

# York 2019-1 CLO DAC

## UK SME CLO



Scope  
Ratings

### Ratings

Credit Protection	Rating	Notional (GBP m)	Notional (% assets)	CE (% assets)	Premium	Legal maturity
Class A	AAA <sub>SF</sub>	2,394.7	77.00	23.00	0.80%	20 March 2029
Class B	A <sub>SF</sub>	264.35	8.50	14.50	1.50%	20 March 2029
Class C	BBB <sub>SF</sub>	93.30	3.00	11.50	2.50%	20 March 2029
Class D	BB <sub>SF</sub>	124.4	4.00	7.50	5.00%	20 March 2029
Class E	NR	233.25	7.50	0.00	12.15%	20 March 2029

Scope's quantitative analysis is based on the portfolio dated 30 April 2019. Scope's Structured Finance Ratings constitute an opinion about relative credit risks and reflect the expected loss associated with the payments contractually promised by an instrument on a particular payment date or by its legal maturity. See Scope's website for its [SF Rating Definitions](#).

### Transaction details

Purpose	Significant risk transfer
Issuer	York 2019-1 CLO DAC (York)
Originator/ protection buyer	Santander UK plc
Closing date	28 June 2019
Payment frequency	Quarterly: 20 March, June, September, December

York is a synthetic significant risk transfer transaction of a GBP 3,080m portfolio of 3,177 referenced obligations granted to 1,268 SMEs and self-employed borrowers in the UK. Santander UK originated or acquired the loans. York 2019-1 CLO DAC, a remote special purpose vehicle, sells credit protection on the portfolio through protection agreements entered into with Santander. Loss allocation is strictly sequential among the tranches in reverse order of seniority – from classes E to A. The amortisation mechanism will be modified pro-rata subject to performance and concentration triggers for senior credit protections – classes A to C – and is strictly sequential for the subordinated junior credit protections – classes D and E.

### Rating rationale (summary)

The ratings reflect the risk for the credit protection seller to make a payment with respect to a credit event under the credit protection deed's terms regarding the York 2019-1 CLO DAC transaction (the transaction). The ratings do not address potential losses resulting from the transaction's early termination, the issued notes, any market risk, nor any counterparty risks associated with the transaction.

Under the credit protection agreements, Santander receives an initial cash payment in the event of a failure to pay or bankruptcy, but not for a restructuring. This payment equals the accounting provision held against the outstanding balance of a reference obligation upon its default and is adjusted for the actual loss during a maximum work-out period of two years. For a restructuring credit event, only the final loss amount can be claimed. Any difference between the initial loss claim and the final loss after work-out will entail a make-up payment. Santander must also service and work-out defaulted reference loans following its internal principles and policies, as it would for loans outside the reference loan portfolio.

The ratings reflect the legal and financial structure of the transaction as defined under the terms of the credit protection deed; the credit quality of the underlying portfolio in the context of macroeconomic conditions in the UK; the ability and incentives of Santander, the main originator and servicer of the reference loans; and the supervision from the verification agent.

The ratings account for the respective credit enhancement of the tranches; the strictly sequential release of risk coverage between senior and junior credit protections; and the modified pro-rata amortisation among the senior credit protections, subject to performance and concentration triggers. The ratings also reflect the credit risk of the static reference portfolio, characterised by a short weighted average life, a limited lifetime default risk and a substantial recovery rate upon default for secured loans.

Our analysis also considered the flexibility granted to Santander to allocate losses associated with defaulted obligations that are not completely worked out upon the termination of the credit protection deed. These losses will reflect Santander's accounting provisions.

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### Related methodologies

[SME ABS Rating Methodology](#)

[Methodology for Counterparty Risk in Structured Finance](#)

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## Rating drivers and mitigants

### Positive rating drivers

**Static portfolio.** The portfolio's static nature reduces the risk of portfolio quality migration because the protection buyer has no power to realise any future adverse selection of obligations.

**Short weighted average portfolio life.** Portfolio amortisation is fast with a 2.5-year weighted average life.

**Robust class A.** The most senior tranche is well protected against extreme downturn scenarios commensurate with AAA stress levels, demonstrated by its resilience to Scope's sensitivity stresses.

**Granularity.** The portfolio has 484 effective exposures to 339 effective borrower groups and approximately 12 effective industries. We calculate the effective number as the inverse of the Herfindahl index. The 10 largest borrower groups account for only 4.85% of the portfolio, and single exposures are capped at 0.5% of the reference notional. The granularity provides stability to lifetime default rate assumptions.

### Upside rating-change drivers

**Increased credit enhancement** from deleveraging accompanied by solid asset performance may result in an upgrade.

### Negative rating drivers and mitigants

**Recent SME lender.** Santander's SME lending activities in the UK date back to 2004 following its acquisition of Abbey National plc. Our analysis incorporates the bank's recent and strong growth combined with its track record during a benign economic period.

**Modified pro-rata structure among senior credit protections.** Classes A to C are subject to pro-rata amortisation depending on performance and concentration triggers. Once thresholds are triggered, the amortisation becomes strictly sequential. This weakens the class A and increases volatility for classes B and C.

**UK macroeconomic uncertainty.** Brexit uncertainties are leading to adverse economic developments that are impacting the general credit performance of UK corporates over the short term. A hard Brexit combined with Santander's recent lending focus on SMEs may exacerbate this. The risk is partially mitigated by Santander's relatively prudent approach to risk, demonstrated by its results under the Bank of England's 2018 stress test.

### Downside rating-change drivers

**Worse-than-expected default and recovery performance** of the assets may result in a downgrade. A hard Brexit may lead to an economic downturn, which would reflect negatively on default rates.

