FitchRatings

Banks
Bank Holding Companies
United Kingdom

Santander UK Group Holdings plc

Update

Ratings

Foreign Currency

Long-Term IDR	A
Short-Term IDR	F1
Viability Rating	a
Shareholder Support Rating	bbb+

Sovereign Risk (United Kingdom)

Long-Term Foreign-Currency IDR	AA-
Long-Term Local-Currency IDR	AA-
Country Ceiling	AAA

Outlooks

Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Local-Currency IDR	Stable

Applicable Criteria

Bank Rating Criteria (March 2024)

Related Research

Fitch Affirms Santander UK Group Holdings at 'A'; Outlook Stable (December 2023)

Major UK Banks' Performance to Remain Robust in 2024 (February 2024)

Santander UK Group Holdings plc (December 2023)

UK Banks' Misconduct Risk Is Highlighted by FCA Motor Finance Probe (January 2024)

UK Bank Ratings Unaffected by Sovereign Outlook Stabilisation (March 2024)

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Key Rating Drivers

Low-Risk Business Model: Santander UK Group Holding's (SGH) Viability Rating (VR) is equalised with that of Santander UK plc (San UK; A+/Stable), reflecting SGH's role as a holding company and its low double leverage. SGH and San UK's VRs are based on SGH's consolidated financial profile and reflect the group's low-risk business model, conservative risk appetite, healthy asset quality, strong capitalisation and stable funding and liquidity profiles. They also reflect a less-diversified business model than larger UK peers.

Strong Franchise; Undiversified Revenues: SGH's business profile benefits from its strong franchise in UK mortgage lending and retail deposits, which support a low-risk business model. SGH's business model diversification is narrower than most major UK banks peers given its focus on mortgage lending and reliance on net interest income.

Conservative Risk Profile: SGH's risk profile is underpinned by its conservative appetite for credit risk, as reflected in a high share of low-risk mortgage lending (mostly owner-occupied), at low loan-to-value. Consumer lending is small and largely focused on secured auto financing and unsecured consumer exposures are low. Corporate, commercial and business lending (10% of loans) is diversified by sector.

Loan Arrears to Rise: We expect slight further deterioration in SGH's impaired loans ratio (end-1Q24: 1.6%) given materially higher interest rates and low loan growth, but for it not to exceed 2% over the next two years. Asset quality will continue to be underpinned by the low-risk mortgage portfolio. Loan impairment charges (LICs) will remain easily absorbable given the largely secured loan book.

Profitability to Soften: We expect SGH's operating profit/risk-weighted assets ratio (RWAs; 2.3% in 1Q24) to remain strong but to move towards about 2.5% in 2024–2025. This reflects our view that SGH's net interest margin will contract given higher deposit costs and tight mortgage loan margins, but will also be supported by structural hedge income. We expect cost efficiency to be supported by recent years of transformation investments.

Strong Capital: SGH's common equity Tier 1 (CET1) ratio remained flat in 1Q24 at 15.2% as profits were offset by accrued dividends and modest RWA inflation. Capital is managed to about a 5% UK leverage ratio, given the low RWA density of the loan book. We expect excess capital above management buffers to be gradually distributed.

Strong Funding and Liquidity: SGH is largely deposit-funded and the loans/deposits ratio improved to 106% at end-1Q24, primarily because of loan contraction. SGH has a strong retail deposit franchise in the UK, and a high 86% of core retail deposits are insured. SGH's funding stability is supported by proven wholesale-funding access, ordinary support from its parent and access to the Bank of England's liquidity facilities, if needed.

Rating Sensitivities

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

SGH's ratings could be downgraded if there was a severe setback to the UK operating environment beyond our expectations, and we expected the impaired loans ratio to increase above 3% without a clear path to reduction, operating profit/RWAs fell sustainably below 1.5%, and the CET1 ratio went below 13% on a sustained basis.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

An upgrade of the ratings is unlikely given SGH's relatively undiversified business model compared with higher-rated peers. An upgrade is also unlikely in the near term due to the weak macroeconomic outlook in the UK. An upgrade would require a much-improved operating environment, a material strengthening in SGH's business profile, and business model diversification, accompanied by solid financial metrics.

