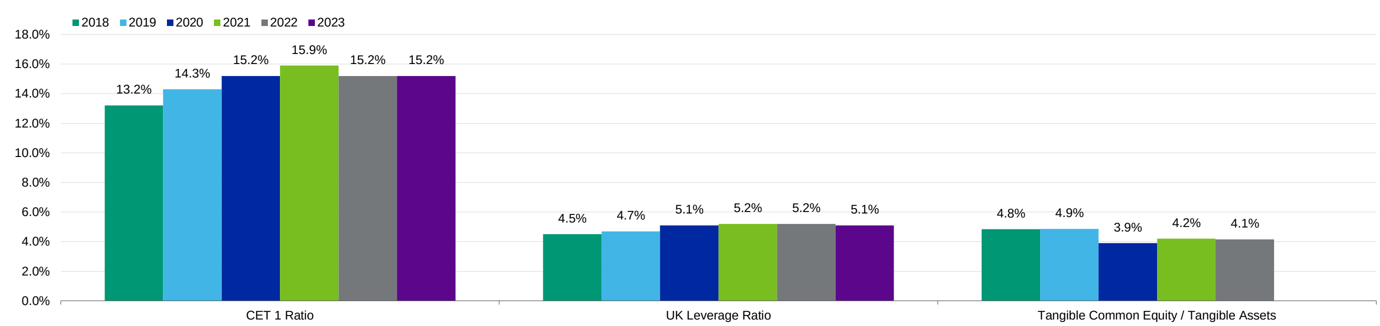
Regulatory capitalisation is currently solid: the Common Equity Tier 1 (CET1) capital ratio was 15.2% at end-2023 (15.2% at end-2022), 390 basis points (bps) above it's Maximum Distributable Amount (MDA). The CET1 ratio has been improving (it was 14.3% at end-2019 and 13.2% at end-2018), reflecting stable retained earnings and a material decrease in risk-weighted assets, driven by a reduction in the exposure towards commercial real estate companies, together with ring-fencing transfers and securitisations. The Tangible Common Equity ratio was 17.1% at end-June 2023.

The leverage ratio calculated according to the UK Prudential Regulation Authority's recommendations (the so-called UK leverage ratio) was 5.1% at the end-2023, above requirements. However, our leverage ratio was 4.4% at end-June 2023.

Exhibit 3

SanUK Group's increase in CET1 ratio mainly reflects lower risk-weighted assets

SanUK Group's main capital ratios



Regulatory ratios on a transitional phase-in basis. The tangible Common Equity ratio excludes high-trigger AT1 instruments from 2020
Source: Moody's Investors Service, company reports

Solid profitability, benefiting from wider deposit margins and low credit provisions

The assigned baa3 Profitability score reflects our expectation of stable profitability in the next twelve months [4] and reflects our profits expectation over the outlook period.

We expect profitability to continue to benefit from healthy new business margins supported by high liability spreads, modest volumes growth, and moderate credit provisions. We estimate around £1.3-1.5 billion net income in 2024. Increasing competition in the mortgage market will affect pricing on new mortgage lending and lower lending volumes will put pressure on revenue; further cost savings and efficiencies, driven by the transformation programme will partially mitigate these pressures.

SanUK's profitability was relatively stable in recent years, due to its concentration in residential mortgages and a smaller-than-peers impact from legacy issues such as payment protection insurance (PPI) redress.

For 2023, SanUK Group reported a profit after tax of £1.6 billion, a 12% increase compared to the same period in the prior year. Revenue increased 3% year-over-year (yoy), driven by an increase in net interest income due to the impact of base rate increases (the banking net interest margin increased to 2.20%, up from 2.06% in 2022). The bank reported £206 million credit impairment charges, a 36% yoy decrease reflecting an improved macroeconomic outlook benefitting expected credit losses. Operating costs of £2.5 billion were 5% higher yoy, due to inflationary pressures which were partially offset by lower transformation programme costs.

Stable retail funding profile

The assigned baa1 Funding Structure score is in line with the Macro-Adjusted score. Being primarily a retail bank, customer deposits are SanUK's main source of funding, accounting for about 72% of total funding at end-2023. Moody's calculated loan-to-deposit ratio was 112% at end-June 2023, a level higher than most of its peers.