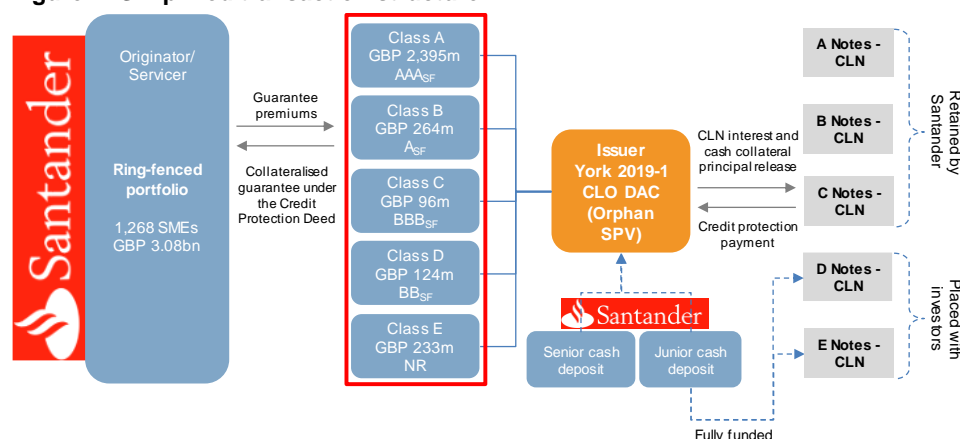
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## 1. Transaction summary

York is a synthetic transaction involving the significant risk transfer of a static portfolio of UK SME loans. We have rated the risk for the credit protection seller to make a payment with respect to a credit event under the credit protection deed's terms. Ratings were assigned to the credit protections for classes A, B, C and D.

**Figure 1: Simplified transaction structure**



Source: Transaction documents and Scope.

## 2. Originator and seller

### 2.1. Business positioning

Santander UK has positioned itself as 'the leading UK scale challenger' of long-established UK banks including HSBC, Lloyds Bank, Royal Bank of Scotland and Barclays, following its 2004 acquisition of Abbey National Treasury Services Plc and, later on, of Alliance & Leicester and Bradford & Bingley.

Santander's strategy is to build a business model characterised by low-to-medium risk, a competitive cost base, and no excessive risk taken throughout the economic cycle. The bank aims to increase market share by targeting good-credit-quality and profitable customers. The bank's recent growth has been illustrated by increased volume both in underwritten lending to UK companies, which grew at five times the rate of the UK market level from 2013 to 2017, and in retail current accounts, seven times faster than the market over the same period.

The business model focuses on three areas: Corporate & Commercial Banking, Retail Banking, and Corporate & Investment Banking. In the latter, customers with UK business are classified as either i) mid-size enterprises (turnover of GBP 6.5m-50m); ii) corporates (GBP 50m-500m); or iii) large corporates (GBP 500m and above).

Santander UK plc is an operating company of Santander Group and is fully owned by holding company Santander UK Group Holdings PLC. Santander UK was ring-fenced following the implementation of the Banking Reform Act. Santander UK plc serves Retail Banking and Corporate & Commercial Banking customers and, in accordance with regulation, has to withstand capital and liquidity stresses on a standalone basis.

York is therefore consistent with Santander UK Group's strategy to: i) optimise balance sheet capital via specific capital-saving initiatives; ii) improve return on capital; iii) increase capital lending capacity in order to expand market share in core businesses; and iv) increase standalone liquidity and funding position. The transaction demonstrates the progress made in strengthening Santander UK plc's capital position, with the CET1 ratio reaching 13.4% as at March 2019.

**Santander's retail and SME businesses grew faster than peers' over the last five years**

**The transaction is consistent with Santander's strategy following the ring-fencing of Santander UK plc**

Santander UK Group's stress test results show a thoughtful risk approach despite an appetite for growth

Santander UK Group's CET1 drawdown was the lowest of all UK banks in the Bank of England's 2018 stress test, at 1.4% before any management actions. This demonstrates Santander's thoughtful risk approach, even with its appetite for growth and recent entry into the UK's retail and SME markets.

Santander UK Group's interests are well aligned with those of the noteholders. Adverse performance or mismanagement may jeopardise senior notes' eligibility as a central bank liquidity instrument or reputational damage.

### 3. Sanctioning and underwriting

#### 3.1. Loan origination

Reference obligations originated out of Corporate & Commercial Banking comprise 87% of the portfolio, with the remainder stemming from Retail Banking.

The sanctioning and execution of the corporate channel's credit applications are effective and limit risk in line with the bank's risk appetite, in our view. Santander involves the risk department throughout the whole process, from early discussions until final execution, which ensures compliance with its risk appetite and policies. Processes are largely in line with standard processes at comparable banks, with a proper segmentation of sanctioning authority as well as the separation of business and risk-review powers, with the business being the first line of defence. There are also six delegated authority levels, with rules-based escalation depending on the exposure type, exposure size and the internal borrower rating.

Credit approval occurs over three stages: i) engagement with the relevant risk team to gauge appetite via a sighting discussion between risk and business functions; ii) a credit application implying further engagement with customers and finalisation of the deal structure; and iii) final credit approval by the appropriate delegated authority.

Risk appetite limits are monitored throughout the balance sheet and apply to dynamic concentration levels by sector, geography, single name, and rating category. At the end of 2018, Santander replaced its internal risk rating system following a recalibration exercise. Our analysis has considered deviations from the former risk model.

### 4. Asset analysis

The reference loan portfolio is static and comprises 3,177 reference obligations composed mostly of term loans (c. 77%), with the remainder being revolving facilities (c. 23%). Secured loans represent approximately 85% of the portfolio.

