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Santander UK Group Holdings PLC

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Santander UK Group Holdings PLC

Rating Score Snapshot

Issuer Credit Rating
BBB/Stable/A-2

SACP: bbb+ → **Support: +2** → **Additional factors: 0**

SACP: bbb+		
Anchor	bbb+	
Business position	Adequate	0
Capital and earnings	Adequate	0
Risk position	Adequate	0
Funding	Adequate	0
Liquidity	Adequate	
CRA adjustment		0

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

Additional factors: 0
Issuer credit rating
A/Stable/A-2
Resolution counterparty rating
A+/A-1

ALAC--Additional loss-absorbing capacity. CRA--Comparable ratings analysis. GRE--Government-related entity. ICR--Issuer credit rating. SACP--Stand-alone credit profile.

Credit Highlights

Overview

Key strengths	Key risks
Good position in U.K. retail banking.	Lower revenue and business diversification than larger U.K. competitors.
Conservative loan book profile.	Parental influence on the medium-term trajectory for SanUK's risk-adjusted capitalization remains uncertain.
Solid capitalization by S&P Global Ratings' measures.	High inflation and slowing economic growth are squeezing marginal borrowers' cash flows.

Our rating on Santander UK (SanUK) balances its deep but relatively narrow U.K. banking franchise, against its solid capital base and well diversified funding and liquidity profile. Although it has developed a deep U.K. prime mortgage business, SanUK's overall scope remains narrower than U.K.-focused peers Lloyds and NatWest, both of which run materially larger commercial lending franchises, or Barclays, which has built an internationally diversified investment banking and credit card franchise. At the same time, SanUK's narrower scope, well managed balance sheet (in which corporate exposures have been steadily reduced), and focus on operating efficiency have enabled it to record resilient risk-adjusted earnings over the past 24 months. Furthermore, the combination of these factors has bolstered our view of its capitalization, with our risk-adjusted capital (RAC) ratio moving above 10%.

SanUK's financial performance has improved materially. The bank has narrowed the scope of business significantly in the past three years, partly through the transfer of certain business units to its parent. It has reduced its corporate exposures by about one-third since year-end 2018, narrowed its consumer lending by almost 50%, and expanded its mortgage lending business more than 15% over the same period. This more focused franchise holds back our assessment of SanUK's strategic diversification to an extent. However, we acknowledge that its tightened scope reflects its strengthened focus on efficiency, exhibited by a cost-to-income ratio of 49% by our measures in first-half 2022, down from 58% in full-year 2018, and a widening of its net interest margin (NIM) to 1.82%, which has been supported by recent rate hikes by the Bank of England. In combination, the group's disciplined lending and its transformation program saw its pretax profitability improve to £993 million in first-half 2022, a 32% increase year on year.

Our favorable view of SanUK's improved RAC position is tempered by our expectation that it will upstream excess capital to its parent, Banco Santander, over the medium term. SanUK's efforts to rationalize its business support its RAC ratio. Net credit exposures have fallen 3% since 2018 and SanUK's recent track record of solid earnings generation has combined with this to move our RAC ratio to 10.3% at year-end 2021. We forecast SanUK will maintain a RAC ratio of 10.25%-10.75% over the next 24 months. At the same time, we expect that the material excess capital generated under our base case is likely to be released to SanUK's ultimate parent Banco Santander in the medium term, likely as extraordinary dividends over and above the subsidiary's current ordinary dividend pay-out policy (50% of recurring profit after tax). We expect that any extraordinary dividends will move our RAC ratio below 10%. In summary, although SanUK's capital and earnings are likely to remain solid, we are not confident that it will maintain a RAC ratio consistently above our 10% threshold.

The group's asset quality remains robust and should provide a stable foundation to face a challenging U.K. macroeconomic outlook. SanUK's mortgage-centric book and narrow, high-quality consumer unsecured and corporate businesses proved resilient throughout the pandemic, and should remain so through a turbulent period in the U.K. economy. Stage 3 assets remained at a historically low level of 1.21% of gross customer lending at the end of first-half 2022. Beyond these nonperforming exposures, the remainder of the loan book was conservatively positioned, in our view, with 7.4% of the book in Stage 2, of which only about 5% is in arrears of more than 30 days. On top of this conservative staging, the group has overlaid a cautious management provision of £344 million as of June 30, 2022, to account for additional risks to lending from the deteriorating U.K. economic picture. All in, the prudent staging of SanUK's narrow, high-quality loan book, and cautious management overlays should support it through a difficult period in the U.K. economy.

Outlook

Santander UK Group Holdings PLC

The stable outlook reflects our view that the bank will maintain robust credit quality that will support earnings. It also reflects our expectation that it will maintain a good position in U.K. retail banking and 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 the bail-in of its subordinated debt instruments for loss absorption and recapitalization than by relying on group support.

Downside scenario: We could lower the ratings over our two-year horizon if a challenging U.K. economic environment compromises SanUK's performance, weakening its earnings.

Upside scenario We could revise the outlook to positive if SanUK delivers an S&P Global Ratings RAC ratio materially above 10% on a sustained basis. This would rest on the group's ability to generate strong earnings and capital generation from its robust U.K. mortgage business, alongside its parent allowing SanUK to maintain material excess capital, supporting the sustainability of its RAC ratio.

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 our 6% threshold.

We could raise or lower our rating if the group SACP strengthened or weakened. We could also lower the ratings if the ALAC ratio were to fall below our 6% 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--				
(%)	**2020a**	**2021a**	**2022f**	**2023f**	**2024f**
Growth in operating revenue	(5.1)	13.0	2.7-3.3	2.4-2.9	1.2-1.5
Growth in customer loans	2.5	0.4	2.9-3.6	2.5-3.0	2.5-3.0
Growth in total assets	3.7	(1.8)	1.5-1.8	0.9-1.1	1.5-1.9
Net interest income/average earning assets (NIM)	1.4	1.7	1.7-1.8	1.7-1.8	1.6-1.8
Cost to income ratio	64.7	56.8	52.5-55.2	51.7-54.4	51.9-54.6
Return on average common equity	1.6	8.8	6.7-7.4	6.8-7.6	6.9-7.6
Return on assets	0.1	0.5	0.4-0.4	0.4-0.5	0.4-0.5
New loan loss provisions/average customer loans	0.3	(0.1)	0.1-0.1	0.1-0.1	0.1-0.1

Santander UK Group Holdings PLC--Key Ratios And Forecasts (cont.)

	--Fiscal year ended Dec. 31--				
(%)	2020a	2021a	2022f	2023f	2024f
Gross nonperforming assets/customer loans	2.0	2.0	1.9-2.1	2.0-2.2	2.0-2.2
Net charge-offs/average customer loans	0.2	0.1	0.1-0.1	0.1-0.1	0.2-0.2
Risk-adjusted capital ratio	9.7	10.2	10.0-10.5	10.1-10.7	10.3-10.8

All figures are S&P Global Ratings-adjusted. a--Actual. f--Forecast. NIM--Net interest margin.

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

We use our Banking Industry Country Risk Assessment (BICRA) economic risk and industry risk scores to determine the anchor. The 'bbb+' anchor reflects the geographical mix of SanUK's total credit exposure. Given SanUK's concentration to the U.K., this leads to a weighted-average economic risk score of '4'.