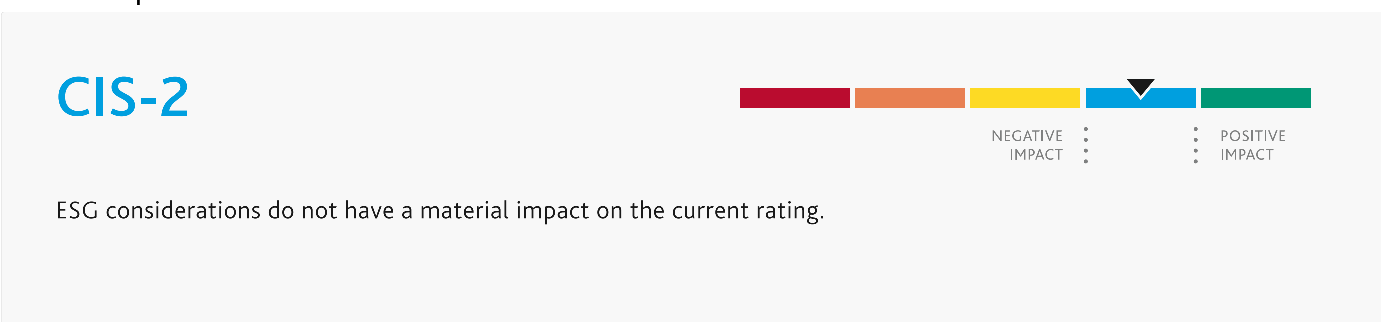
Wholesale funding reliance is moderate and broadly stable, representing 23% of tangible banking assets at end-June 2023. SanUK has Term Funding Scheme with additional incentives for SMEs (TFSME) repayments of £13 billion due by 2025 and the remaining £4 billion between 2027 and 2031. The bank repaid £8 billion of TFSME in 2023.

We assign a baa1 Liquid Resources score, in-line with the Macro-Adjusted score to reflect the expected trend. SanUK Group has a good stock of liquid assets, representing 22.2% of the bank's tangible banking assets at end-June 2023. The Group reported a strong 162% liquidity coverage ratio as of end-2023. The liquidity coverage ratio-eligible liquidity pool was £50.9 billion as of the same date, covering 4.3 times the wholesale funds with a residual maturity of less than one year.

ESG considerations

Santander UK Group Holdings plc's ESG credit impact score is CIS-2

Exhibit 4
ESG credit impact score



Source: Moody's Investors Service

Santander UK Group's **CIS-2** reflects that ESG considerations do not have a material impact on the rating to date. In particular, governance risks are low, supported by sound capital, liquidity and risk management.

Exhibit 5
ESG issuer profile scores

Source: Moody's Investors Service

Environmental

Santander UK Group faces lower-than-industry-average exposure to environmental risks. The bank has limited exposure to carbon transition risks because its loan book is concentrated in UK residential mortgages, with very low exposure to commercial loans.

Social

Santander UK Group faces high social risks from customer relations because of considerable focus on consumer protection in the UK, exposing banks to potential fines from regulators and litigation from customers as well as cyber risk and the financial and reputational implications of data breaches. The bank's developed policies and procedures help manage associated credit risks. The bank also faces moderate social risks related to potential competition from technology firms and other disruptors.

Governance

Santander UK Group faces low governance risks. The bank's risk management, policies, and procedures are in line with industry best practices, as evidenced by its good asset quality. The bank demonstrates sound management of capital and liquidity, while profitability recently improved. Because Santander UK is fully owned by Banco Santander SA, we aligned the subsidiary's board structure, policies and procedures score with that of its parent, given the bank's strategic importance and public affiliation with the group, the parent's oversight of its subsidiary board and the regulated nature of both entities.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Support and structural considerations

Affiliate support

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

Loss Given Failure (LGF) analysis

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

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

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

SanUK's and SanUK Group's dated subordinated debt are likely to face high loss-given-failure because the loss absorption provided by limited junior instruments and residual equity will be small. We also incorporate notching for Additional Tier 1 instruments, reflecting coupon features.

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

Government support

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

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

About Moody's Bank Scorecard

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

Rating methodology and scorecard factors

Exhibit 6

Santander UK Group Holdings plc

Macro Factors							
Weighted Macro Profile	**Strong +**	**100%**					

Factor	Historic Ratio	Initial Score	Expected Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	1.3%	aa3	↓	a1	Expected trend	
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	17.1%	aa2	↓	a1		
Profitability						
Net Income / Tangible Assets	0.2%	b1	↑↑	baa3	Expected trend	
Combined Solvency Score		a2		a2		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	22.5%	baa1	↔	baa1	Market funding quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	21.0%	baa1	↔	baa1	Expected trend	
Combined Liquidity Score		baa1		baa1		
Financial Profile				a3		
Qualitative Adjustments				Adjustment		
Business Diversification				-1		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				-1		
Sovereign or Affiliate constraint				Aa3		
BCA Scorecard-indicated Outcome - Range				a3 - baa2		
Assigned BCA				baa1		
Affiliate Support notching				0		
Adjusted BCA				baa1		

Balance Sheet	in-scope (GBP Million)	% in-scope	at-failure (GBP Million)	% at-failure
Other liabilities	62,966	21.7%	76,899	26.5%
Deposits	199,034	68.5%	185,102	63.7%
Preferred deposits	179,131	61.6%	170,174	58.5%
Junior deposits	19,903	6.8%	14,928	5.1%
Senior unsecured bank debt	2,015	0.7%	2,015	0.7%
Dated subordinated bank debt	799	0.3%	799	0.3%
Junior subordinated bank debt	525	0.2%	525	0.2%
Senior unsecured holding company debt	13,499	4.6%	13,499	4.6%
Dated subordinated holding company debt	934	0.3%	934	0.3%
Preference shares(holding company)	2,200	0.8%	2,200	0.8%
Equity	8,721	3.0%	8,721	3.0%
Total Tangible Banking Assets	290,693	100.0%	290,693	100.0%

