

# Banco Santander SA

## Auto ABS – USA

### New Issue Report



Scope  
Ratings

## Ratings

Series	Rating	Notional (USD m)	Notional (% assets)	CE (% assets)	Coupon	Final maturity
CLN Class A	NR	1,043.0	75.5	24.5	0.000%	25 September 2026
CLN Class B	NR	13.8	1.0	23.5	0.000%	25 September 2026
CLN Class C	A <sub>SF</sub>	96.7	7.0	16.5	4.875%	25 September 2026
CLN Class D	BBB <sub>SF</sub>	60.8	4.4	12.1	5.875%	25 September 2026
CLN Class E	BB <sub>SF</sub>	34.5	2.5	9.6	6.375%	25 September 2026
CLN Class F	BB <sub>SF</sub>	23.5	1.7	7.9	6.875%	25 September 2026
CLN Class G	NR	64.9	4.7	3.2	10.000%	25 September 2026
CLN Class H	NR	44.2	3.2	0.0	0.000%	25 September 2026
Rated notes		215.5				

Scope's quantitative analysis is based on the preliminary portfolio dated 28 February 2019 and subsequent updates as provided by the originator. Scope's Structured Finance Ratings constitute an opinion about relative credit risks and reflect the expected loss on each respective tranche over a risk horizon equal to the expected weighted average life of the tranche, i.e. the risk for the credit protection seller to make payments with respect to credit events under the terms of the credit protection deed. See Scope's website for the [SF Rating Definitions](#).

## Transaction details

Purpose	Risk transfer
Issuer	Banco Santander SA
Originator	Santander Consumer USA Inc
Servicer	Santander Consumer USA Inc
Closing date	28 June 2019
Payment frequency	Quarterly, 25 <sup>th</sup> September, 25 <sup>th</sup> December, 25 <sup>th</sup> March, 25 <sup>th</sup> June

The transaction is a synthetic risk transfer via credit-linked notes (CLN) of a static USD 1,381.5m auto loan portfolio with no residual value risk. The loans were granted to private individuals and commercial customers in the United States by Santander Consumer USA Inc. (SCUSA). Banco Santander SA (Santander) is the issuer of the credit-linked notes and holder of the collateral account.

## Rating rationale (summary)

The ratings reflect the legal and financial structure of the CLN issuance as defined under the terms and conditions of the notes; the credit quality of the underlying portfolio in the context of macroeconomic conditions in the US; the incentives and credit quality of Santander as protection buyer and account bank; the abilities of SCUSA, the servicer of the reference loans; and the supervision from the verification agent, a reputable global accounting firm.

The ratings account for the respective credit enhancement of the classes of notes and the pro-rata release of risk coverage reflecting reference portfolio amortisation, which is subject to a performance trigger. The ratings also capture the credit risk of the highly granular reference portfolio, which is composed of well-seasoned amortising auto loans with high loan-to-value (LTV) ratios extended to good-quality obligors in the US.

The ratings reflect the sensitivity of the instruments to changes in analytical assumptions as well as the timing of defaults, driven by the evolution of absolute credit enhancement available under the pro-rata amortisation mechanisms.

The ratings incorporate our view on a potential US economic slowdown, in the context of the portfolio's relatively limited 4.5-year risk horizon. The currently low level of

## Analytical Team

Sebastian Dietzsch  
+49 30 27891 252  
[s.dietzsch@scoperatings.com](mailto:s.dietzsch@scoperatings.com)

Thomas Miller-Jones  
+49 30 27891 231  
[t.miller-jones@scoperatings.com](mailto:t.miller-jones@scoperatings.com)

David Bergman  
+39 02 30315 838  
[d.bergman@scoperatings.com](mailto:d.bergman@scoperatings.com)

## Investor Outreach

Michael John MacKenzie  
+44 203 71449 81  
[m.mackenzie@scopegroup.com](mailto:m.mackenzie@scopegroup.com)

## Related Research

General Structured Finance  
Rating Methodology,  
December 2018

Consumer and Auto ABS Rating  
Methodology, March 2019

Methodology for Counterparty  
Risk in Structured Finance,  
August 2018

Why the United States is no  
longer AAA, March 2019

## Scope Ratings GmbH

Lennéstraße 5  
10785 Berlin

Tel. +49 30 27891 0  
Fax +49 30 27891 100

[info@scoperatings.com](mailto:info@scoperatings.com)  
[www.scoperatings.com](http://www.scoperatings.com)



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unemployment and the generally good credit quality of the obligors, based on FICO scores, also limit the impact of economic stress on the portfolio.