After a relatively strong economic rebound in 2021 with the waning of the COVID-19 pandemic, the U.K. economy looks set to enter a period of turbulence--characterized by slow to negative growth and sharp inflation. Our latest projection for 2022 is 3.2% GDP growth, containing within it a technical recession in the second half, and inflation rising sharply to 10.1% by the fourth quarter (see "Economic Outlook U.K. Q3 2022: The Great Inflation Squeeze" published June 27, 2022, on RatingsDirect). We forecast a continuation in policy rate increases by the Bank of England, which will give uplift to bank earnings, but also further squeeze households, who will be hit by a broad-based fall in living standards. Low unemployment, stable house prices, and strong corporate asset quality should give banks some wiggle room to see out this turbulent period--but these foundations will be tested under our current base case.

The industry risk trend is also stable. The firm actions of the Bank of England and government measures during the pandemic speak to the U.K.'s well developed regulatory framework, which helped U.K. banks to navigate the crisis. After a period of pressure from low rates, volatile impairments, and restructuring, U.K. banks' earnings have good momentum in 2022. The policy rate moves by the Bank of England and widening swaps will support earnings; costs should be stable, even as investment continues at pace; and impairments look set to normalize--underpinned by record low nonperforming assets in the system (see "Higher Rates Spur U.K. Banks' Strong First-Half Earnings Amid A Weakening Economic Outlook," published Aug. 10, 2022). However, if the sector is unable to take advantage of these tailwinds, and we believe medium-term earnings prospects could be structurally weak, we could eventually consider revising down our industry risk assessment.

Business Position: A Deep U.K. Mortgage Franchise And Increasing Efficiency

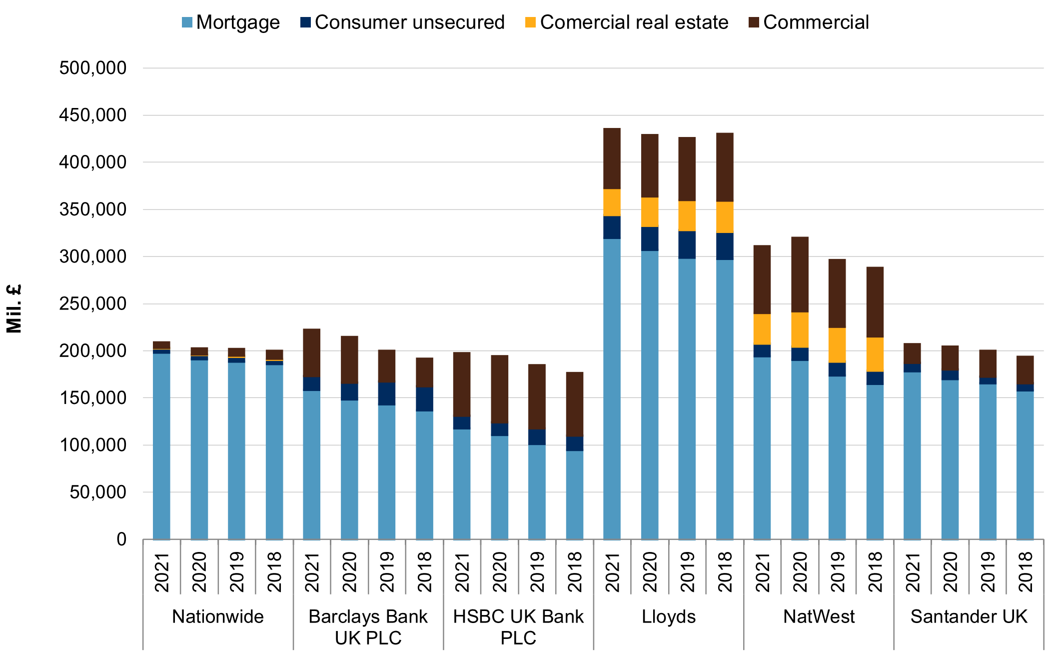
Our assessment of SanUK's business position as adequate reflects the strength of its increasingly efficient retail banking franchise, offset by its lower business and revenue diversification compared with its closest domestic peers.

SanUK is one of the U.K.'s leading banks by deposits and mortgage loan balances, indeed, indicative of its scale, SanUK has about 14 million active customers as of June 30, 2022. This large customer base is a product of the group's consistent focus on winning U.K. retail current accounts, although its market share and retail deposit base appears to have plateaued to some degree since it has tightened its pricing and shed unprofitable customers in the past 18 months. At the same time as shifting its focus to winning a material share of the U.K.'s current account market, SanUK has also focused heavily on the U.K. prime mortgage market, expanding its market share to about 10% of outstanding U.K. mortgage stock at June 30, 2022 (see chart 1).

Chart 1

Santander UK Has Expanded Its Mortgage Market Share

Gross lending by category



Nationwide data are as of April 4 in the following year. For example, 2021 is April 4, 2022. Source: banks' discloures.

Alongside its decision to deploy its capital toward the U.K. mortgage market, SanUK has pared back its commercial lending book, reducing its loan book by about one-third over the past four years through a combination of transfers of business to Banco Santander (London Branch) and managed wind down of unprofitable exposures. Furthermore, even as it reduces its commercial exposures, we see good evidence that SanUK is actively leveraging the parent's international franchise by targeting internationally focused U.K. companies. We expect this strategic shift will continue--although related income expansion will lag the initial investment. Taken together, SanUK's strong mortgage growth, and increasingly focused commercial book provide the group with a solid footing in the U.K. banking market. That said, relative to U.K. peers, we think that SanUK's balance sheet and earnings are relatively more concentrated on the resilient, but highly leveraged, U.K. household sector.

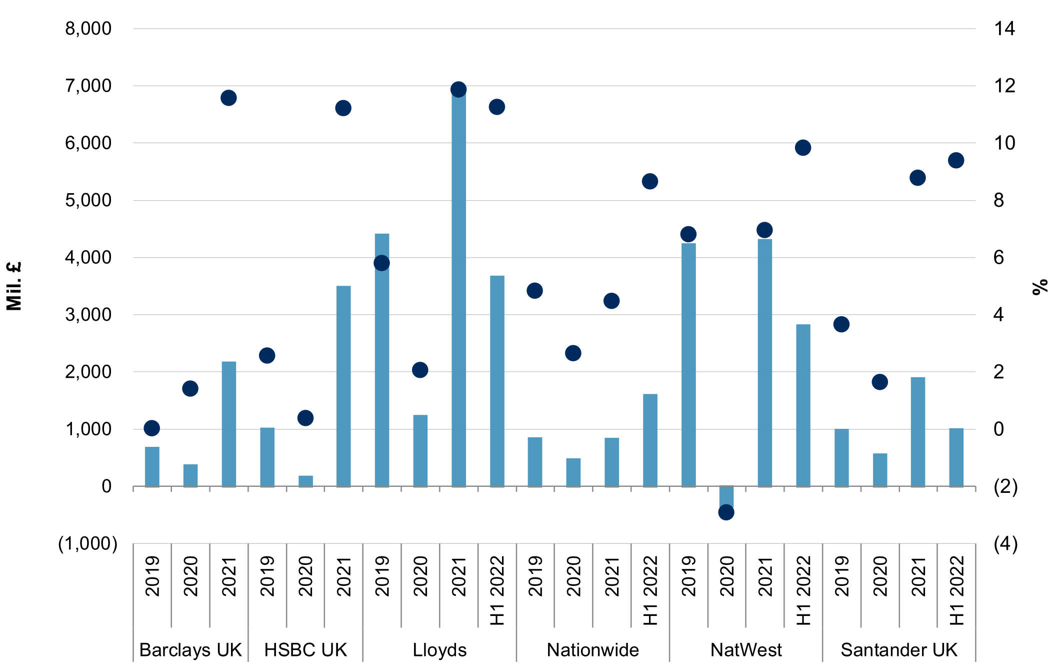
Indeed, SanUK lacks the material commercial franchises of its closest domestic peers Lloyds Banking Group PLC ('a-' group SACP) and NatWest Group PLC ('bbb+'). Furthermore, when compared with U.K. ring-fenced banks like