The reference loans are mostly denominated in British pounds (c. 94.7%), with the rest in US dollars or euros.

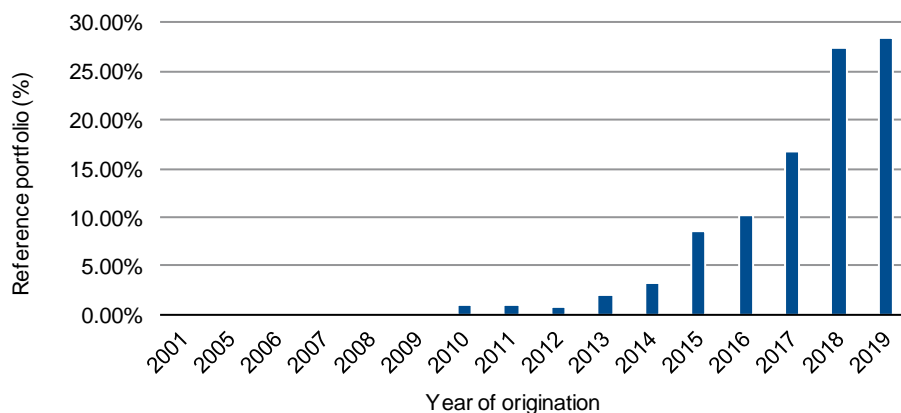
The portfolio has a limited vintage life: around 93% has been originated since 2015 and around 56% since 2018. This reflects the recent growth in Santander's SME lending activity and its focus on short- to mid-term SME loan lending.

Proper involvement of business and risk functions in sanctioning

Santander recalibrated its internal risk system at the end of 2018

Recently originated static portfolio exposed to UK SMEs over a short weighted average life

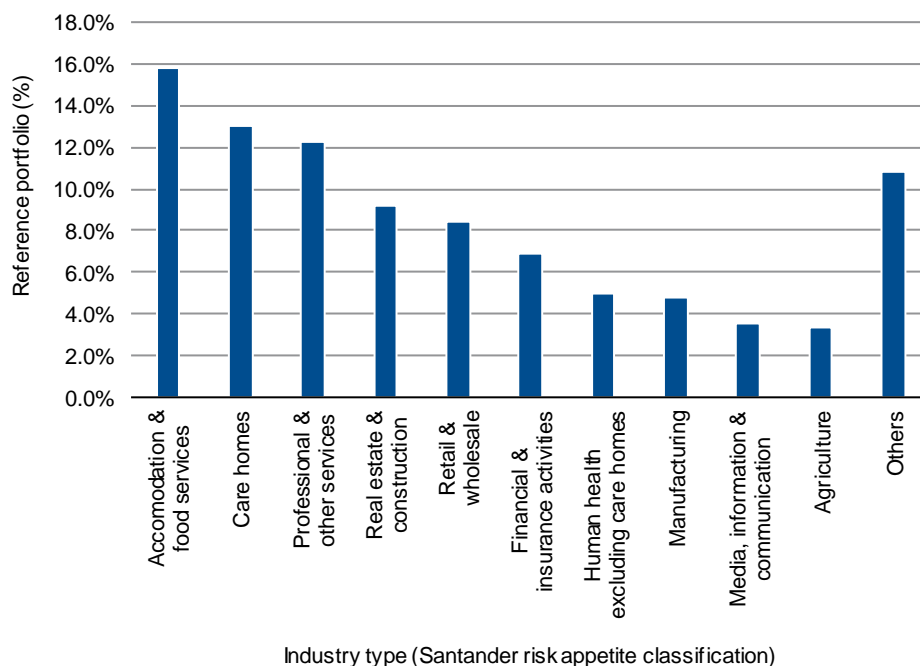
**Figure 2:Vintage distribution of the reference portfolio by origination bucket**



Top-three industries represent 41.3% of the reference portfolio exposure

The portfolio is diversified across industry sectors, with a focus on accommodation and food services (15.8%), care homes (13%), and professional and other services (12.5%).

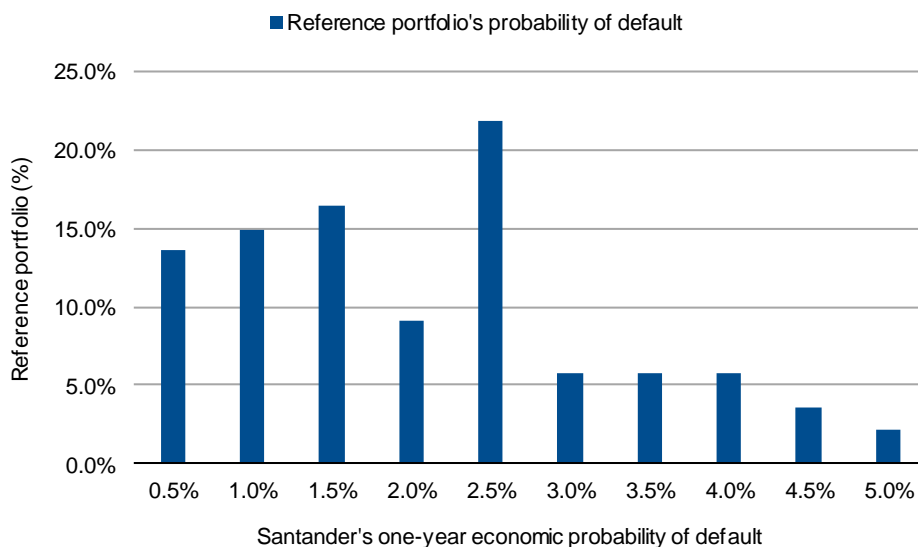
**Figure 3: Industry distribution of the reference portfolio**



Portfolio's weighted average one-year probability of default is 1.82%

The portfolio has an average economic one-year probability of default of 1.82% as per Santander's internal risk assessment. Santander has provided us with the historical performance of its UK SME loans over the last eight years but these are not published in this report on request of Santander for commercially sensitive reasons. The weighted average one-year default rate is commensurate with a BB rating. However, the information does raise some concerns: i) vintage data do not capture a full economic cycle; ii) the longest vintages (2011/2012) are commensurate with a B+ or BB rating; and iii) volatility is significant among the origination years, with a factor of 4 around the weighted average cumulative probability of default. We have addressed these by applying specific stresses to the one-year probability of default as described in the Quantitative analysis section below.