The ratings also reflect the counterparty risk exposure of the credit-linked notes to Banco Santander SA (AA-/Stable/S-1+) as payer of the coupon and holder of the collateral account. The bank's credit quality limits the CLN ratings, as the collateral account holds the funds available for loss coverage and note repayment.

## Rating drivers and mitigants

### Positive rating drivers

**Positive asset selection.** The portfolio is positively selected with respect to the FICO scores of the obligors and the financing of new and used vehicles, compared to the net loss performance data presented by SCUSA.

The portfolio is also well seasoned, which reflects positively on expected portfolio defaults.

**Limited macroeconomic exposure.** The pro-rata amortisation of the notes and the relatively short remaining term of the underlying loans limit the exposure of the non-senior tranches to the envisaged economic slowdown in the US. The impact is also mitigated by the high quality of borrowers.

**Experienced staff; limited track record.** Industry experience of staff members ranges from 10 years to more than 30 years. SCUSA's origins in sub-prime auto lending complement the company's push into the prime segment.

**Efficient synthetic structure.** The transaction works with an immediate loss-determination mechanism reflecting Santander's IFRS 9 provisions. This mechanism is in line with the quick realisation of recovery proceeds due to SCUSA's repossession and sales processes in addition to limiting the counterparty exposure to Santander.

### Negative rating drivers and mitigants

**Pro-rata amortisation.** The amortisation mechanisms erode absolute credit enhancement for the highest tranches. This is partially mitigated by a pro-rata stop trigger set at 2.7% cumulative losses and class G's exclusion during early pro-rata periods.

**High LTVs and low default risk.** Portfolio loans have high loan-to-value ratios, at more than 96% on average, which reflects negatively on recovery proceeds. This is mitigated by the high obligor quality (average FICO score at 753) as well as moderate levels on average for the payment-to-income ratio (8%) and debt payment-to-income ratio (30%), which reduce the likelihood of a foreclosure.

**Default reclassification.** Santander can reclassify bankruptcy and failure-to-pay cases as restructuring, which leaves restructured loans in the reference portfolio and could have an adverse impact on transaction performance. Our calibration of portfolio loss parameters based on net losses and the relatively high volatility mitigates this. Moreover, Santander has to adhere to its internal servicing practices and standards.

**Counterparty risk.** All funds available for note repayment are exposed to the credit quality of Santander (AA-/Stable/S-1+), the holder of the collateral account. A replacement of the bank as account holder upon loss of BBB- partially mitigates the risk.

### Upside rating-change drivers

Faster-than-expected amortisation **following the early activation of the cumulative loss trigger** may reflect positively on the rated instruments.

### Downside rating-change drivers

Significantly **higher unemployment** may increase defaults in the reference portfolio.

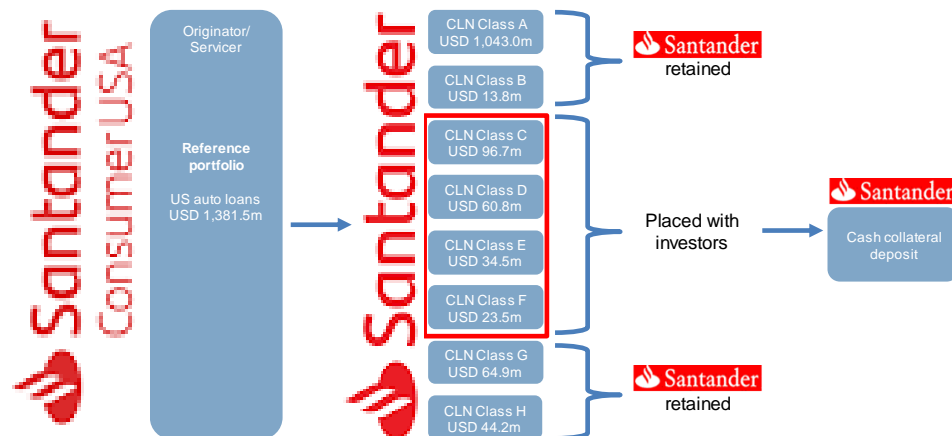
**Head-line risk related to Fiat Chrysler**, given the portfolio's high share of vehicles from this company, may reduce recovery rates.

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## 1. Transaction summary

**Figure 1: Simplified transaction overview**



Source: CLN terms & conditions and Scope.

