Banco Santander SA

Santander retrenches in UK as mortgage price war bites

Bank caught between smaller challengers and incumbent ‘Big Four’ lenders

Santander UK chief executive Nathan Bostock says critics 'underestimate' the strength of its business bank © FT montage / Alamy

Nicholas Megaw and **David Crow** in London JANUARY 13 2020

It is 10 years this week since Abbey National signs started disappearing from the UK high street to be replaced by those of Santander, the Spanish bank that acquired the building society in 2004.

Some customers might have mourned the retirement of the Abbey brand but Santander’s push into Britain would turn out to be a rare success story following the 2008 financial crisis.

While rivals shrank, Santander UK grew rapidly via a string of acquisitions and considered a £20bn flotation in London. Ana Botín, the daughter of architect of modern Santander Emilio Botín, was parachuted in to run the business in 2010 and promised nothing less than to "transform UK banking".

A decade later, however, Santander UK is struggling. Its IPO plans are a distant memory and its parent, which Ms Botin now runs, recently slashed its valuation by €1.5bn, blaming economic uncertainty related to Brexit and new regulations.

The bank is caught between smaller challengers who dismiss it as an old-fashioned incumbent and the "Big Four" — Lloyds, Barclays, HSBC and RBS — that still dwarf it in scale.

"It never quite managed to deliver on its promise other than very briefly around 2012-13," said a senior executive at a rival bank."It illustrates once again that enormous advantage the large incumbents have."

Although the market was difficult for all British banks last year, Santander had a particularly tough time. Pre-tax profit dropped 24 per cent in the first nine months of 2019, putting it on track for its third successive year of declines. Within the wider Santander group the UK is forecast to generate the lowest return on equity, in the medium term, of any of its main markets.

However Nathan Bostock, who took over from Ms Botín as UK chief executive in 2014, said he would not follow his rivals into riskier areas of lending in an attempt to speed up its recovery.

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"My view is our speed of growth needs to be proportionate to the uncertainty . . . If we get certainty and you can see things [improving], then I'll grow," he said in an interview.

Many of Santander's recent challenges have been caused by factors outside its

connected to how that business will evolve

Nathan Bostock, UK chief executive

control but they have been exacerbated by strategic decisions made over the past decade, according to investors and former executives.

After entering the UK with what was then Europe's largest cross-border banking deal — the £9.5bn purchase of Abbey National in 2004 — it added Alliance & Leicester and the healthy parts of Bradford & Bingley in 2008.

The trio of former building societies allowed Santander to quickly become a significant player in the mortgage and savings markets, but it has left the business particularly exposed to a recent price war in home loans that has compressed margins across the sector.

"Santander UK's top line growth has been impacted by the low [interest] rate environment, excess liquidity in the mortgage market," said Benjamin Toms, an analyst at RBC, adding that the lender had also been hurt by customers moving off more profitable variable rate mortgages to cheaper fixed deals.

He added: "In addition, regulation and IT expenses have augmented costs. These factors along with the residual impact of litigation [related to the mis-selling of payment protection insurance] have recently damped the bank's profitability."

New rules requiring banks to "ringfence" their retail banking operations from international business have not only added costs for Santander but also left rivals like HSBC with billions of pounds in excess deposits that can only be deployed in the UK, encouraging an aggressive expansion in home loans which has driven down prices.

“Our balance sheet fundamentally has more mortgages . . . [compared with] the largest incumbents,” Mr Bostock acknowledged. So “[we] are more connected to how that business will evolve.”

Meanwhile Santander’s efforts to diversify into business lending were repeatedly frustrated. It considered a bid for Clydesdale and Yorkshire Bank before it was spun out of National Australia Bank, and twice tried to buy a network of branches and customers from RBS.

Mr Bostock says critics “underestimate” the strength of its business bank, which has organically grown to around 300,000 customers.

But corporate lending still accounts for less than 10 per cent of its loan book and was not enough to prevent a drop of 10 basis points in net interest margin to 1.12 per cent in the year to September 2019.

Ms Botín said in a statement to the FT that UK regulations had become “more demanding than any in the world, and this has impacted growth in recent years”. But she added the UK remained a “critically important market” and that she “believe[s] in the long-term value Santander UK brings to the group”.

Mr Bostock and other senior figures are keen to stress that a recent executive reshuffle, which saw him dropped from the group management committee, is not a reflection of the UK’s diminishing importance.

“I go to the European [management committee]. I speak to Jose Antonio [Alvarez, group CEO] all the time . . . if anything, that helps create more capacity to focus,” said Mr Bostock.

But two former executives expressed alarm at the decline in the group’s status within the Santander empire, with one saying the business was in “hibernation” and another saying it had been put in “fuel-save mode”.

The subsidiary's near-term focus will be on cost savings rather than lobbying its parent for increased resources when there are better returns available elsewhere, especially in fast-growing Latin American markets like Brazil.

Santander closed around a fifth of its UK branches last year, and there are further back-office cuts to come. "You have to reduce headcount," Mr Bostock said. "It's about digitising . . . it's about simplification."

The bank will also consider cutting the expensive incentives it offers to current account customers.

Its flagship 123 account, which gives cashback and pays interest in exchange for a monthly fee, was central to Santander's efforts to become customers' main bank instead of a secondary savings provider. But while the strategy helped increase current account deposits more than fivefold between 2011 and 2018 to £68bn, it is expensive compared with those of larger banks that pay no interest.

Mr Bostock said the 123 account would remain "the most competitive" product on the market, but noted that rivals had reduced their offering in recent months, and "we could change it again".

Though the UK unit will struggle to keep up with the levels of technology investment announced by larger rivals, it will benefit from group initiatives such as the £350m purchase of a stake in British fintech Ebury, which will provide new systems for its business bank, he said.

Santander UK's domestic rivals have turned to higher-returning areas such as consumer credit to offset declines in mortgage margins.

But Mr Bostock — who was chief risk officer at RBS after its government bailout — said the potential downside in the event of a hard Brexit was not worth it.

"I'm running the UK but I'm also thinking about the group as a whole," he said.