Barclays Bank UK PLC (parent SACP of 'bbb+') and HSBC UK Bank PLC (parent SACP of 'a') SanUK's franchise is clearly narrower--even though its depth and expertise in the U.K. mortgage and commercial lending market give it a solid foundation of competitive advantage and earnings stability. That said, SanUK has greater breadth from its commercial and consumer unsecured businesses than a narrowly focused mortgage specialist like Nationwide ('a-'), and materially greater scope and market penetration than a lower rated and less diverse U.K. peer like 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-').

Although its scope is certainly narrower than larger U.K. banking groups, we acknowledge that SanUK generally demonstrated greater earnings and business stability over the past several years and through the pandemic. Indeed, despite its narrower scope it was able to record a stronger return on equity than diversified peers like HSBC UK or Barclays UK throughout the pandemic, and has recorded resilient returns through the past 18 months as the pandemic has abated (see chart 2).

Chart 2

S&P Global Ratings-Adjusted Profit Before Tax And Return On Equity
Period up to most recent reporting date



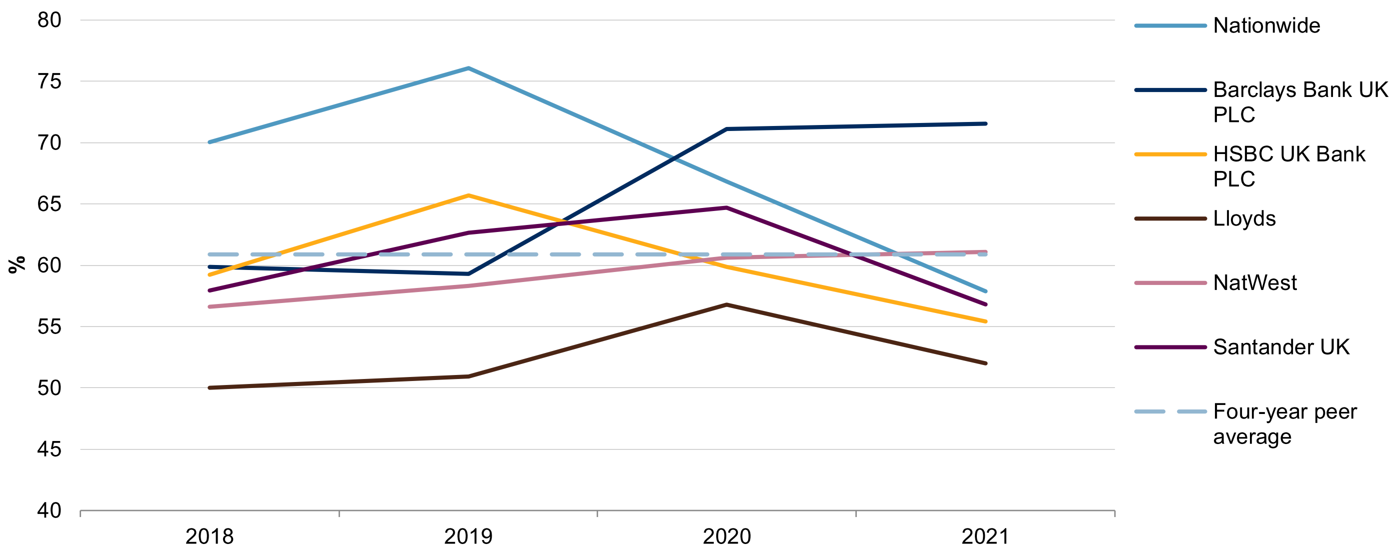
H1--First half. Source: S&P Global Ratings.

This performance mainly reflects its more modest conduct and litigation charges, and its generally more limited restructuring and investment program. SanUK's transformation program has placed a significant emphasis on tight cost control, which has borne fruit through the past two years, with the group's cost to income ratio falling to 49% at

June 30, 2022. We forecast a cost-to-income ratio of about 50% through to 2024 (see chart 3).

Chart 3

Santander UK Has Materially Improved Its Operating Efficiency
Cost-to-income ratios for Santander UK and U.K. bank peers