The credit-linked notes constitute direct obligations of Banco Santander SA and reference the credit performance of a static USD 1,381.5m portfolio of auto loans granted to high-quality obligors in the United States. The loans were originally securitised over four transactions that are now fully consolidated on Santander's balance sheet. The bank seeks to get capital relief on the loans through the synthetic securitisation of the credit risk.

## 2. The US auto loan market

Severe delinquencies in the US auto loan market are again on the rise after the post-crisis low in Q3 2014. The credit performance data provided by SCUSA covers Q1 2013 to Q1 2019, a period of average credit market performance.

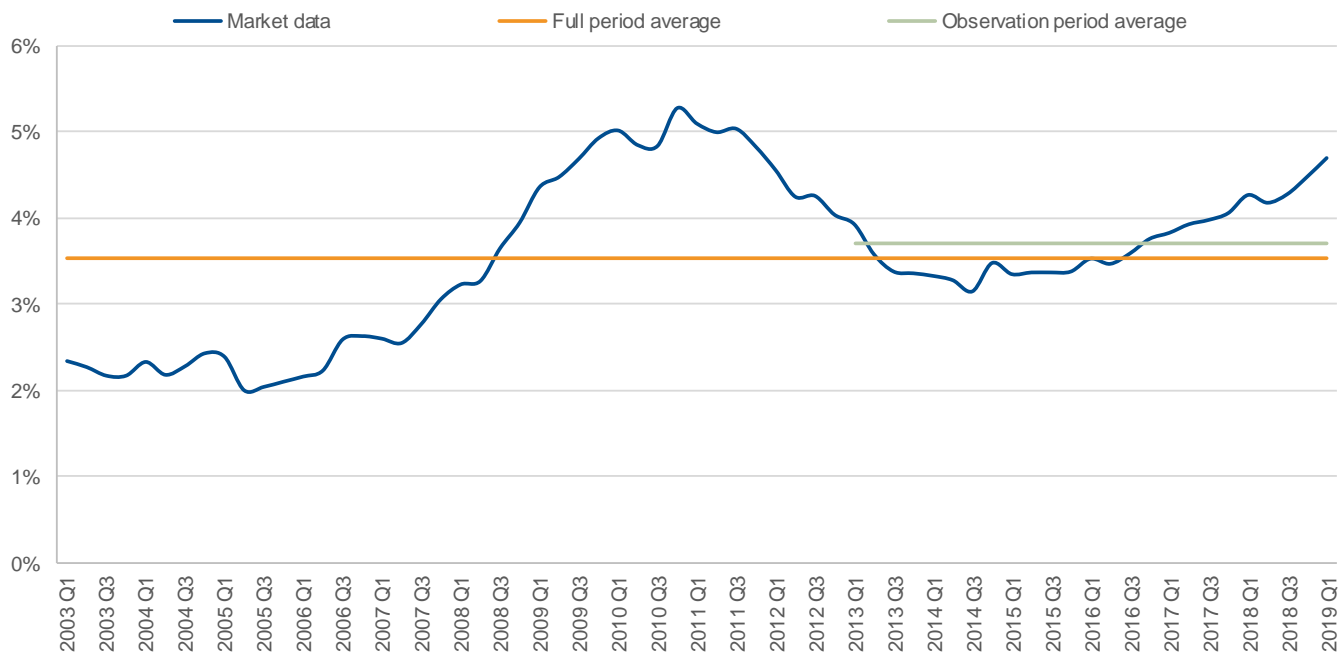
We consider portfolio obligors to be of above-average credit quality. This is based on the average FICO score in the portfolio of 753, generally associated with 'prime' US borrowers. We expect these obligors to be impacted later by a potential economic slowdown in the US, resulting in a significant reduction of the reference portfolio through monthly instalments paid.

According to post-crisis market data, car loans receive preferential treatment from obligors compared to other forms of debt such as housing loans. In the US, cars are often the only means of transport and thus a prerequisite to making a living.

Current tensions between the US and its global trading partners may offset the credit impacts for loans in this reference portfolio. Higher tariff-induced costs could make end-customers less able to service debt, but the same tariffs may also increase recovery proceeds as consumers redirect demand towards US car brands.

**Good credit profiles of obligors protect against economic slowdown**

Figure 2: 90 days-past-due delinquencies in the US auto loan market



Source: New York Fed Consumer Credit Panel/Equifax and Scope.

