30 Jan 2018 - Scope Ratings AG

Scope assigns AAA(SF) to Serie A of FT PYMES Santander 13 – Spanish SME ABS

Scope Ratings GmbH has assigned final ratings to a EUR 2.7bn securitisation comprising credit lines, secured and unsecured loans to SMEs and individuals in Spain, co-originated by Santander, Banesto and Banif. The transaction closed on 25 January 2018.

The rating actions are as follows:

Serie A (ISIN ES0305289003), EUR 2,254.5m: final rating AAA_{SF}

Serie B (ISIN ES0305289011), EUR 445.5m: final rating $BB+_{SF}$

Serie C (ISIN ES0305289029), EUR 135m: final rating CCC_{SF}

The transaction is a strictly sequential three-tranche cash-flow securitisation with a combined priority of payments, a cash reserve available for default provisioning, and a liquidity facility to fund potential further drawings under the credit line segment after the transaction closes.

The final ratings are based on the portfolio dated 27 December 2017.

Download the full rating report here.

Rating rationale

The final ratings reflect the quality of the underlying collateral in the context of the Spanish macroeconomic environment; the legal and financial structure of the transaction; the transaction-specific protection features; the counterparty risk exposure to Santander S.A. (Santander) as servicer, account bank, paying agent, liquidity facility provider and subordinated loan provider; and the management ability of Santander de Titulización SGFT SA.

The Serie A rating reflects the tranche's risk exposure to fast-amortising assets, weighted average life of 1.3 years (calculated by Scope using a 0% constant prepayment rate assumption), and 21.5% credit enhancement protection against losses. This level of credit enhancement, while lower than that of previous PYMES Santander transactions, is associated with better-quality securitised assets.

The Serie B rating reflects the tranche's weighted average life of 4.5 years, which Scope derived using a 15% constant prepayment rate assumption, reflecting the exposure to long-maturity mortgage loans. The tranche benefits from 5% credit enhancement, but remains exposed to the medium-term economic uncertainties in Spain beyond Scope's outlook.

Serie C provides funds for the cash reserve, and its rating reflects the expected provisioning of portfolio losses from this reserve (weighted average life of 16.3 years, calculated under a 15% constant prepayment rate assumption).

All rated series benefit from expected periodic excess spread, which stands at 1.2% as of the pool cut date, and to which the Serie C is entitled unless required for shortfall provisioning.

Counterparty risk exposure to Santander is mitigated by i) the automatic guarantee or replacement of the bank upon loss of a long-term BBB rating by Scope (as account bank, paying agent and liquidity facility provider); ii) Scope's view on Santander's long-term credit quality (AA-/S-1/Stable); and ii) the expected short life of the Serie A.

Scope's analysis also considers the recent political developments in Catalonia, as well as the agency's long-term view on the Spanish economy. This view takes into account Spain's euro-area membership; the size, diversity and resilient recovery of its economy; commitment to structural reforms; and ongoing improvements in its banking sector; though constrained by the country's political risks. The transaction's three asset segments are exposed to Catalonia, with the mortgage segment being the most exposed at 18.9%.

Key rating drivers

Obligor credit quality (positive). The portfolio's obligors are on average stronger than those in previous PYMES Santander transactions. This is illustrated by the weighted average one-year probability of default of 2.1% assigned by Santander to the portfolio, significantly lower than the 3.3% for PYMES 12. The outstanding portfolio, alongside the early expected amortisation of the credit lines, is also expected to perform better than PYMES 12, based on Santander's internal one-year probability of default data.

Fast amortisation (positive). Serie A's short expected life substantially limits the risk exposure to counterparties and to possible macroeconomic deterioration. Its weighted average life is 1.3 years under a 0% constant prepayment rate assumption, mainly driven by the fast amortisation of the credit line segment.

Spanish economy (positive). Scope's Stable Outlook on the Kingdom of Spain, driven by the country's ongoing structural reforms and banking sector improvements, will benefit the Serie A and may also benefit the Serie B, unless persistent challenges (e.g. from unemployment or political uncertainties) lead to a slower economic development during the life of the mezzanine class.

Relatively low credit enhancement (negative). The credit enhancement available for the Series A and B is lower for this transaction compared to previous PYMES transactions analysed by Scope, but reflects the portfolio's higher credit quality.

High default rate volatility for mortgage segment (negative). Under a stress scenario, the performance of the mortgage segment could deviate significantly from Scope's mean default rate assumptions. This is reflected mainly by the mortgage segment's high point-in-time coefficient of variation and point-in-time historical mean default rate.

Undrawn credit lines exposure (negative). This segment exposes the transaction to revolving and refinancing risks which may increase portfolio default rates under stress scenarios. These risks are mitigated by i) Santander's solid track record in originating and managing credit lines, ii) the portfolio's repayment profile, and iii) the very short life of the credit lines. The weighted average use of these credit lines is 79% and could only theoretically increase up to 105% within the next six months post-closing.

Positive rating-change driver. Stronger-than-expected performance of the Spanish economy would positively impact the rating of the Serie B.

Negative rating-change driver. The crystallisation of the political tensions in Catalonia during the life of the Serie B, and their negative impacts on the economy, may adversely impact this class. However, such scenario is unlikely and, by this point, additional credit enhancement would be available for the Serie B.