**Figure 4: Portfolio credit quality by Santander one-year probability-of-default bucket**



Reference obligation notional capped at 0.5% of the total portfolio notional

We have analysed the portfolio's granularity in terms of its 'effective' number, which we calculate as the inverse of the Herfindahl index. The 10 largest borrower groups account for only 4.85% of the portfolio, and single exposures are capped at 0.5% of the reference notional. The granularity provides stability to lifetime default rate assumptions

**Figure 5: Portfolio granularity**

Granularity	Scope effective number
Effective exposures	484
Effective borrower groups	339
Effective industries	12

#### 4.1. Eligibility criteria

The reference obligations are subject to eligibility criteria. The key criteria are summarised below.

**Figure 6: Main eligibility criteria for this transaction**

Eligibility criteria	
<b>Obligation type</b>	Term loan or revolving credit facility originated or acquired by the protection buyer or an affiliate of the protection buyer
<b>Obligation seniority</b>	Senior obligation
<b>Obligor type</b>	SME, corporate entity, non-corporate entity
<b>Currency</b>	Group of 10 countries as per the BIS, or denominated in either Australian dollars, Hong Kong dollars, or Singaporean dollars
<b>Remaining maturity</b>	No greater than 7.75 years
<b>Watchlist</b>	'Not a Serious Watchlist Obligation' as per the protection buyer's watchlist system
<b>IFRS 9 stage</b>	Not an IFRS stage 3
<b>Maximum probability of default</b>	The associated obligation probability of default does not exceed 5.0%.

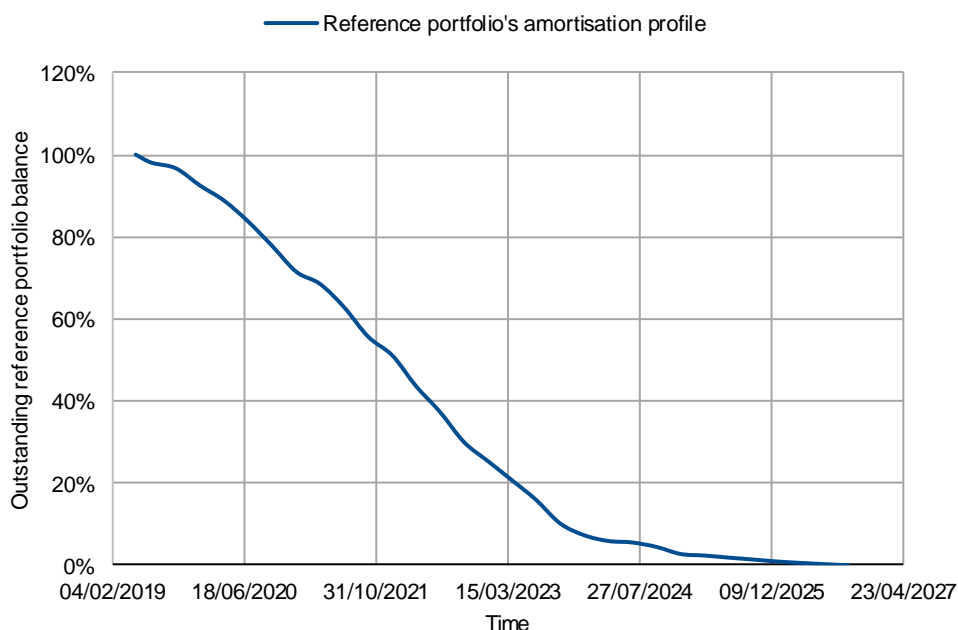
<b>Probability-of-default concentration</b>	Santander one-year default probability of above 2.5% should not represent more than 0.2% of the reference portfolio Santander one-year default probability of above 0.6% for reference entities with unsecured exposures should not represent more than 0.3% of the reference portfolio
<b>Obligation rating</b>	The latest rating confirmation or recalculation has occurred within the last 18 months

Static portfolio has reduced migration risk and results in a short portfolio weighted average life

#### 4.2. Amortisation profile

The static portfolio has a weighted average life of 2.5 years considering scheduled amortisation, and 3.1 years excluding scheduled amortisation; the loan with the longest term matures in March 2027.

**Figure 7: Expected portfolio amortisation profile (0% prepayment, 0% defaults)**



## 5. Credit protections

### 5.1. Credit protection structure

At closing, the issuer and Santander entered into a credit protection deed which included five credit protection agreements – classes A to E –, whereby the issuer sells credit protection on the reference portfolio. The credit protections are strictly sequential for loss allocation. The amortisation mechanism will be modified pro-rata subject to performance and concentration triggers for senior credit protections – classes A to C – and is strictly sequential for the subordinated junior credit protections – classes D and E.