### 3. Asset analysis

#### 3.1. Securitised assets

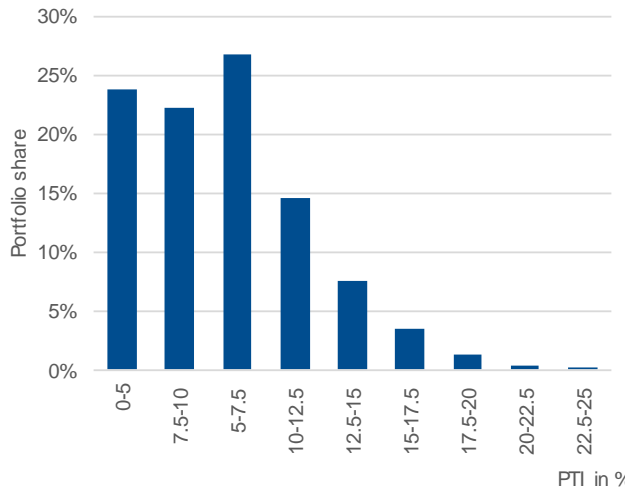
The portfolio is mainly composed of 59,771 loans to prime US borrowers (FICO cut-off of 630; FICO average 753) originated by SCUSA to finance new and used vehicles. The loans are granted predominantly to private individuals to finance the purchase of mainly Chrysler vehicles, at 96.9% of the current reference portfolio balance, while commercial borrowers represent 3.6%. The 20 largest exposures only account for 0.12% of the portfolio balance.

The loans have an average seasoning of 1.4 years and an average remaining term of 4.5 years. All loans are amortising with no residual value risk. Loan origination mostly took place during 2017 and early 2018, with a few loans from Q4 2016.

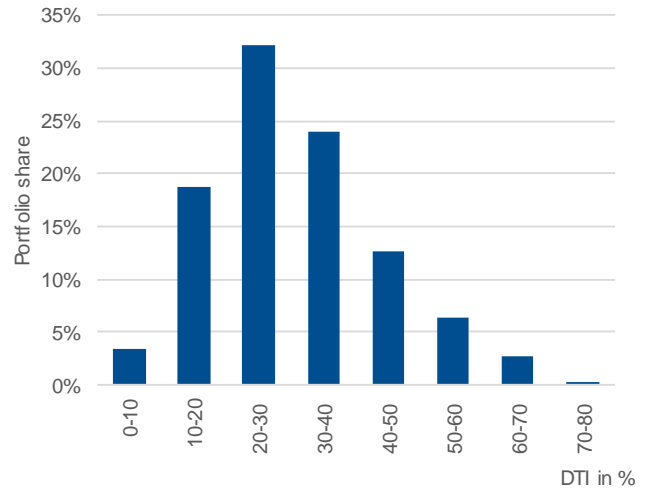
Most borrowers in the portfolio qualify as 'prime' under US lending standards, with FICO scores averaging 753 and ranging between 630 and 900. Affordability ratios in the portfolio are moderate: an average debt-to-income (DIT) ratio of 30.4% and average payment-to-income (PTI) ratio of 8%. This offsets the portfolio's relatively high loan-to-value of 96.7%.

Well-seasoned and granular  
reference portfolio

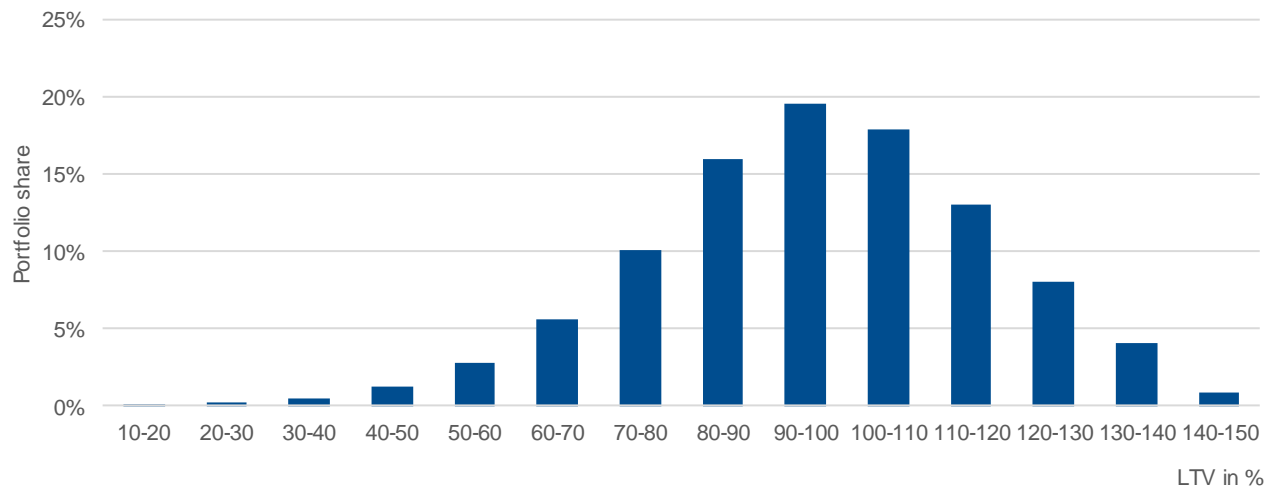
**Figure 3: Portfolio PTI distribution**