Other Debt and Issuer Ratings

Rating level	SGH	San UK	Santander Financial Services plc (SFS)
Long-Term IDR	A	A+	A+
Short-Term IDR	F1	F1	F1
Viability Rating	a	a	-
Shareholder Support Rating (SSR)	bbb+	bbb+	a
Derivative Counterparty Rating (DCR)	-	A+(dcr)	-
Long- and short-term senior unsecured debt/programmes	A/F1	A+/F1	-
Tier 2 subordinated debt	BBB+	BBB+	-
Legacy upper Tier 2	-	BBB	-
Non-innovative Tier 1 notes	-	BBB-	-
Additional Tier 1 debt	BBB-	-	-

Source: Fitch Ratings

San UK's and SFS's Long-Term IDRs are one notch above SGH's because the single-point-of-entry UK resolution plan envisages the operating companies' third-party senior creditors being protected in a bank failure by sufficient qualifying junior debt and equity raised by SGH. The Short-Term IDRs of 'F1' for SGH and its rated subsidiaries are the lower of two options mapping to the Long-Term IDRs, as our assessment of the group's funding and liquidity profile does not warrant a higher Short-Term IDR. The senior unsecured debt instruments of all entities are rated in line with their Long-Term IDRs.

San UK's derivative counterparty rating (DCR) is at the same level as the bank's Long-Term IDR because counterparties have no preferential status over other senior obligations in a resolution under UK legislation.

The ratings of all subordinated debt and hybrid securities issued by SGH and San UK are notched down from their VRs, reflecting our expectation of below-average recoveries. SGH's subordinated Tier 2 instruments are notched down twice from the VR to reflect poor recovery prospects in case of failure. Additional Tier 1 capital securities are rated four notches below the group's VR to reflect above-average loss severity risk (two notches) and higher risk of non-performance as coupon payments are fully discretionary (two notches).

Legacy Upper Tier 2 securities are rated three notches below San UK's VR (two for loss severity and one for non-performance). Legacy dated Lower Tier 2 instruments are notched down twice from the VR for loss severity. Legacy Tier 1 securities issued by San UK are rated four notches below the bank's VR to reflect higher loss severity risk (two notches) and higher risk of non-performance due to discretionary coupon payments (two notches).

Significant Changes from Last Review

1Q24 Financial Performance in Line with Expectations

SGH's profitability weakened in 1Q24 from strong levels, with reported pre-tax profit falling 29% yoy primarily due to lower net interest income (NII). The drop in NII is in line with our expectations as low loan margins and increased deposit costs weigh on SGH's net interest margin, notwithstanding some support from structural hedge income. LICs remained low at 4bp of loans in 1Q24, reflecting SGH's low risk loan portfolio and its improved assessment of the UK economic outlook, and the impaired loans ratio ticked up to 1.6% at end-1Q24 from 1.4% at end-2023. Operating expenses grew by 7% yoy, and continued to reflect inflationary pressures and the tail end of investments in efficiency and customer systems. SGH's operating profit/RWAs fell to 2.3% in 1Q24 from 3.1% in 2023 primarily due to lower NII and higher costs.