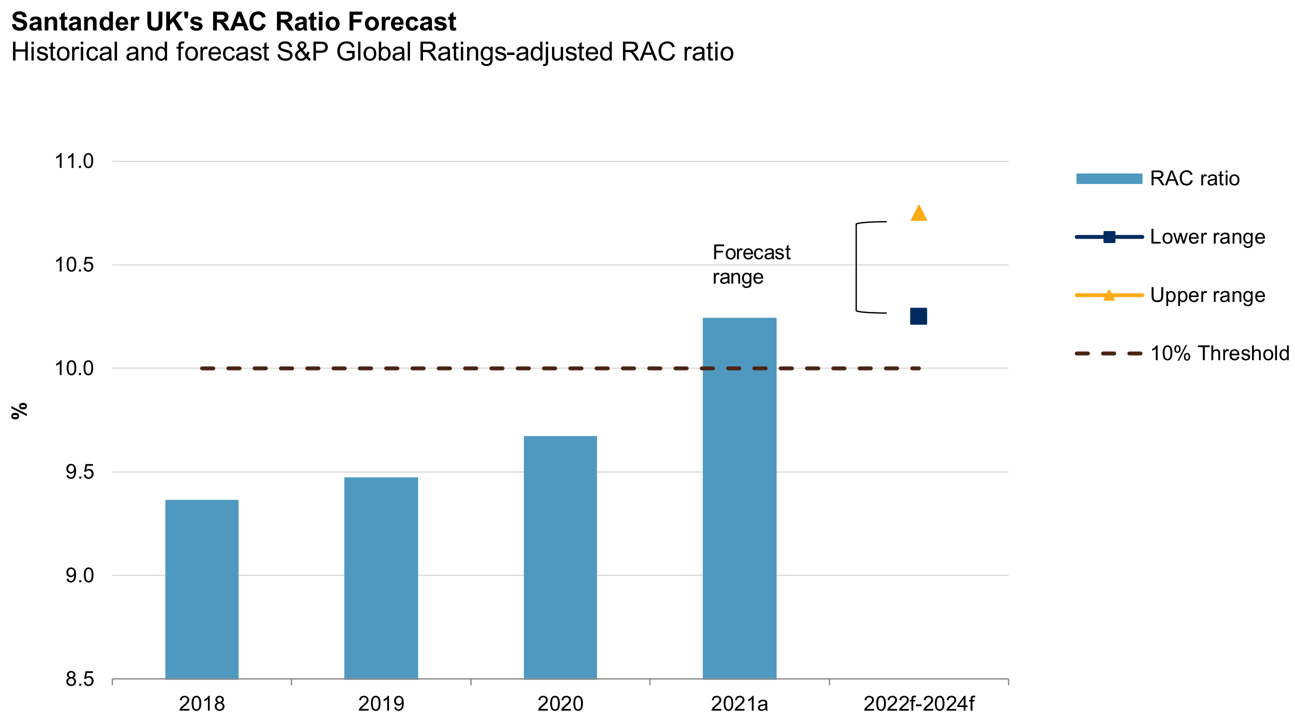


Nationwide data are as of April 4 the following year. For example, 2021 is April 4, 2022. Source: banks' discloures.

Capital And Earnings: An Improving Risk-Adjusted Capital Position Is Tempered By Potential Distributions To The Parent

SanUK's S&P Global Ratings risk-adjusted and regulatory capitalization has gradually strengthened in recent years. We calculate a RAC ratio of 10.3% at Dec. 31, 2021, and we project that it will remain 10.25%-10.75% through year-end 2024 (see chart 4).

Chart 4



S&P Global Ratings' RAC ratio before diversification. RAC--Risk-adjusted capital. f--Forecast. Source: S&P Global Ratings.

SanUK exceeds the 10% threshold that could be commensurate with a stronger assessment of its capital position. That said, and although we expect the group to continue to generate meaningful surplus capital under our forecasts and maintain material headroom above its regulatory requirements, we do not expect it to maintain comfortable headroom above a 10% RAC ratio over the medium term. Primarily this is because we believe that a material portion of excess capital could be distributed to the parent given its status as a subsidiary of a larger banking group. Indeed, Banco Santander generally runs its subsidiaries with limited excess capital. As such, we see a material chance that SanUK's excess capital will be distributed to the parent in the medium term, and that any material distribution will move the subsidiary's RAC ratio toward or below 10%.

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

- Strong preprovision operating income in 2022. This forecast reflects growth in NIM from the rise in the Bank of England's base rate, with subsequent solid growth in asset yields, and still-low deposit costs. Although mortgage market competition is likely to remain high through the rest of 2022 this should present a manageable headwind to NIM. We assume that preprovision operating income growth will continue to improve in 2023 as tailwinds to earnings persist and disciplined cost control continues.
- Uneven lending growth in 2022, balancing good growth in mortgage lending, stable consumer unsecured balances,

and resilient commercial lending balances as the restructuring of that business comes to an end. Growth should be more balanced in 2023 as mortgage lending demand slows, and the groups turns its focus to the consumer unsecured and commercial franchises.

- Stabilizing loan loss rates at 10 basis points (bps)-12 bps across our base case.
- Ongoing restructuring costs and digitalization investments continuing to weigh on statutory earnings in 2022, before tailing off in 2023.
- A dividend policy to distribute 50% of earnings continuing across our forecast. We see potential for an additional distribution of special dividends.
- S&P Global Ratings' RWAs expand 2%-5% through to 2024, with stronger growth in retail mortgages in 2022 evening out across consumer unsecured and corporate exposures over 2023 and 2024.

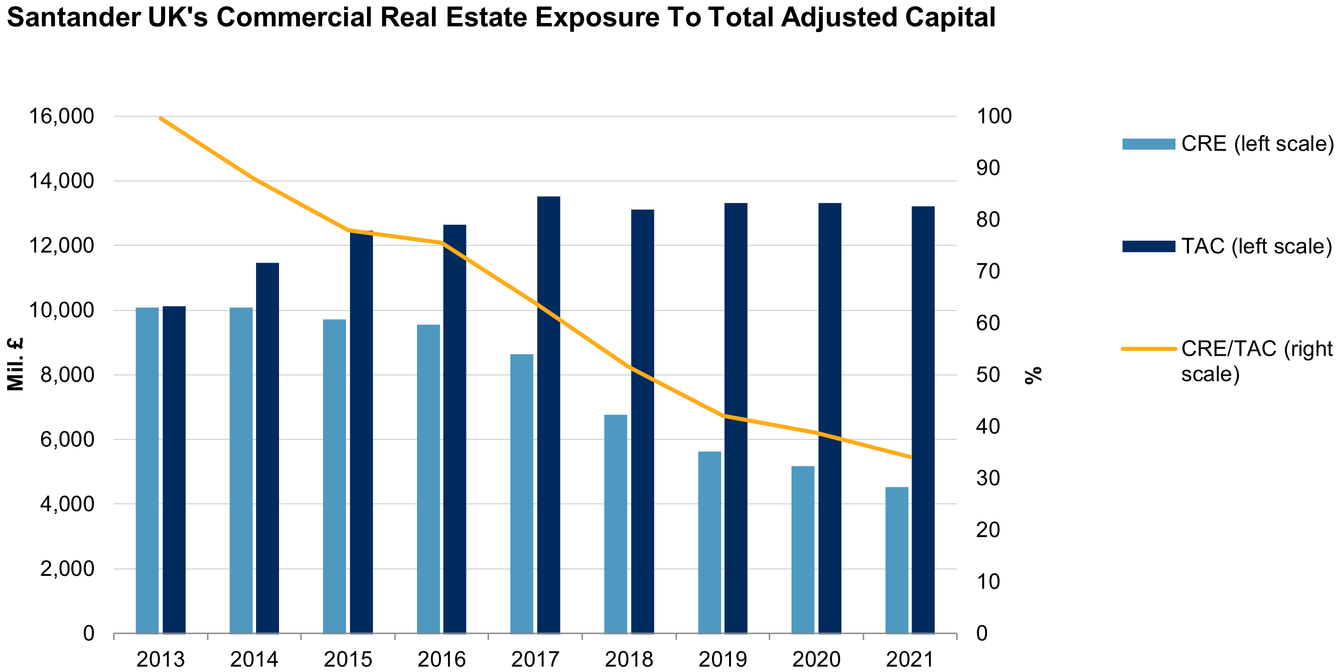
At June 30, 2022, SanUK reported a statutory profit before tax of £993 million. Within this, the S&P Global Ratings-adjusted NIM increased to 1.82% from 1.66%, underlying noninterest income expanded strongly (adjusting for the sale of the company's headquarters in first-half 2021), and the adjusted cost-to-income ratio fell to 49%.

Risk Position: Solid Mortgage Book And Disciplined Commercial Lending

Our assessment of SanUK's risk position reflects our view that its capital and earnings adequately capture its exposure to, and capacity to absorb, unexpected losses. Furthermore, we believe that the profile and credit quality of SanUK's loan book is broadly in line with that of peers.