**Figure 4: Portfolio DTI distribution**



**Figure 5: Portfolio LTV distribution**

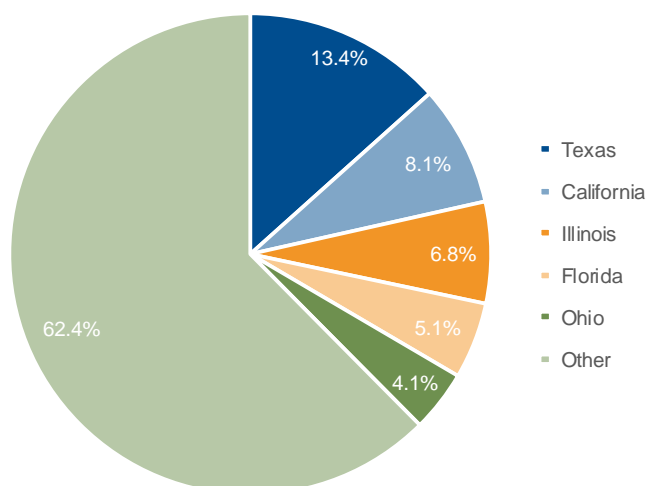


The portfolio is well distributed across the United States

### 3.2. Regional distribution

The portfolio is well distributed across the US: the five largest states combined comprise only 37.6% of the portfolio balance. This reflects the nationwide reach of SCUSA's business model.

**Figure 6: Portfolio regional distribution**



The reference portfolio is positively selected

### 3.3. Portfolio eligibility criteria and positive selection

The eligibility criteria for the reference portfolio result in a positive selection compared to those in SCUSA's previous transactions and the performance data provided by the bank.

The share of well-performing segments in the portfolio – as measured by high FICO-score obligors and new car financings – is much higher than in the available vintage data.

For inclusion in the reference portfolio loans must be i) less than 120 days overdue; ii) granted for the purpose of vehicle financing to US citizens or entities; iii) not subject to a credit event; and iv) not originated from a debt restructuring. In addition, v) obligors or guarantors must have a minimum FICO score of 630; and vi) at least one instalment must have been paid on the amortising loans.

## 4. Portfolio modelling assumptions

**Figure 7: Portfolio modelling inputs for the reference portfolio**

	Portfolio
Share in portfolio at start of amortisation period	100.0%
Point-in-time default rate	6.1%
Coefficient of variation	50.0%
Base case recovery rate	50.0%
AAA rating-conditional recovery rate	25.0%
Low constant prepayment rate	0.0%
High constant prepayment rate	20.0%

### 4.1. Default definition

Loan default, as defined by the terms and conditions of the credit-linked notes, include: i) a failure to pay with respect to the reference obligation; ii) a bankruptcy of the obligor; or iii) a loss from the restructuring of a reference obligation.

Credit protection agreements grant significant supervisory rights to the external verification agent, a reputable global accounting firm. This agent ensures the validity of all

Positive selection and seasoning reflect positively on risk assumptions

Analysis incorporates rating-conditional recovery assumptions

loss claims and determines whether both expected loss and final loss comply with Santander’s internal policies. Santander also must demonstrate to the verification agent that its servicing and work-out processes accord with its own internal business principles and policies. The verification is, however, limited to a certain number of defaulted cases, reflecting the high granularity of the portfolio.

#### 4.2. Default rate analysis on portfolio

We have derived for the portfolio a 90-days-past-due mean default rate of 6.1% over a weighted average life of 3.1 years and a coefficient of variation of 50%. Our calculations were based on net loss vintage data and recovery data from SCUSA’s previous securitisation transactions.

The portfolio mean default rate considers a risk horizon of 5.9 years, adjusted for an average seasoning of 1.4 years.