Quantitative analysis and key assumptions

Scope has performed a cash flow analysis of the transaction over the amortisation period and incorporated in the analysis important mechanisms in the structure. The agency applied a large homogenous portfolio approximation approach to analyse the highly granular collateral pool and assumed portfolio defaults to follow an inverse Gaussian distribution to calculate the expected loss of each rated tranche. The analysis also provides the expected weighted average life of each tranche. Scope has considered asset and liability amortisation and the evolution in the pool composition. Scope's analysis considered six distinct asset segments: the segments for credit lines, mortgage loans and unsecured loans split respectively into large and small obligors.

Scope assumed a portfolio point-in-time '90 days past due' default rate of 5.8%, a point-in-time coefficient of variation of 97.7%, a cure rate of 15%, and a base recovery rate of 55.1% – all weighted by segment. Scope has applied a rating-conditional haircut to the base recovery rate of 41% and 8% for Serie A and Serie B respectively.

Scope has also applied a long-term adjustment to default rate parameters, resulting in a long-term-adjusted '90 days past due' portfolio default rate of 2.9%, and a long-term coefficient of variation of 95.1%. The long-term adjustments are derived from corporate delinquency data available from the Bank of Spain, covering the years 1993-2014, a period which, in Scope's opinion, represents a full economic cycle in the country.

Scope derived its initial portfolio modelling assumptions from obligor-segment-specific vintage data provided by Santander, which reflect the bank's internal recovery practices and foreclosure costs, and cover a period from Q1 2010 to Q2 2017, a period of significant economic stress in Spain.

The underlying portfolio is segmented into 19.4% of fast-amortising credit lines, 57.3% of amortising unsecured loans, and 23.2% amortising long-maturity mortgages. The portfolio's weighted average life is 2.1 years under 0% constant prepayment rate.

The credit lines exhibit limited credit risk over a short period (weighted average life of 0.3 years). Scope's modelling assumptions have integrated the associated refinancing and revolving risks.

The unsecured loans are well-seasoned (2.1 years) and highly diversified (77% of asset pool obligors), with a strong weighted average credit quality as per Santander's internal one-year probability of default (1.6%).

The mortgage loans are secured by commercial and residential properties and are characterised by a weighted average loan-to-value of 50.8% (prior to indexation) and a low one-year probability of default (2.0%) as assigned by Santander. On the other hand, historical performance has been very volatile. Scope's recovery assumptions for the mortgage segment reflect the agency's fundamental analysis of real estate properties value in Spain.

Rating sensitivity

Scope tested the resilience of the rating against deviations of the main input parameters: i) the portfolio mean default rate and ii) the portfolio recovery rate.

This analysis has the sole purpose of illustrating the sensitivity of the rating to input assumptions and is not indicative of expected or likely scenarios.

The following shows how the quantitative results change compared to the assigned credit ratings when the portfolio's expected default rate is increased by 50% and the portfolio's expected recovery rate is reduced by 50%, respectively:

- Serie A: sensitivity to probability of default, zero notches; sensitivity to recovery rates, zero notches.

- Serie B: sensitivity to probability of default, one notch; sensitivity to recovery rates, one notch.
- Serie C: sensitivity to probability of default, two notches; sensitivity to recovery rates, two notches.

Methodology

The methodologies used for this rating(s) and/or rating outlook(s) SME ABS Rating Methodology, 30 June 2017; General Structured Finance Rating Methodology, August 2017; Methodology for Counterparty Risk in Structured Finance, August 2017 are available on www.scoperatings.com.

Historical default rates of Scope Ratings can be viewed in the rating performance report on https://www.scoperatings.com/#governance-and-policies/regulatory-ESMA Please also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope's definition of default as well as definitions of rating notations can be found in Scope's public credit rating methodologies on www.scoperatings.com.

The rating outlook indicates the most likely direction of the rating if the rating were to change within the next 12 to 18 months.

Solicitation, key sources and quality of information

The rated entity and/or its agents participated in the rating process.

The following substantially material sources of information were used to prepare the credit rating: issuer, public domain, third parties and scope internal sources. Prior to publication, the rated entity was given the opportunity to review the rating and/or outlook and the principal grounds on which the credit rating and/or outlook is based. Following that review, the rating was not amended before being issued.

Scope Ratings GmbH has relied on a third-party asset due diligence/assed audit. The audit review has no negative impact on the credit rating.

Regulatory disclosures

This credit rating and/or rating outlook is issued by Scope Ratings GmbH.

Lead analyst Sebastian Dietzsch, Associate Director.

Person responsible for approval of the rating: Guillaume Jolivet, Managing Director.

The ratings/outlooks were first released as preliminary rating by Scope on 18.01.2018.

Potential conflicts

Please see www.scoperatings.com. for a list of potential conflicts of interest related to the issuance of credit ratings.

Conditions of use / exclusion of liability

Scope Ratings GmbH, Lennéstrasse 5, 10785 Berlin, District Court for Berlin (Charlottenburg) HRB 192993 B, Managing Director(s): Dr. Stefan Bund, Torsten Hinrichs.

Analyst Contact: **Sebastian Dietzsch** : **s.dietzsch@scoperatings.com**

Team Leader: **Guillaume Jolivet**: **g.jolivet@scoperatings.com**

Press: **André Fischer**: **an.fischer@scopeanalysis.com**

Rating Cards

- FT PYMES SANTANDER 13 - Class A
- FT PYMES SANTANDER 13 - Class B
- FT PYMES SANTANDER 13 - Class C