We note SanUK's relatively cautious approach to credit growth, reducing its commercial exposures, while expanding its strongly collateralized mortgage lending. Within its efforts to pare down the size of its commercial lending, the group has continued to reduce the absolute size of its commercial real estate (CRE) exposure, which had been something of a negative outlier (see chart 5). SanUK states that CRE loans further reduced by £0.4 billion in first-half 2022.

Chart 5

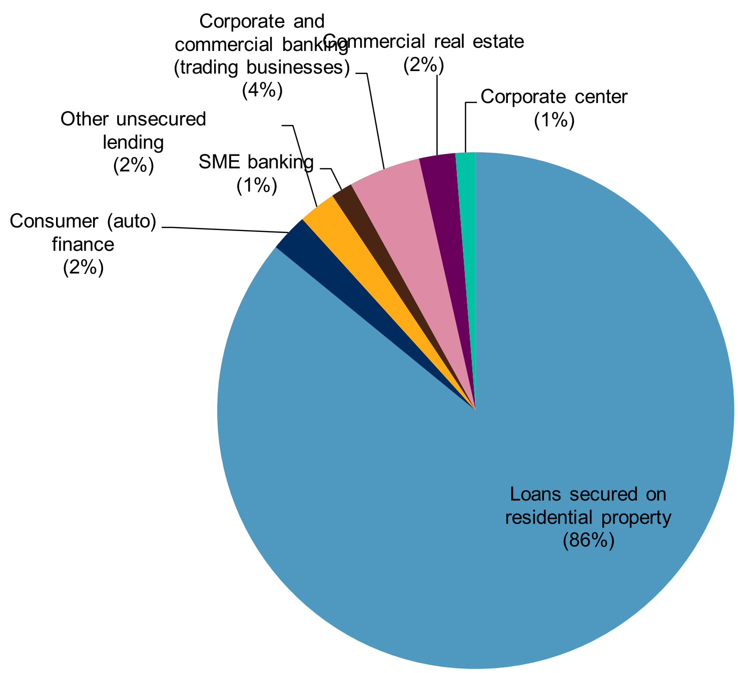


CRE--Commercial real estate. TAC--Total adjusted capital. Source: As reported and S&P Global Ratings database.

SanUK's total loan book remains heavily biased toward residential mortgages, which constituted 86% of the gross customer loan book (excluding amounts due from Banco Santander affiliates) at June 30, 2022. Conversely, relative to U.K. peers, SanUK's loan book exposure to consumer credit is relatively modest (see chart 6). A material part (£5.1 billion) of SanUK's consumer credit book is auto finance, which can be particularly volatile during periods of recession--that said, we note that the vast majority of such customer loans are secured.

Chart 6

Santander UK's Gross Customer Loans By Sector
On balance sheet exposures at June 30, 2022



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

We believe that SanUK'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 about 9% of the mortgage stock, well below the industry figure of about 16%.

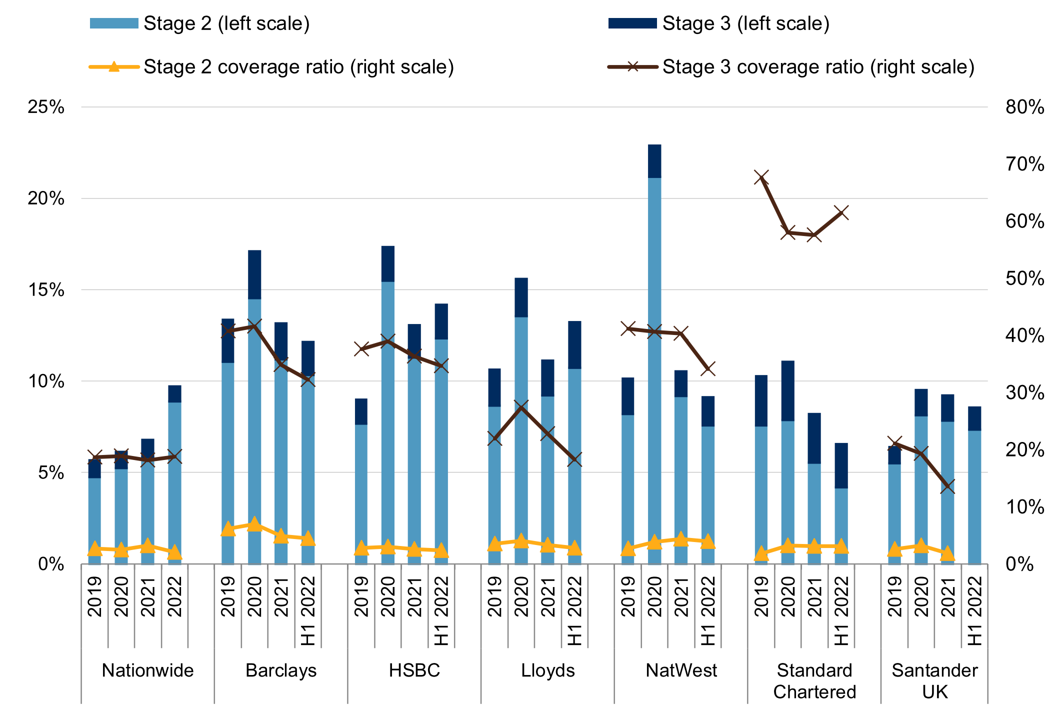
SanUK reports that less than 1% of the mortgage book showed negative equity at June 30, 2022, with a further 4.4% having an indexed loan-to-value (LTV) ratio of 80%-100%. The bank's reported simple average, nonindexed LTV for the portfolio is 51%. We consider these figures to be fairly typical for U.K. mortgage lenders. Furthermore, the proportion of interest-only mortgages has steadily reduced over recent years.

The stock of nonperforming and problematic loans remains low. SanUK reported that Stage 3 loans were £2.6 billion or 1.2% of gross loans at June 30, 2022. The bank's total Stage 2 loans are relatively low, partly owing to its mortgage book bias. At June 30, 2022, £15.6 billion of customer loans were defined as Stage 2. Combined, Stage 2 and Stage 3 loans to total loans was 8.6% at June 30, 2022, which is lower than that of most U.K. peers (see chart 7).

Chart 7

Santander UK's Loan Breakdown By Stage Versus Peers'

Stages 2 and 3 loans as percentages of total portfolios in first-half 2022



Nationwide data are as of April 4. For example, 2022 data is as of April 4, 2022. Santander UK does not report in this format in its first-half disclosures. Source: Banks' disclosures.