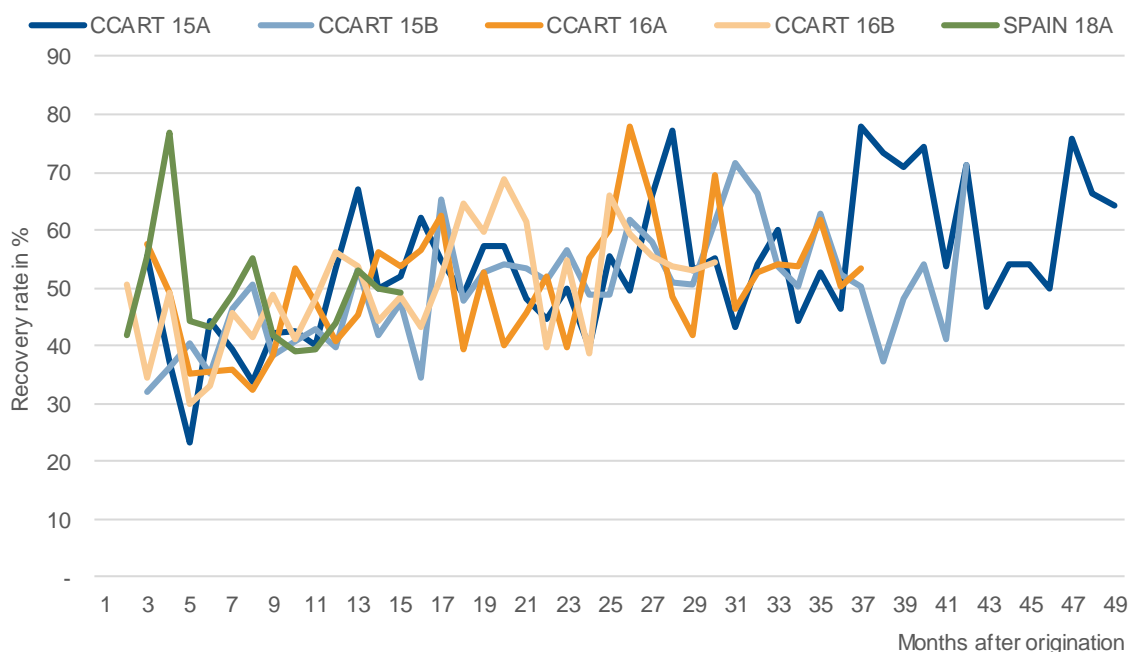
The most relevant data can be found in Appendix II on page 14.

#### 4.3. Recovery rate

We considered a base case recovery rate of 50%. The rating-conditional recovery rates are therefore: 50% for B, 45% for BB, 40% for BBB, 35% for A, 30% for AA, and 25% for AAA.

We analysed recovery performance data from previous transactions serviced by SCUSA. This data covers the period from 2015 to 2019 and represents over 17,000 recovery processes (Figure 8).

**Figure 8: Recovery data of previous SCUSA securitisation transactions**



Source: Intex and Santander

We have modelled the loan portfolio using fixed assumptions for recovery rates, which we then stressed with haircuts based on the target rating of the credit-linked notes.