Every quarter, Santander will pay a protection fee to the issuer that covers all the protection seller's expenses. This combines i) the credit protection premiums of classes A to E, based on the effective tranche balance, i.e. its outstanding balance minus allocated losses; ii) the issuer's taxes and costs; iii) realised recoveries in excess of expected recoveries; and iv) make-up fees, which reflect unpaid credit protection premiums, or those paid in excess of the difference between expected and realised losses on the reference portfolio.

The credit protection deed minimises cash flows between Santander and the issuer through netting, which applies unless either of the two parties has defaulted.

Santander UK plc or its affiliates retain the associated senior CLN notes –A to C Notes – while the junior CLN notes – D and E Notes – are placed with investors.

In addition, as required under the Capital Requirements Regulation, European-regulated credit institutions and investment firms must retain, on an ongoing basis, a net economic interest of at least 5% in the securitisation. Santander will do this by retaining at least 5% of each reference obligation (not part of the reference portfolio). In addition, the definition of defaulted notional amount in the transaction limits the claimable amount to 95% of the lender total exposure to a defaulted reference obligation.

### 5.2. Definitions of events of default and credit protection termination

The structure features default and early-termination events that trigger the termination of the credit protection deed.

Santander can claim a credit event upon a default of a loan in the reference portfolio. The transaction defines a loan credit event as: i) a failure to pay with respect to the reference obligation; ii) a bankruptcy of either the obligor or the obligor group; or iii) a loss from the restructuring of a reference obligation.

**Figure 8: Events of default and early-termination options under credit protections**

<b>Events of defaults</b>	Non-payment of due amounts by either of the two parties to the credit protection deed subject to a 10-day grace period
	Bankruptcy including insolvency by either of the two parties
<b>Early-termination options</b>	Illegality event: illegality under the credit protection deed or credit protection notes
	Tax event: payments from either the protection seller or protection buyer from which an amount is likely to be taxed or withheld and that one of the two parties has not elected to pay.
	Clean-up call event: reference portfolio amortises to below 10% of the closing portfolio
	Regulatory event: adverse change in the protection buyer's ability to reflect the full regulatory capital benefit of the transaction as anticipated at closing
	Collateral shortfall: the junior note outstanding balance exceeds the cash and security collateral outstanding

Santander retains at least 5% in each reference obligation

A breach of reporting obligations does not constitute an event of default



Restructuring credit events do not result in an initial cash payment

Strictly sequential loss allocation after a maximum work-out period of two years

External verification agent has significant supervisory rights but will not verify the accuracy of initial security valuations

Modified pro-rata amortisation for classes A, B and C; strictly sequential for classes D and E

### 5.3. Loss definition and allocation

Under the credit protection deed, Santander will receive an initial cash payment in the event of a failure to pay or a bankruptcy, but not for a restructuring. This payment equals the accounting loss provision held against the outstanding balance of a reference obligation upon its default and is adjusted for the actual loss during a maximum work-out period of two years. For a restructuring credit event, only a final loss amount can be claimed. Any difference between the initial loss claim and the final loss after work-out will entail a make-up payment. Losses are allocated to the respective tranches in reverse order of seniority, i.e. from classes E to A.

The credit protection deed grants some flexibility to Santander with respect to loss allocation regarding defaulted obligations that are not fully worked out at the earliest of a two-year work-out period and the termination of the credit protection deed. These losses will reflect Santander's accounting provisions.

Santander's loss claims can survive the termination of the credit protection deed in the case of exposures that have defaulted prior to the termination.

### 5.4. External verification of losses

The credit protection agreements grant supervisory rights to the external verification agent, a global accounting firm. This agent ensures all loss claims are valid and satisfy eligibility criteria at inclusion and determines whether expected loss and final loss are accurate and comply with Santander's internal policies. If the agent does not provide a verification report containing this information, total loss will be assumed at zero. However, if the defaulted exposure is secured, the agent will not verify whether security valuations were accurate and complied with Santander's internal policies. Santander must also service and work-out defaulted reference loans following its internal business principles and policies, as it would for loans outside the reference loan portfolio.

### 5.5. Amortisation

Amortisation of the reference portfolio will be reflected in a release of credit protection in order of seniority. The amortisation mechanism will be modified pro-rata subject to performance and concentration triggers for senior credit protections – classes A to C – and is strictly sequential for the subordinated junior credit protections – classes D and E.

**Figure 9: Subordination events triggering a strictly sequential amortisation**

Subordination events	Level
<b>Credit loss</b>	Cumulative credit loss is more than 2% of initial reference portfolio amount
<b>Borrower group concentration</b>	Effective number is below 50
<b>Probability of default</b>	Outstanding reference obligations with a one-year probability of default of greater than 5% represent at least 10% of total outstanding portfolio
<b>Unmatured losses</b>	Cumulative unmatured losses is greater than class D and E effective outstanding balances
<b>Protection buyer discretionary call</b>	Written notification to protection seller

## 6. Quantitative analysis

For each group borrower, we have determined i) pairwise asset correlations with the other borrowers in the pool; ii) a one-year default probability extrapolated in accordance with our idealised default probability tables over the transaction's lifetime; and iii) a recovery upon default. We then analysed the reference portfolio's performance using a single-step Monte

Scope's single-step Monte Carlo simulation involves a three-factor correlation framework: global, country and industry factors

Portfolio default rate of 8.5% over a 2.5-year weighted average life with a 58% coefficient of variation

Carlo simulation that implements a Gaussian-copula dependency framework. The resulting rating-conditional loss distributions and default timings were then used to project tranche losses, reflecting the loss-allocation mechanisms as well as the credit enhancement of the respective tranche.