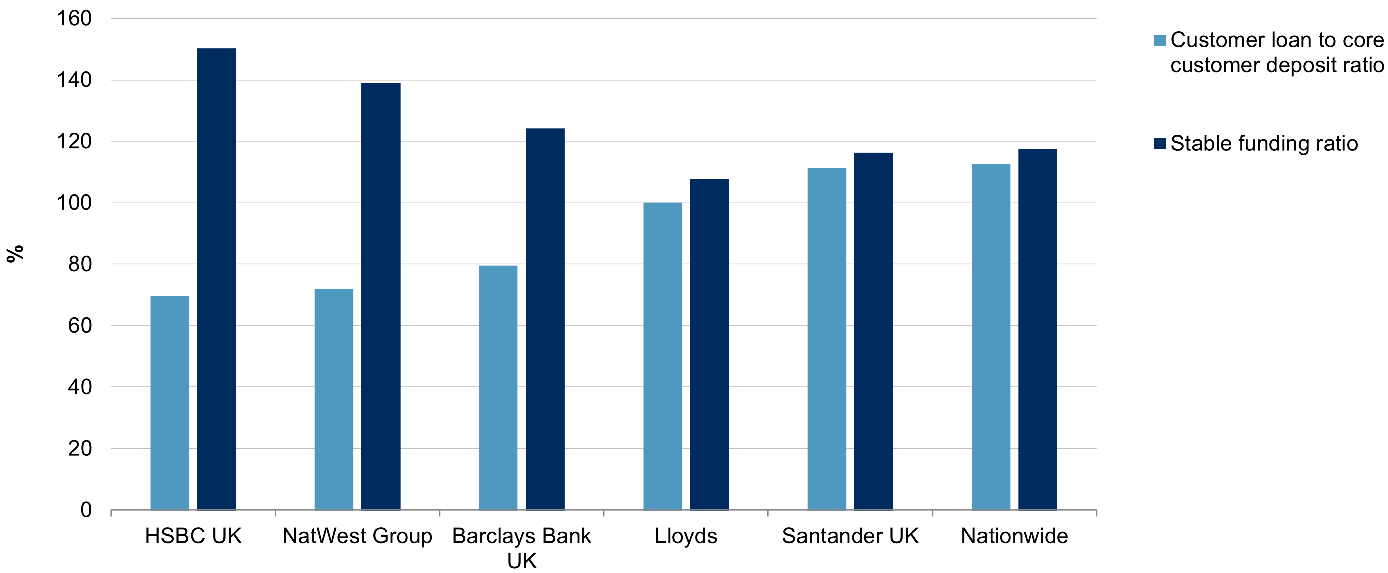
Funding And Liquidity: Granular Deposit Franchise And Access To Diversified Funding Sources

SanUK'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. SanUK has no structural reliance on group funding and is self-supporting from a liquidity standpoint.

At June 30, 2022, SanUK's loan-to-deposit ratio was 116%--relatively high versus the peer set (see chart 8). On the other hand, our stable funding ratio of 114% was broadly in line with the average of 125% for major U.K. banks.

Chart 8

S&P Global Ratings' Funding Metrics For U.K. Peers
Most recent full year reporting date

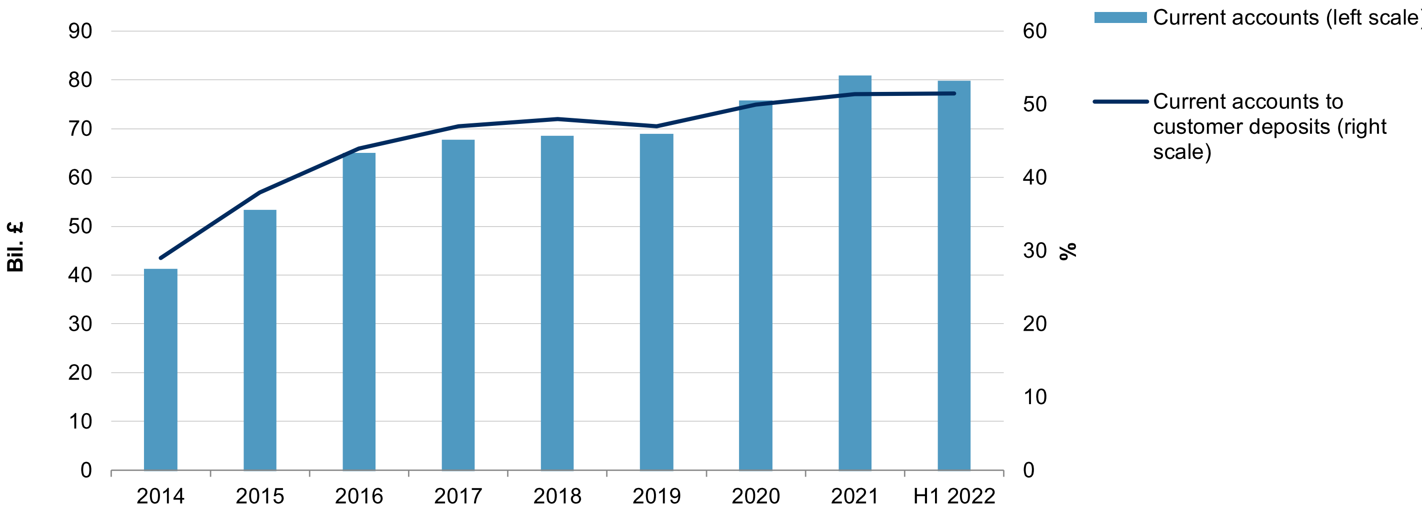


Nationwide data are as of April 4, 2022. All others are Dec. 31, 2021. Source: S&P Global Ratings.

Despite a relatively higher loan-to-deposit ratio than some U.K. peers, we continue to believe that SanUK has a high-quality deposit franchise. To this end, at June 30, 2022, current accounts represented 51% of retail banking customer deposits (see chart 9).

Chart 9

Important And Stable Role Of Current Accounts In Santander UK's Funding Base (Retail Banking Division)



H1--First half. Source: Company accounts.

As of first-half 2022, SanUK's regulatory reported liquidity coverage ratio (LCR) was 172%. Furthermore, our measure of the bank's liquidity is robust, led by its restrained use of short-term wholesale funding (6.5% of the funding base at June 30, 2022), its stock of liquid assets, and its ability to further monetize its mortgage book. Our measure of broad liquid assets to short-term wholesale funding was a comfortable 3.1x at June 30, 2022. On top of this robust start point, we believe that the material unencumbered mortgage book could generate additional liquidity.

The bank currently has £31.9 billion of term funding from the Bank of England with additional incentives for small and midsized entities (TFSME). Although the majority of this will mature over the next two to five years, we believe that SanUK's flexible balance sheet, with relatively limited asset encumbrance, a well-diversified wholesale funding franchise, and significant excess liquidity, will be sufficient to manage maturing liabilities.

Support: Two Notches Of ALAC Support

Our ALAC ratio was 8.8% at year-end 2021. We expect our ALAC measure will remain above our 6% 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, SanUK 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 SanUK 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).

Table 1

Santander UK Group Holdings PLC--Additional Loss-Absorbing Capacity Buffer

	For fiscal year ended Dec. 31, 2021	(Mil. £)	% S&P Global Ratings RWAs
A	Adjusted common equity	10,993	
B	Hybrids in TAC	2,191	
C (=A+B)	TAC	13,184	10.2
E	ALAC-eligible instruments	11,387	8.8
	of which senior nonpreferred	9,023	
	of which Tier 2 hybrids	2,359	
	of which other	5	
F	Amount of eligible instruments maturing within 12-24 months exceeding 0.5% of S&P RWAs	-	
G (=E-F)	ALAC buffer	11,387	8.8
	S&P Global Ratings RWAs	128,721	

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

Environmental, Social, And Governance Factors

ESG Credit Indicators

E-1	**E-2**	E-3	E-4	E-5	S-1	**S-2**	S-3	S-4	S-5	G-1	**G-2**	G-3	G-4	G-5

ESG credit indicators provide additional disclosure and transparency at the entity level and reflect S&P Global Ratings' opinion of the influence that environmental, social, and governance factors have on our credit rating analysis. They are not a sustainability rating or an S&P Global Ratings ESG Evaluation. The extent of the influence of these factors is reflected on an alphanumerical 1-5 scale where 1 = positive, 2 = neutral, 3 = moderately negative, 4 = negative, and 5 = very negative. For more information, see our commentary "ESG Credit Indicators: Definition And Applications," published Oct. 13, 2021.