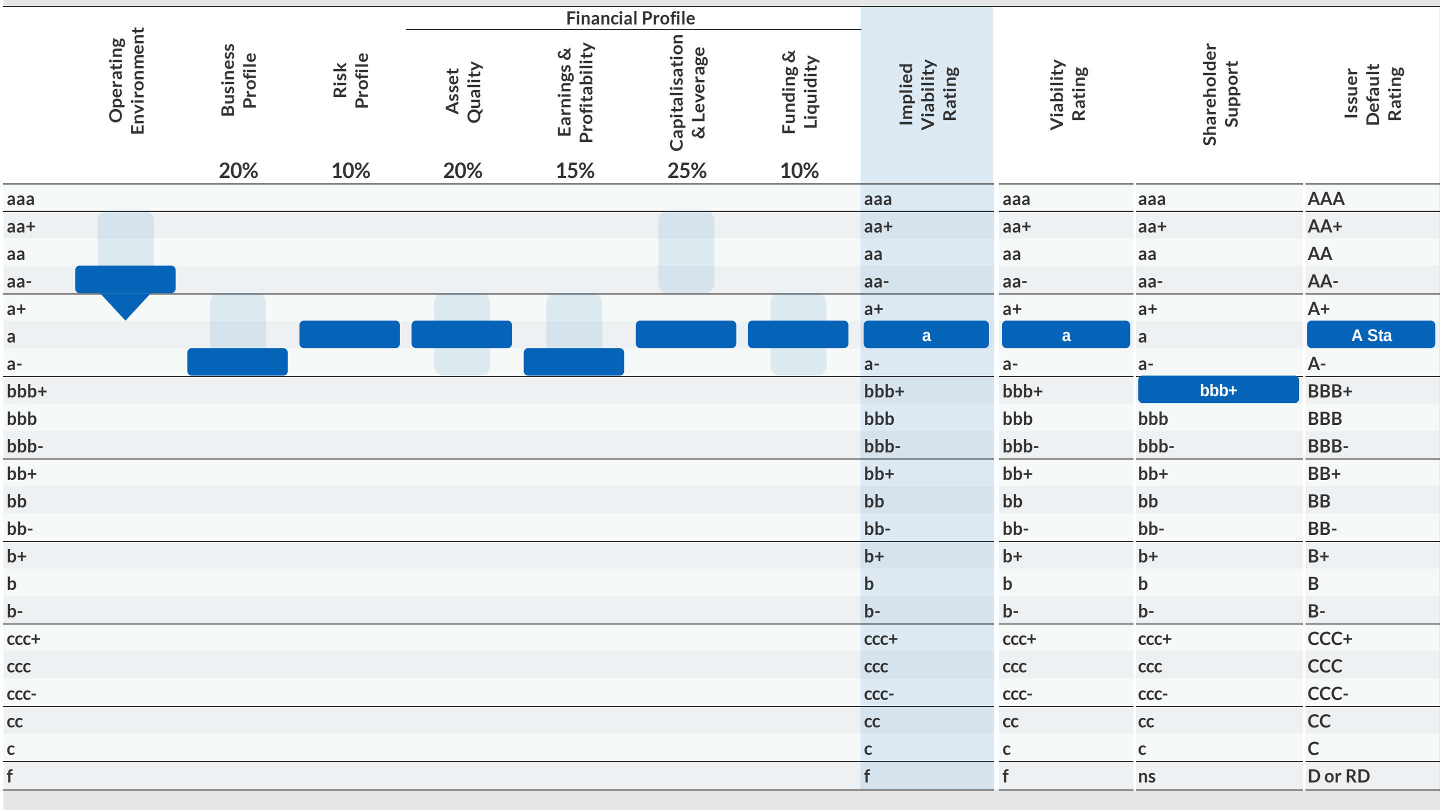
SGH continued to optimise its balance sheet returns in 1Q24, with the bank reporting lower customer loans (down 1% QoQ). We expect SGH's loan growth to remain muted in 2024 given challenging mortgage market dynamics, although it could pick up in 2H24 as interest rates fall, and if mortgage margins improve. We expect SGH to easily be able to replace TFSME funding (end-1Q24: GBP15 billion) over the next year or so given the bank's strong retail deposit franchise and wholesale funding access. SGH's liquidity pool represented a high 29% of customer deposits at end-1Q24.

Uncertainty Surrounding FCA's Review into Motor Finance

The Financial Conduct Authority (FCA) announced in early 2024 it is reviewing historical discretionary commission arrangements in the UK motor finance market following a high number of complaints from customers. The probe will review motor finance loans provided between 2007 and 2021, as the FCA had banned discretionary commissions in 2021. The review is unlikely to have a material impact on our assessment as motor loans only made up a small portion (end-2021: 2% of loans) of SGH's business, although there is high uncertainty surrounding the outcome and potential costs. SGH has not set aside provisions relating to this FCA review given the still-high uncertainty around the scope and timing of any findings.

Ratings Navigator

Santander UK Group Holdings plc ESG Relevance: **Banks** Ratings Navigator



The Key Rating Driver (KRD) weightings used to determine the implied VR are shown as percentages at the top. In cases where the implied VR is adjusted upwards or downwards to arrive at the VR, the KRD associated with the adjustment reason is highlighted in red. The shaded areas indicate the benchmark-implied scores for each KRD.

VR - Adjustments to Key Rating Drivers

The outlook on the operating environment score for domestic UK banks was negative at the time of the last rating committee, but was revised to stable on 25 March 2024, following the revision of the Outlook on the UK's 'AA-' sovereign rating to Stable.