### 6.1. Borrower asset correlation

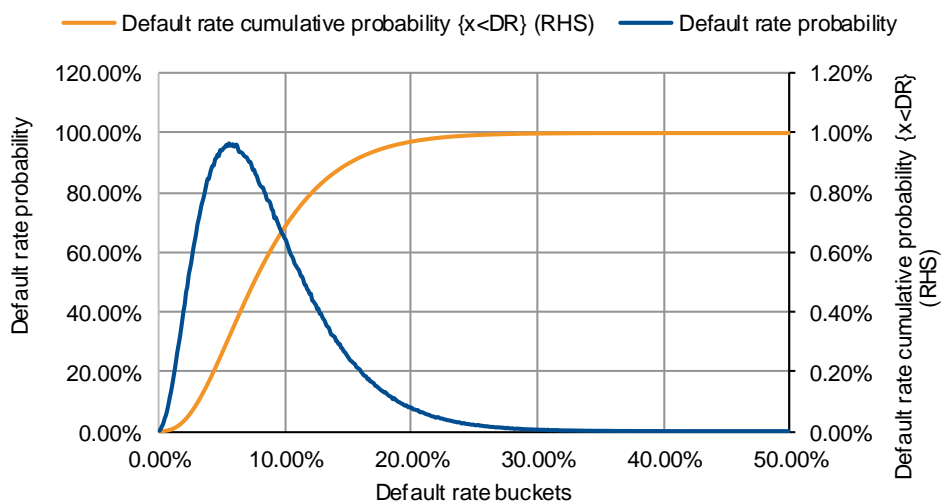
For this transaction, we have assumed pairwise asset correlations ranging from 7% to 27%, composed of additive factors reflecting the borrower's exposure to common factors, i.e. a global factor of 2%, a country factor of 5% and an industry factor of 20%. We did not consider a top-obligor additional factor since no reference obligation represents more than 0.5% of the reference portfolio.

### 6.2. Loan-by-loan probability of default analysis

We have derived a probability of default for each loan based on Santander's one-year economic probability of default, vintage default data, and market data on corporate insolvencies and write-offs in the UK. The probabilities of default were adjusted based on qualitative aspects ascertained during our due diligence of Santander's risk systems and processes.

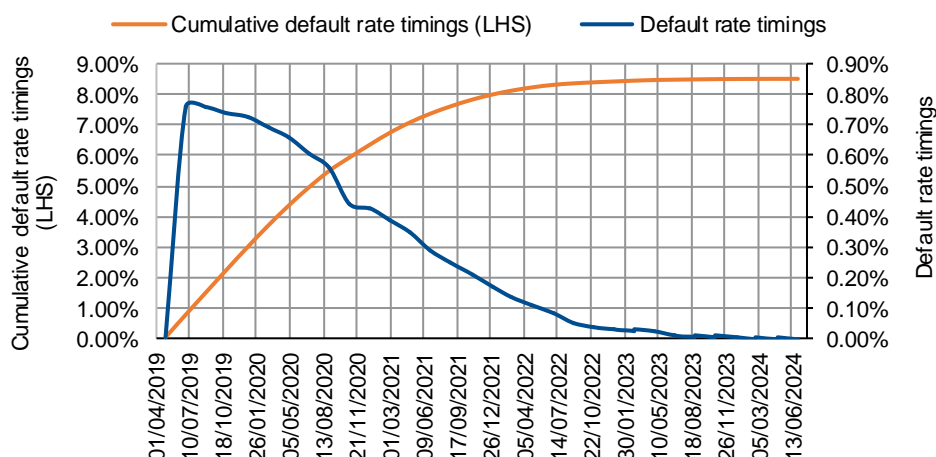
Scope has derived for the outstanding portfolio an average one-year default rate of 3.0% and extrapolated it in accordance with Scope's idealised default probability tables over the weighted average life of each exposure. Scope derived a pool weighted average life of 2.6 years. The portfolio's default rate distribution has a lifetime mean default rate of 8.5% and a coefficient of variation of 58%<sup>1</sup>. Our calculations were based on a Monte Carlo simulation of the portfolio.

**Figure 10: Reference portfolio default rate distribution**



<sup>1</sup> The coefficient of variation is the standard deviation divided by the mean. The default distribution is non-parametric and provided for reference purposes only.

**Figure 11: Reference portfolio default rate time**



**6.3. Loan-by-loan portfolio recovery rate analysis**

We have assumed a base case portfolio recovery rate of 63.8% and a AAA portfolio recovery rate of 44.6%.

Recovery rate assumptions were based on a target rating and whether we considered the loan as secured or unsecured. We classify a loan as secured when it is backed by commercial real estate. All other reference obligations, including unsecured loans and loans secured by non-commercial real estate assets, were considered unsecured.

Santander underwrites SME loans on an ‘all monies’ basis, meaning securities are used as collateral for all the bank’s exposures to the relevant borrower, including future exposures to that borrower or cross-collateralisation with other obligors. We gave no credit to low loan-to-value reference obligations, because borrowers can opt to increase leverage and Santander can lend more to these borrowers based on the same secured assets. As a result, we applied a 60% floor to the loan-to-value. For secured loans with a loan-to-value of above 100%, we applied unsecured recovery rate assumptions.

We assumed recovery proceeds to be crystallised instantly after the default of the obligation, while legal documentation allows for a two-year work-out period before the protection buyer settles the loss based on its internal accounting provision.

**Figure 12: Scope’s recovery rate assumptions**

Recovery rate assumptions	B	BB	BBB	A	AA	AAA
Unsecured (generic curve)	55.00%	50.60%	46.20%	41.80%	37.40%	33.00%
Secured (weighted average)	65.36%	61.58%	57.82%	54.08%	50.35%	46.64%
Portfolio (weighted average)	63.83%	59.95%	56.09%	52.26%	48.43%	44.62%

**7. Rating outcomes**

We have assigned ratings to the credit protection agreements (classes A to D) as shown in

Figure 13. The ratings reflect each tranche’s protection, the strictly sequential loss allocation from the reference portfolio as well as the modified pro-rata release of credit protection alongside the reference portfolio amortisation.