We see ESG credit factors for SanUK as being broadly consistent with domestic peers--balancing its strong governance arrangements, and contained climate risk exposures.

Although SanUK 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 mis-selling episode to be an issue of the past and do not expect further provisions 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.

Beyond its governance, SanUK has outlined a sustainability strategy that covers social and environmental aspects. To this end, since 2020 the group has originated in excess of £6.5 billion of green finance, which includes projects to enhance energy efficiency, renewable energy projects, or electric vehicle financing. The bank has further committed to £20 billion of support by 2025 across its business. At the same time as it is seeking to expand its sustainable lending, SanUK does remain exposed to climate-related risks--facing transition and physical risk across its loan book. In its mortgage book, the primary risk the group faces is that the assets it lends against become unmarketable, or marketable only at steep discount, as efforts to improve the energy efficiency of Britain's housing stock intensify. Furthermore, SanUK's largest physical risks tend to focus on flooding and coastal erosion. In the group's focused commercial lending book its risks will tend to reflect the risk to the creditworthiness of its borrowers from the climate transition.

Group Status: Highly Strategic Subsidiary Of Banco Santander

We consider SanUK 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. Although we understand that Banco Santander may provide support to SanUK 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. As such, 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.

Additionally, 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.

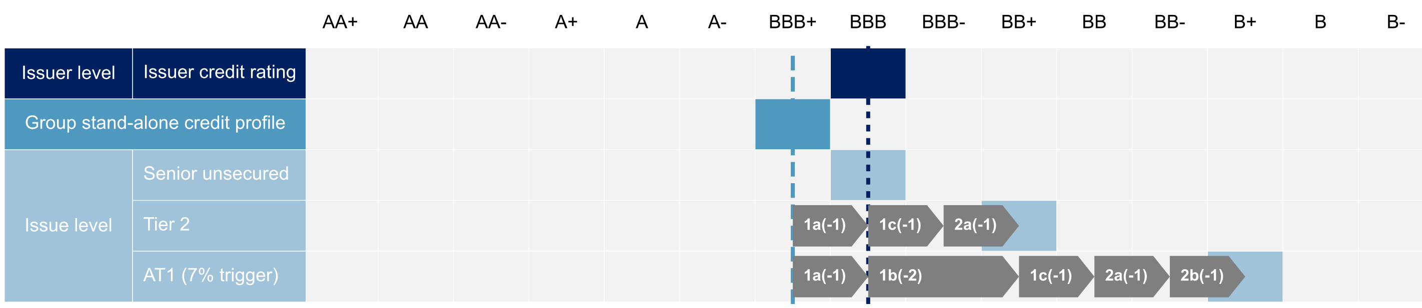
The group structure is relatively straightforward, mainly comprising the ring-fenced bank. We rate the non-ring-fenced bank, Santander Financial Services PLC (SFS), one notch below the group credit profile (GCP) because we believe it is a highly strategic subsidiary and consider it tactically important 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 10 and 11). We do not apply Step 2a notch for additional Tier 1 instruments given our confidence that SanUK's common equity Tier 1 (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 15.5% at June 30, 2022, and we expect it will remain in excess of 14% beyond our two-year outlook horizon, notwithstanding ordinary and extraordinary dividend payments to its parent, given that the bank's binding constraint is the U.K. leverage ratio.

Chart 10

Santander UK Group Holdings plc: NOHC Notching



Key to notching

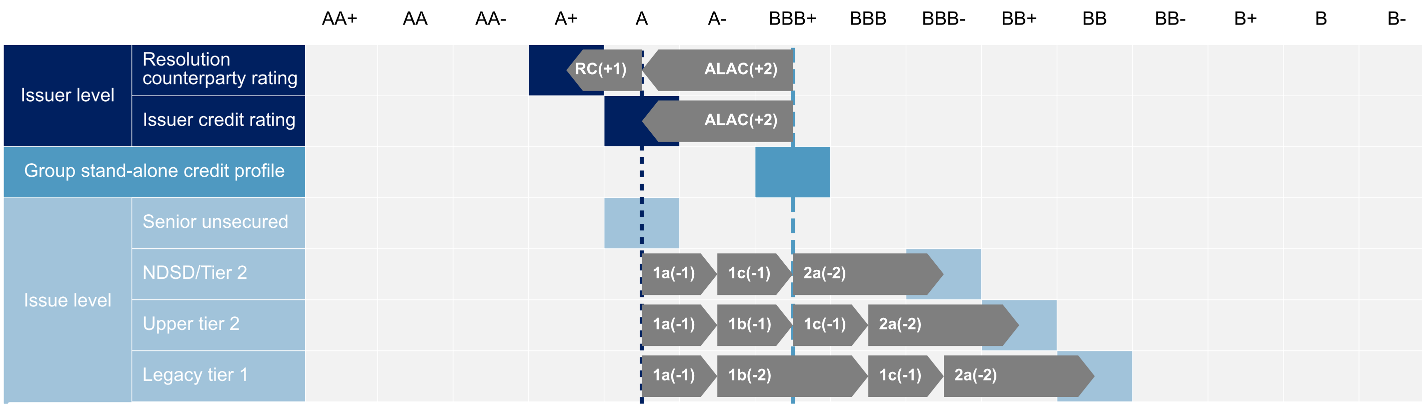
- Group stand-alone credit profile (dashed light blue line)
- Issuer credit rating (dotted dark blue line)

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 2 of our “Hybrid Capital: Methodology And Assumptions” criteria, published on March 2, 2022.
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 11

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 2 of our "Hybrid Capital: Methodology And Assumptions" criteria, published on March 2, 2022.
NDSD--Non-deferrable subordinated debt.

Resolution Counterparty Ratings (RCRs)

We set 'A+/A-1' RCRs on Santander UK PLC, one notch above the 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 2

Santander UK Group Holdings Plc--Key Figures

	--Fiscal year ended Dec. 31--				
(Mil. £)	**2022***	**2021**	**2020**	**2019**	**2018**
Adjusted assets	289,295	292,131	297,415	286,712	287,567
Customer loans (gross)	222,443	214,885	214,094	208,879	202,952
Adjusted common equity	10,759	10,993	11,045	11,055	11,027
Operating revenues	2,415	4,471	3,958	4,170	4,543
Noninterest expenses	1,186	2,540	2,561	2,613	2,632
Core earnings	757	1,449	418	794	1,073

*Data as of June 30.