Financials

Financial Statements

	31 Mar 24		31 Dec 23	31 Dec 22	31 Dec 21
	3 months - 1st quarter (USDm) Unaudited	3 months - 1st quarter (GBPm) Unaudited	Year end (GBPm) Audited - unqualified	Year end (GBPm) Audited - unqualified	Year end (GBPm) Audited - unqualified
Summary income statement					
Net interest and dividend income	1,323	1,053	4,667	4,472	3,997
Net fees and commissions	n.a.	n.a.	296	324	280
Other operating income	119	95	213	217	194
Total operating income	1,443	1,148	5,176	5,013	4,471
Operating costs	927	738	2,821	2,791	2,919
Pre-impairment operating profit	515	410	2,355	2,222	1,552
Loan and other impairment charges	24	19	206	321	-233
Operating profit	491	391	2,149	1,901	1,785
Other non-operating items (net)	n.a.	n.a.	n.a.	-7	105
Tax	129	103	553	471	485
Net income	362	288	1,596	1,423	1,405
Other comprehensive income	n.a.	n.a.	329	-1,682	465
Fitch comprehensive income	362	288	1,925	-259	1,870
Summary balance sheet					
Assets					
Gross loans	257,185	204,667	212,514	224,795	214,910
- Of which impaired	4,019	3,198.1	3,000	2,600	2,940
Loan loss allowances	1,215	967	937	955	853
Net loans	255,969	203,700	211,577	223,840	214,057
Interbank	n.a.	n.a.	1,216	1,105	1,420
Derivatives	n.a.	n.a.	842	-215	1,720
Other securities and earning assets	n.a.	n.a.	21,593	14,214	19,385
Total earning assets	255,969	203,700	235,228	238,944	236,582
Cash and due from banks	n.a.	n.a.	40,523	46,635	50,494
Other assets	98,894	78,700	6,332	6,664	6,600
Total assets	354,864	282,400	282,083	292,243	293,676
Liabilities					
Customer deposits	242,901	193,300	195,149	197,313	192,914
Interbank and other short-term funding	n.a.	n.a.	16,059	41,250	50,671
Other long-term funding	69,741	55,500	51,224	33,683	28,373
Trading liabilities and derivatives	n.a.	n.a.	977	1,906	1,822
Total funding and derivatives	312,642	248,800	263,409	274,152	273,780
Other liabilities	23,247	18,500	3,160	3,036	3,174
Preference shares and hybrid capital	n.a.	n.a.	2,744	2,540	2,535
Total equity	18,975	15,100	12,770	12,515	14,187
Total liabilities and equity	354,864	282,400	282,083	292,243	293,676
Exchange rate		USD1 = GBP0.795798	USD1 = GBP0.789827	USD1 = GBP0.828638	USD1 = GBP0.74438

Source: Fitch Ratings, Fitch Solutions, SGH

Key Ratios

	31 Mar 24	31 Dec 23	31 Dec 22	31 Dec 21
Ratios (%; annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	2.3	3.1	2.7	2.6
Net interest income/average earning assets	1.9	2.1	2.0	1.8
Non-interest expense/gross revenue	64.3	54.5	55.7	65.3
Net income/average equity	8.3	11.3	9.5	9.0
Asset quality				
Impaired loans ratio	1.6	1.4	1.2	1.4
Growth in gross loans	-3.7	-5.5	4.6	0.4
Loan loss allowances/impaired loans	30.2	31.2	36.7	29.0
Loan impairment charges/average gross loans	0.0	0.1	0.1	-0.1
Capitalisation				
Common equity Tier 1 ratio	15.2	15.2	15.2	15.9
Tangible common equity/tangible assets	5.4	4.0	3.8	4.3
Basel leverage ratio	4.4	4.4	4.4	4.3
Net impaired loans/common equity Tier 1	21.1	19.6	15.2	19.2
Funding and liquidity				
Gross loans/customer deposits	105.9	108.9	113.9	111.4
Gross loans/customer deposits + covered bonds	97.5	101.1	105.8	104.1
Liquidity coverage ratio	166.2	162.4	162.8	166.0
Customer deposits/total non-equity funding	77.7	73.6	71.6	70.1
Net stable funding ratio	137.4	138.1	136.8	n.a.

Source: Fitch Ratings, Fitch Solutions, SGH

Support Assessment

Shareholder Support	
Parent IDR	A-
Total Adjustments (notches)	-1
Shareholder Support Rating	bbb+
Shareholder ability to support	
Shareholder Rating	A-/ Stable
Shareholder regulation	1 Notch
Relative size	1 Notch
Country risks	Equalised
Shareholder propensity to support	
Role in group	1 Notch
Reputational risk	Equalised
Integration	1 Notch
Support record	1 Notch
Subsidiary performance and prospects	Equalised
Legal commitments	2+ Notches

The colours indicate the weighting of each KRD in the assessment.
Higher influence Moderate influence Lower influence

The 'bbb+' Shareholder Support Ratings (SSR) of SGH and San UK are one notch below Banco Santander S.A.'s Long-Term IDR (Santander; A-/Stable) because we view Santander's ability to provide support as constrained by the UK entities' relatively large size, as well as by possible regulatory restrictions. In our view, Santander has a strong propensity to support both entities, given the strategic importance of the UK as well as the high reputation risk Santander would face in the case of a default by its UK entities.

Environmental, Social and Governance Considerations

FitchRatings **Santander UK Group Holdings plc** — Banks, Ratings Navigator

Credit-Relevant ESG Derivation

Santander UK Group Holdings plc has 5 ESG potential rating drivers

- Santander UK Group Holdings plc has exposure to compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security) but this has very low impact on the rating.
- Governance is minimally relevant to the rating and is not currently a driver.