For secured loans, we applied an LTV floor and unsecured recovery rate assumptions for high-LTV loans

Robust class A with short expected weighted average life

**Figure 13: Expected loss rate, expected weighted average life and rating outcomes by rated tranche**

Rated tranche	Expected loss rate	Expected weighted average life (years) <sup>2</sup>	Rating outcomes
Class A	0.0000%	2.38	AAA <sub>SF</sub>
Class B	0.0155%	3.26	A <sub>SF</sub>
Class C	0.1442%	3.30	BBB <sub>SF</sub>
Class D	0.8926%	4.46	BB <sub>SF</sub>

Class A, rated AAA, is resilient to significant stresses on default rate and recovery rate

No losses for senior notes at portfolio cumulative default rates of 42.4%

Sovereign risk does not limit the ratings

## 8. Rating stability

### 8.1. Rating sensitivity

We tested the resilience of the ratings against deviations of the main input parameters: portfolio default probability, and the portfolio recovery rate. This analysis has the sole purpose of illustrating the sensitivity of the ratings to input assumptions and is not indicative of expected or likely scenarios. The following shows how the results for each rated tranche change compared to the assigned ratings when the assumed portfolio default probability increases by 50% or the portfolio's expected recovery rate reduces by 50%, respectively:

- Class A: sensitivity to default probability, zero notches; to recovery rates, zero notches
- Class B: sensitivity to default probability, four notches; to recovery rates, one notch
- Class C: sensitivity to default probability, four notches; to recovery rates, one notch
- Class D: sensitivity to default probability, four notches; to recovery rates, one notch

### 8.2. Break-even analysis

Our break-even analysis is based on a constant default rate (CDR) approach, which allows us to back-test the quantitative outcomes. We assumed both a tranche-specific CDR over the life of each tranche and a rating-conditional recovery rate.

**Figure 14: Tranche-specific break-even analysis**

Rated tranche	Breakeven CDR	Cumulative default rate	Rating-conditional recovery rate
Class A	19.0%	42.4%	44.6%
Class B	13.0%	30.2%	52.2%
Class C	11.0%	27.1%	56.1%
Class D	7.5%	19.3%	59.9%

## 9. Sovereign risk

Sovereign risk does not limit the ratings on this transaction. Scope's long-term sovereign rating on the UK of AA/Negative incorporates the risks of an institutional framework meltdown and legal insecurity. We do not, however, anticipate a 'no-deal' or a 'hard' Brexit.

In our view, the most probable long-term outcome to Brexit negotiations is a 'soft Brexit' (baseline), with the second most likely being no Brexit at all. In addition, we believe that the longer that Brexit negotiations run, the higher the likelihood of a 'Breversal'. Until then, our short-term expectation consists of either i) a third extension to Article 50 negotiations, to

<sup>2</sup> The weighted average tranche life reflects the principal amortisation, the interest payments, the strictly sequential reference portfolio loss allocation and the modified pro-rata amortisation.

be agreed by 31 October; or ii) a Brexit-in-name-only by that date, with the UK exiting the EU and entering thereafter in a transition state.

Several macroeconomic factors are likely to apply pressure to UK CRE prices. Weak UK economic growth is one factor, which we anticipate at 1.4% in 2019, after 1.4% in 2018 and 1.8% in 2017, driven by the postponement of investment decisions until Brexit effects can be quantified and uncertainties alleviated. We see potential growth at only 1.5% in the medium run, weaker than our earlier assessment of 1.5%-2.0%.

The retail and residential property markets will also suffer despite high basic pay growth (currently at 3.4% year-on-year), which is likely to contribute to the Bank of England raising the base rate in 2020 by 25 bps. Furthermore, the UK's tradeable sector is vulnerable, reflecting its import dependency as well as insufficient actions to remedy deficiencies in international competitiveness and productivity growth. Most external balances remain deeply negative. On the other hand, the reserve currency status of the pound sterling has not meaningfully weakened since the 2016 referendum, based on IMF COFER data. This supports the UK's AA credit ratings. Our next review on the UK's ratings is scheduled on 22 November.

## 10. Data quality

A global accounting firm performed an agreed-upon-procedure (AUP) to assess the overall quality of the originator's relevant reporting system but it did not exclusively assess the quality of the reference portfolio. The AUP used a sampling approach to assess that no more than 5% of the observed population contained errors in the relevant audited attributes, under a 95% confidence interval. The audited fields were standard for synthetic transactions and excluded reference portfolio collateral assessments. Following the AUP and the identification of discrepancies, Santander conducted further internal reviews and decided to remove around GBP 30.0m of reference obligations from the final portfolio cut-off, with no adjustment to the size of the credit protections. Scope analysis considered the final portfolio.

## 11. Legal structure

### 11.1. Legal framework

The credit protection agreements are governed by the laws of England and Wales. The transaction represents a synthetic risk transfer by means of financial guarantees to a bankruptcy-remote vehicle, represented by the trustee, Citicorp Trustee Company Limited.

### 11.2. Use of legal and tax opinions

We have reviewed and considered the legal and tax opinions produced by the issuer's legal and tax advisers, concluding that no legal or tax questions call for a specific analytical treatment.

## 12. Monitoring

We will monitor this transaction based on the performance reports from the collateral administrator as well as other available information. The ratings will be monitored continuously and reviewed at least once a year, or earlier if warranted by events.