Table 3

Santander UK Group Holdings Plc--Business Position

	--Fiscal year ended Dec. 31--				
(%)	**2022***	**2021**	**2020**	**2019**	**2018**
Total revenues from business line (currency in millions)	2,415.0	4,576.0	3,958.0	4,170.0	4,543.0
Commercial banking/total revenues from business line	12.9	11.1	14.7	14.7	18.2
Retail banking/total revenues from business line	86.6	87.1	87.9	85.7	82.9
Return on average common equity	9.4	8.8	1.6	3.6	6.5

*Data as of June 30.

Table 4

Santander UK Group Holdings Plc--Capital And Earnings

	--Fiscal year ended Dec. 31--				
(%)	**2022***	**2021**	**2020**	**2019**	**2018**
Tier 1 capital ratio	18.7	19.3	18.6	17.9	16.2
S&P Global Ratings' RAC ratio before diversification	N/A	10.2	9.7	9.5	9.4
S&P Global Ratings' RAC ratio after diversification	N/A	9.3	8.9	8.8	8.9
Adjusted common equity/total adjusted capital	83.0	83.4	83.1	83.1	84.3
Net interest income/operating revenues	88.9	89.4	86.8	79.0	79.4
Fee income/operating revenues	6.9	6.3	9.7	16.5	16.5
Market-sensitive income/operating revenues	0.0	(0.1)	1.9	0.6	2.8
Cost to income ratio	49.1	56.8	64.7	62.7	57.9
Preprovision operating income/average assets	0.8	0.7	0.5	0.5	0.6
Core earnings/average managed assets	0.5	0.5	0.1	0.3	0.4

*Data as of June 30. RAC--Risk-adjusted capital. N/A--Not applicable.

Table 5

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	59,100	0	0	258	0

Table 5

Santander UK Group Holdings Plc--Risk-Adjusted Capital Framework Data (cont.)					
Of which regional governments and local authorities	0	0	0	0	0
Institutions and CCPs	4,031	600	15	765	19
Corporate	21,600	13,200	61	25,173	117
Retail	205,800	42,600	21	85,866	42
Of which mortgage	189,300	39,200	21	69,151	37
Securitization§	2,363	788	33	724	31
Other assets†	5,702	3,400	60	7,458	131
Total credit risk	298,596	60,588	20	120,244	40
Credit valuation adjustment					
Total credit valuation adjustment	--	400	--	0	--
Market Risk					
Equity in the banking book	100	200	200	750	750
Trading book market risk	--	200	--	300	--
Total market risk	--	400	--	1,050	--
Operational risk					
Total operational risk	--	6,741	--	7,427	--
	Exposure	**Basel III RWA**	**Average Basel II RW (%)**	**S&P Global Ratings RWA**	**% of S&P Global Ratings RWA**
Diversification adjustments					
RWA before diversification	--	68,129	--	128,721	100
Total diversification/ concentration adjustments	--	--	--	12,437	10
RWA after diversification	--	68,129	--	141,158	110
		Tier 1 capital	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global Ratings RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		13,154	19.3	13,184	10.2
Capital ratio after adjustments‡		13,154	19.3	13,184	9.3

*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. CCPs--Central counterparty clearing house. Sources: Company data as of Dec. 31, 2021, S&P Global Ratings.

Table 6

Santander UK Group Holdings Plc--Risk Position					
	--Fiscal year ended Dec. 31--				
(%)	**2022***	**2021**	**2020**	**2019**	**2018**
Growth in customer loans	7.0	0.4	2.5	2.9	(2.8)
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	9.7	8.4	7.2	4.8
Total managed assets/adjusted common equity (x)	27.0	26.7	27.1	26.1	26.2
New loan loss provisions/average customer loans	0.1	(0.1)	0.3	0.1	0.1

Table 6

Santander UK Group Holdings Plc--Risk Position (cont.)

	--Fiscal year ended Dec. 31--				
(%)	**2022***	**2021**	**2020**	**2019**	**2018**
Net charge-offs/average customer loans	0.2	0.1	0.2	0.2	0.2
Gross nonperforming assets/customer loans + other real estate owned	1.1	2.0	2.0	1.7	1.8
Loan loss reserves/gross nonperforming assets	34.4	18.9	30.7	21.8	20.7

*Data as of June 30. RWA--Risk-weighted assets. N/A--Not applicable.

Table 7

Santander UK Group Holdings Plc--Funding And Liquidity

	--Fiscal year ended Dec. 31--				
(%)	**2022***	**2021**	**2020**	**2019**	**2018**
Core deposits/funding base	70.5	70.5	69.5	66.5	64.7
Customer loans (net)/customer deposits	116.2	111.0	110.2	116.2	116.4
Long-term funding ratio	93.8	92.5	86.4	84.0	87.7
Stable funding ratio	114.0	116.0	108.6	102.6	108.2
Short-term wholesale funding/funding base	6.5	7.9	14.3	16.9	13.0
Broad liquid assets/short-term wholesale funding (x)	3.1	2.9	1.6	1.2	1.6
Broad liquid assets/total assets	18.6	21.3	21.2	18.5	19.1
Broad liquid assets/customer deposits	28.4	32.5	32.8	29.8	31.8
Net broad liquid assets/short-term customer deposits	19.5	21.5	12.5	4.6	12.2
Short-term wholesale funding/total wholesale funding	21.4	26.1	45.5	49.2	35.9

*Data as of June 30.

Santander UK Group Holdings PLC--Rating Component Scores

Issuer Credit Rating	**A/Stable/A-2**
SACP	bbb+
Anchor	bbb+
Economic risk	4
Industry risk	3
Business position	Adequate
Capital and earnings	Adequate
Risk position	Adequate
Funding	Adequate
Liquidity	Adequate
Comparable ratings analysis	0
Support	+2
ALAC support	+2
GRE support	0
Group support	0
Sovereign support	0
Additional factors	0

ALAC--Additional loss-absorbing capacity. GRE--Government-related entity. SACP--Stand-alone credit profile.

Related Criteria

- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- 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: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Higher Rates Spur U.K. Banks' Strong First-Half Earnings Amid A Weakening Economic Outlook, Aug. 10, 2022
- Global Banking Outlook--Midyear 2022: Here Comes The Rain Again, , July 21, 2022
- Rising Inflation Will Normalize U.K. Banks' Domestic Credit Losses In 2022, April 20, 2022
- Update: Santander UK Group Holdings Ltd., March 2, 2022

Ratings Detail (As Of September 9, 2022)*	
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

Ratings Detail (As Of September 9, 2022)*(cont.)	
Commercial Paper	
Foreign Currency	A-2
Senior Unsecured	A-
Banco Santander S.A.	
Issuer Credit Rating	A+/Stable/A-1
Resolution Counterparty Rating	AA-/--/A-1+
Commercial Paper	
Foreign Currency	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-1
Resolution Counterparty Rating	A+/--/A-1
Commercial Paper	A-1
Senior Subordinated	BBB+
Senior Unsecured	A
Santander Consumer Finance S.A.	
Issuer Credit Rating	A/Stable/A-1
Resolution Counterparty Rating	A+/--/A-1
Commercial Paper	
Local Currency	A-1
Senior Subordinated	BBB+
Senior Unsecured	A

Ratings Detail (As Of September 9, 2022)*(cont.)	
Short-Term Debt	A-1
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.