			ESG Relevance to Credit Rating
key driver	0	issues	5
driver	0	issues	4
potential driver	5	issues	3
not a rating driver	4	issues	2
	5	issues	1

Environmental (E) Relevance Scores

General Issues	E Score	Sector-Specific Issues	Reference	E Relevance
GHG Emissions & Air Quality	1	n.a.	n.a.	5
Energy Management	1	n.a.	n.a.	4
Water & Wastewater Management	1	n.a.	n.a.	3
Waste & Hazardous Materials Management; Ecological Impacts	1	n.a.	n.a.	2
Exposure to Environmental Impacts	2	Impact of extreme weather events on assets and/or operations and corresponding risk appetite & management; catastrophe risk; credit concentrations	Business Profile (incl. Management & governance); Risk Profile; Asset Quality	1

How to Read This Page
ESG relevance scores range from 1 to 5 based on a 15-level color gradation. Red (5) is most relevant to the credit rating and green (1) is least relevant.

The Environmental (E), Social (S) and Governance (G) tables break out the ESG general issues and the sector-specific issues that are most relevant to each industry group. Relevance scores are assigned to each sector-specific issue, signaling the credit-relevance of the sector-specific issues to the issuer's overall credit rating. The Criteria Reference column highlights the factor(s) within which the corresponding ESG issues are captured in Fitch's credit analysis. The vertical color bars are visualizations of the frequency of occurrence of the highest constituent relevance scores. They do not represent an aggregate of the relevance scores or aggregate ESG credit relevance.

The Credit-Relevant ESG Derivation table's far right column is a visualization of the frequency of occurrence of the highest ESG relevance scores across the combined E, S and G categories. The three columns to the left of ESG Relevance to Credit Rating summarize rating relevance and impact to credit from ESG issues. The box on the far left identifies any ESG Relevance Sub-factor issues that are drivers or potential drivers of the issuer's credit rating (corresponding with scores of 3, 4 or 5) and provides a brief explanation for the relevance score. All scores of '4' and '5' are assumed to result in a negative impact unless indicated with a '+' sign for positive impact.h scores of 3, 4 or 5) and provides a brief explanation for the score.

Classification of ESG issues has been developed from Fitch's sector ratings criteria. The General Issues and Sector-Specific Issues draw on the classification standards published by the United Nations Principles for Responsible Investing (PRI), the Sustainability Accounting Standards Board (SASB), and the World Bank.

Social (S) Relevance Scores

General Issues	S Score	Sector-Specific Issues	Reference	S Relevance
Human Rights, Community Relations, Access & Affordability	2	Services for underbanked and underserved communities: SME and community development programs; financial literacy programs	Business Profile (incl. Management & governance); Risk Profile	5
Customer Welfare - Fair Messaging, Privacy & Data Security	3	Compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security)	Operating Environment; Business Profile (incl. Management & governance); Risk Profile	4
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Business Profile (incl. Management & governance)	3
Employee Wellbeing	1	n.a.	n.a.	2
Exposure to Social Impacts	2	Shift in social or consumer preferences as a result of an institution's social positions, or social and/or political disapproval of core banking practices	Business Profile (incl. Management & governance); Financial Profile	1

Governance (G) Relevance Scores

General Issues	G Score	Sector-Specific Issues	Reference	G Relevance
Management Strategy	3	Operational implementation of strategy	Business Profile (incl. Management & governance)	5
Governance Structure	3	Board independence and effectiveness; ownership concentration; protection of creditor/stakeholder rights; legal /compliance risks; business continuity; key person risk; related party transactions	Business Profile (incl. Management & governance); Earnings & Profitability; Capitalisation & Leverage	4
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Business Profile (incl. Management & governance)	3
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Business Profile (incl. Management & governance)	2
				1

CREDIT-RELEVANT ESG SCALE

How relevant are E, S and G issues to the overall credit rating?

5	Highly relevant, a key rating driver that has a significant impact on the rating on an individual basis. Equivalent to "higher" relative importance within Navigator.
4	Relevant to rating, not a key rating driver but has an impact on the rating in combination with other factors. Equivalent to "moderate" relative importance within Navigator.
3	Minimally relevant to rating, either very low impact or actively managed in a way that results in no impact on the entity rating. Equivalent to "lower" relative importance within Navigator.
2	Irrelevant to the entity rating but relevant to the sector.
1	Irrelevant to the entity rating and irrelevant to the sector.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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