Scope analysts are available to discuss all the details surrounding the rating analysis, the risks to which this transaction is exposed and the ongoing monitoring of the transaction.

## 13. Applied methodology and data adequacy

For the analysis of this transaction, we applied our SME ABS Rating Methodology, available on [www.scoperatings.com](http://www.scoperatings.com).

Santander decided to remove GBP 30m of reference obligations following an internal review post AUP.

No legal or tax questions called for a specific analytical treatment

Scope analysts are available to discuss all details surrounding the rating analysis



# York 2019-1 CLO DAC

## UK SME CLO

### 14. Appendix: A comparison of Scope-UK SME/Large Cap rated deals

UK SME/Large Cap transactions rated by Scope	York 2019-1 CLO DAC	Heta Funding DAC	Sirius Funding plc	Newfoundland CLO 1 Ltd
Originators	Santander UK	Barclays	Barclays	Barclays
Purpose	B/S optimisation	Liquidity	Liquidity	Liquidity
Type of structure	Synthetic	Cash	Cash	Cash
<b>General portfolio attributes</b>				
Asset type	SME loan	SME loan	SME loan / Large Cap	Large Cap
Asset jurisdiction	UK	UK	UK	Global
Size (local currency million)	3115.00	8000.00	4500.00	8344.00
Currency	GBP	GBP	GBP / USD / EUR	USD
Agreed upon procedure at closing	Yes	Yes	Yes	Yes
<b>Granularity</b>				
Obligation (#)	3177	1013	706	898
Obligors (#)	1268	512	325	305
Effective obligors (#)	339	165	min 40	
Effective industry (#)	12.00	8.80	min 6	11.70
Top1 (%)	0.5%	3.0%	2.5%	2.5%
Top10 (%)	4.9%	13.7%	13.8%	19.9%
<b>Asset analysis</b>				
Average portfolio credit quality (PD term)	BB	BB+	BB+	BB+
Secured loan (%)	85.00%	0.00%	0.00%	0.00%
Unsecured loan (%)	15.00%	100.00%	100.00%	100.00%
Top1 country exposure (% / name)	100% - UK	100% - UK	70% - UK	61% - US
Top2 country exposure (% / name)	0%	0%	6.4% - Netherlands	17% - UK
Top1 industry (% / name)	15.8% - Accomodation & Food Services	22.6% - Construction & materials	15% - Financial services	14.8% - Banking & finance
Top2 industries (% / name)	13.0% - Care homes	16% - Government & public sector	14.1% - Professional services	14.5% - Energy
Top3 industries (% / name)	12.5% - Professional & other services	11.6% - Accomodation, leisure & entertainment	10% - Construction & material	12.9% - Construction & materials
WA RTM (excl. replenishment) (years)	2.50	4.89	2.63	2.78
<b>Liability</b>				
If replenishable, replenishment period (years)	na	2	3	2
Amortisation allocation	modified pro-rata senior & sequential junior	Sequential	pro-rata senior & sequential junior	pro-rata senior & sequential junior
Loss allocation	Sequential	Sequential	pro-rata senior & sequential junior	pro-rata senior & sequential junior
<b>Quantitative assumptions</b>				
WA portfolio default rate	3.1%	6.4%	6.6%	5.5%
WA portfolio RR_B	64.0%	63.2%	57.8%	51.4%
WA portfolio RR_AAA	45.0%	37.9%	32.4%	30.9%
Correlation: global/country/region/city/industry/top obligor	2% / 5% / x / x / 20% / x	2% / 5% / x / x / 20% / 20%	2% / 5% / x / x / 20%/20%	2% / 5% / x / x / 20% / 20%
Top obligor haircut (# or % of portfolio share/ % haircut)	na	5% / 10%	5% / 10%	5% / 10%
<b>Quantitative outputs</b>				
Mean default rate	8.5%	6.4%	6.6%	5.5%
Mean loss rate_B case	2.9%		2.8%	
Mean loss rate_AAA case	4.5%		4.3%	
Implicit coefficient of variation	58.0%	68.6%	63.5%	65.5%
Recovery rate_B case	63.8%	63.7%	57.8%	51.4%
Recovery rate_AAA case	44.6%	38.2%	34.8%	30.9%
Weighted average life (years)	2.5	5.3	5.5	5.4
<b>Capital structure</b>				
Class A (attachment / thickness)	23% / 77%	27.5% / 72.5%	25% 75%	20% / 80%
Class B (attachment / thickness)	14.5% / 8.5%	15.5% / 12%	25% 75%	90.3% / 5.4%
Class C (attachment / thickness)	11.5% / 3.0%	0% / 15.5%	25% 75%	0% / 9.3%
Class D (attachment / thickness)	7.5% / 4.0%		0% / 25%	na
Class E (attachment / thickness)	0% / 7.5%		na	na
<b>Final rating</b>				
Class A	AAA	AAA	AAA	AAA
Class B	A	AA	AAA	AAA
Class C	BBB	not rated	AAA	A+
Class D	BB		not rated	A+
Class E	not rated		na	not rated
<b>Sensitivity scenarios</b>				
Sensitivity 1	PD + 50%	PD + 50%	PD + 50%	PD + 50%
Sensitivity 2	RR - 50%	RR - 50%	RR - 50%	RR - 50%
<b>Sensitivity outcome (deviation from assigned rating)</b>				
Class A (notch impact)	0 / 0	0 / 0	0 / 0	0 / 0
Class B (notch impact)	4 / 0	1 / 3	0 / 0	3 / 3
Class C (notch impact)	4 / 0		0 / 0	na
Class D (notch impact)	4 / 0		not rated	na
Class E (notch impact)	not rated		na	not rated



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