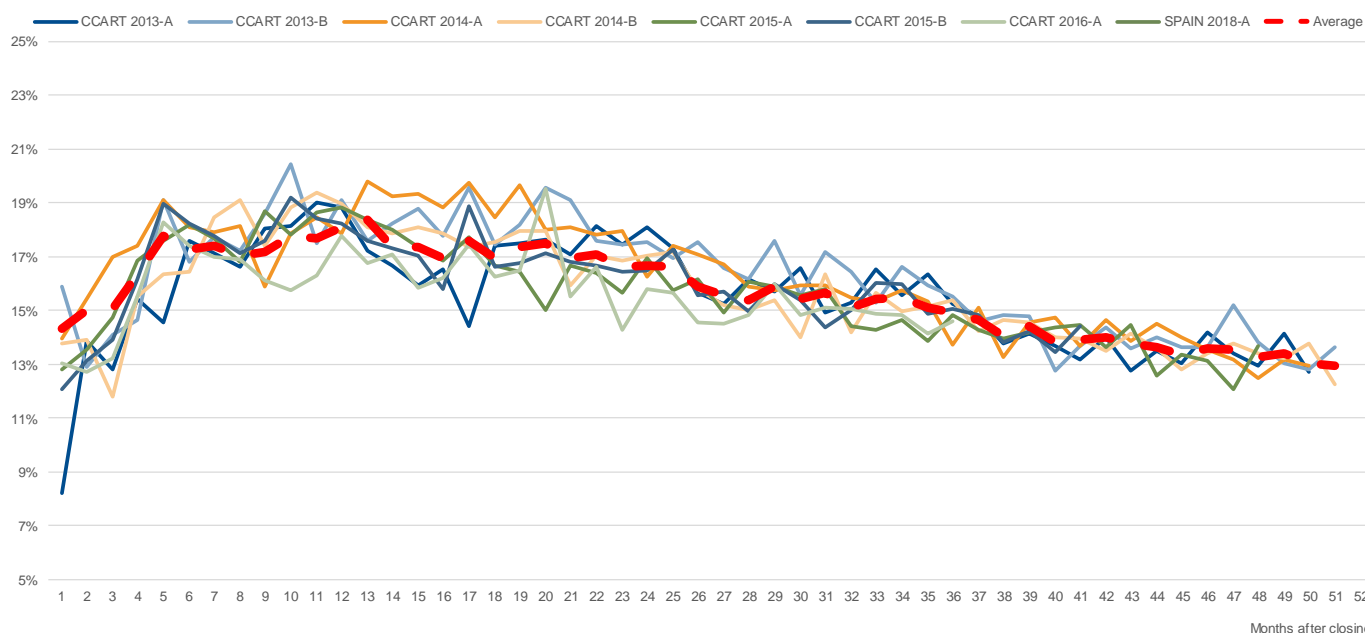
#### 4.4. Constant prepayment rate (CPR)

We tested the rated notes against CPR assumptions of 0% and 20%, which, accounting for the 1.4-year seasoning of the reference portfolio, represent stress levels that are comparable to the historical performance of SCUSA’s transactions (Figure 9).

We tested the ratings against stressed CPR assumptions

The ratings generally consider the high prepayment scenario, as this amplifies the erosion of credit enhancement.

**Figure 9: Prepayment data of previous SCUSA securitisation transactions**



Source: Intex, Santander and Scope

## 5. Financial structure

### 5.1. Capital structure and risk-cover release

The credit-linked notes are split into eight different classes. Each class represents a certain claim on the repayment of collateral – following portfolio amortisation or the realisation of recovery proceeds as well as an obligation to cover portfolio credit losses – in reverse order of seniority.

The initial credit enhancement levels from the subordination for each class are: 24.50% for class A, 23.50% for class B, 16.50% for class C, 12.10% for class D, 9.60% for class E, 7.90% for class F, and 3.20% for class G. Class H has no credit enhancement.

#### 5.1.1. Risk-cover release mechanisms – pro-rata to sequential

The pro-rata risk-cover release mechanism for classes A to G results in an erosion of credit enhancement for the more senior tranches, which makes the credit-linked notes sensitive to back-loaded defaults and losses. This risk is partially mitigated by the release schedule, which changes to fully sequential when cumulative portfolio losses reach above 2.7%, and by the exclusion of class G from repayment until it accounts for 7.5% of the combined balance of outstanding credit-linked notes.

The repayment of the class H will always remain subordinated.

### 5.2. Loss allocation

Under the credit-linked notes, the cash payments that Santander would receive from paid-in collateral will equate to the loss as determined by the bank on a defaulted reference asset, in line with its internal loss calculation under IFRS 9. The amount is then adjusted for the actual loss during a maximum work-out period of 12 months. Losses are allocated to the respective tranches in reverse order of seniority, i.e. from Class H to A.

Early-amortisation triggers protect against portfolio underperformance



SCUSA has a reputable and stable market share in prime auto lending

Proactive servicing and recovery processes

## 6. Originator – Santander Consumer USA Inc.

We consider SCUSA a competitive player in the US auto loan underwriting market. Their prime auto loan business is driven by a strategic partnership with Fiat Chrysler Automobiles, buttressing a reputable and stable market share.

### 6.1. Sanctioning and underwriting

SCUSA is Santander's consumer credit arm in the US, underwriting auto loans and leases, operating under the global standards of Banco Santander.

SCUSA primarily conducts its auto loan business through partnerships with brands, dealers and auto leasing/rental companies. Originally established as a subprime auto loan lender in 2000, their extensive experience and growth (2018 market share ~14%), has positioned them well for the prime auto lending segment. Their 2018 market share in the prime market was roughly 2% - largely driven by the partnership with Fiat Chrysler.<sup>1</sup>

The US auto loan market is quite fragmented, in part due to the consumer financing arms of global and domestic banks, as well as automotive captive financing companies. The largest players only have about 7% market share, with SCUSA collectively having approximately 4% of the market. Despite a high number of loan requests, the 10% funding rate reflects this highly fragmented market.