Debt Class	De Jure waterfall		De Facto waterfall		Notching		LGF Notching Guidance vs. Adjusted BCA	Assigned LGF notching	Additional Notching	Preliminary Rating Assessment
	Instrument volume + subordination	Sub-ordination	Instrument volume + subordination	Sub-ordination	De Jure	De Facto				
Counterparty Risk Rating	15.0%	15.0%	15.0%	15.0%	3	3	3	3	0	a1
Counterparty Risk Assessment	15.0%	15.0%	15.0%	15.0%	3	3	3	3	0	a1 (cr)
Deposits	15.0%	9.2%	15.0%	9.9%	2	2	2	2	0	a2
Senior unsecured bank debt	15.0%	9.2%	9.9%	9.2%	2	1	2	2	0	a2
Senior unsecured holding company debt	9.2%	4.5%	9.2%	4.5%	0	0	0	0	0	baa1
Dated subordinated bank debt	4.5%	3.9%	4.5%	3.9%	-1	-1	-1	-1	0	baa2
Dated subordinated holding company debt	4.5%	3.9%	4.5%	3.9%	-1	-1	-1	-1	0	baa2
Junior subordinated bank debt	3.9%	3.8%	3.9%	3.8%	-1	-1	-1	-1	-1	baa3
Non-cumulative bank preference shares	3.8%	3.0%	3.8%	3.0%	-1	-1	-1	-1	-2	ba1
Holding company non-cumulative preference shares	3.8%	3.0%	3.8%	3.0%	-1	-1	-1	-1	-2	ba1

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Rating	3	0	a1	1	Aa3	Aa3
Counterparty Risk Assessment	3	0	a1 (cr)	1	Aa3(cr)	
Deposits	2	0	a2	1	A1	A1
Senior unsecured bank debt	2	0	a2	1	A1	A1
Senior unsecured holding company debt	0	0	baa1	0	Baa1	Baa1
Dated subordinated bank debt	-1	0	baa2	0	Baa2	
Dated subordinated holding company debt	-1	0	baa2	0	Baa2	Baa2
Junior subordinated bank debt	-1	-1	baa3	0	Baa3 (hyb)	Baa3 (hyb)
Non-cumulative bank preference shares	-1	-2	ba1	0	Ba1 (hyb)	
Holding company non-cumulative preference shares	-1	-2	ba1	0	Ba1 (hyb)	

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
Source: Moody's Investors Service

Ratings

Exhibit 7

Category	Moody's Rating
SANTANDER UK GROUP HOLDINGS PLC	
Outlook	Stable
Baseline Credit Assessment	baa1
Adjusted Baseline Credit Assessment	baa1
Issuer Rating -Dom Curr	Baa1
Senior Unsecured	Baa1
Subordinate	Baa2
Pref. Stock Non-cumulative -Dom Curr	Ba1 (hyb)
Other Short Term	(P)P-2
SANTANDER FINANCIAL SERVICES PLC	
Outlook	Stable
Counterparty Risk Rating	Aa3/P-1
Bank Deposits	A1/P-1
Baseline Credit Assessment	baa1
Adjusted Baseline Credit Assessment	baa1
Counterparty Risk Assessment	Aa3(cr)/P-1(cr)
Issuer Rating	A1
ST Issuer Rating	P-1
SANTANDER UK PLC	
Outlook	Stable
Counterparty Risk Rating	Aa3/P-1
Bank Deposits	A1/P-1
Baseline Credit Assessment	baa1
Adjusted Baseline Credit Assessment	baa1
Counterparty Risk Assessment	Aa3(cr)/P-1(cr)
Issuer Rating	A1
Senior Unsecured	A1
Subordinate -Dom Curr	Baa2
Jr Subordinate	Baa3 (hyb)
Pref. Stock Non-cumulative -Dom Curr	Ba1 (hyb)
Commercial Paper	P-1
Other Short Term	(P)P-1

Source: Moody's Investors Service

Endnotes

1 The bank ratings shown in this report are the bank's deposit rating, senior unsecured debt rating, and Baseline Credit Assessment.

2 Including Local Authorities and Housing Associations

3 Balanced weighted average LTV

4 The historic net income / tangible banking assets ratios shown in the key indicators table and in the scorecard, which drive the Profitability Macro Adjusted score, include our standard adjustment for defined benefit pension schemes. Under our standard approach, we adjust banks' profit to take into account gains and losses from the actual returns on plan assets, which in recent years have been sizable. We do not include in profit any other remeasurements of actuarial gain/loss components, like the impact of changes in the pension liability discount rate. Given the high level of fixed income securities among pension assets, the rapid increase in interest rates in 2022 led to a material decline in the value of the pension assets, which drove a large negative adjustment that hindered the bank's adjusted profitability. These changes did not however, materially affect the bank's pension deficit or surplus, as they have been largely offset by a lower value of the pension scheme's obligations in 2022 to reflect the increase in the discount rates (i.e. higher interest rates). In recent years, the value of pension assets have also been affected by equity markets, as pension assets also include a material level of shares.

REPORT NUMBER 1395146

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

Moody's
INVESTORS SERVICE