SCUSA's strategy is prudent and fits into the overall strategy of Banco Santander, in that it is not an aggressive lender and operates discerningly in its home market. The main focus is on achieving consistency, while having stable net loss performance and keeping costs under control.

The bank provides direct end-customer credit, as well as dealer financing, on a highly automated basis. Credit approvals are mostly digitalised and implement predefined credit policies into the pricing process.

Credit assessment models are developed in the US and reflect local specificities; however, final approval comes from Banco Santander, ensuring the group's risk framework is applied.

### 6.2. Servicing and recovery

We consider SCUSA's loan servicing and management of non-performing loans sufficiently in line with the market. The approach is proactive and risk-based, incorporating behavioural risk assessments.

The collections process starts at 10 days past due (dpd) and terminates with the charge-off after 120+dpd. Car repossession is triggered at 75+dpd. The process for more risky accounts begins after only five days. Accounts are treated individually after 60dpd, whereas, before this point is reached, measures consist of a more general approach such as regular calls.

The work-out of a defaulted loan mainly involves the repossession and sale of the vehicle through an auction. Historically, this has resulted in a recovery rate of about 45%. The vehicle sale accounts for about 90%, while additional proceeds result from pledged insurances and collections from the obligor.

SCUSA's loan servicing team is highly experienced, ranging between 10 years and more than 30 years in the industry. The automation of the servicing process also ensures consistent results. USD 52bn of loans are currently under management, requiring the monitoring of 2.7m customers.

<sup>1</sup> Market share data sourced from JD Power PIN data.

## 7. Quantitative analysis

We have based the ratings on our collateral release and loss-allocation analysis. The results are supported by the slow-changing macroeconomic conditions and the strong support from the credit enhancement mechanisms.

We projected the loss for each tranche. This incorporates the collateral release and loss-allocation mechanisms as well as the credit enhancement of the respective credit-linked note as outlined in its terms and conditions.

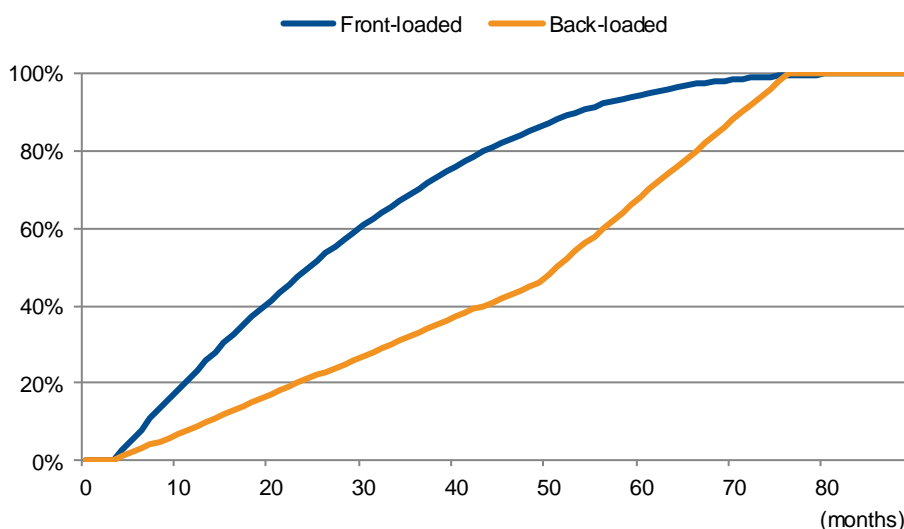
We used a large homogenous portfolio approximation approach to analyse the highly granular collateral pool. The calculation of expected loss assumed an inverse Gaussian distribution for defaults. Our analysis also provided the expected weighted average life of each note class and considered the combined portfolio.

A long-term adjustment of the default rate and coefficient of variation is not justified in our view, given that the market performance during the period covered by vintage data is generally in line with the long-term market performance (Figure 2).

Pro-rata makes the credit-linked notes sensitive to default timing

We considered both a front-loaded and a back-loaded default-timing term structure (Figure 10). The credit-linked notes are sensitive to default timing due to the pro-rata risk-cover release mechanism, through which the absolute credit enhancement of more senior tranches erodes through repayments and prepayments. The base case cumulative default-timing assumption (Figure 10) represent the reference portfolio. The defaults are classified as 90+dpd, in line with definitions in the documentation.

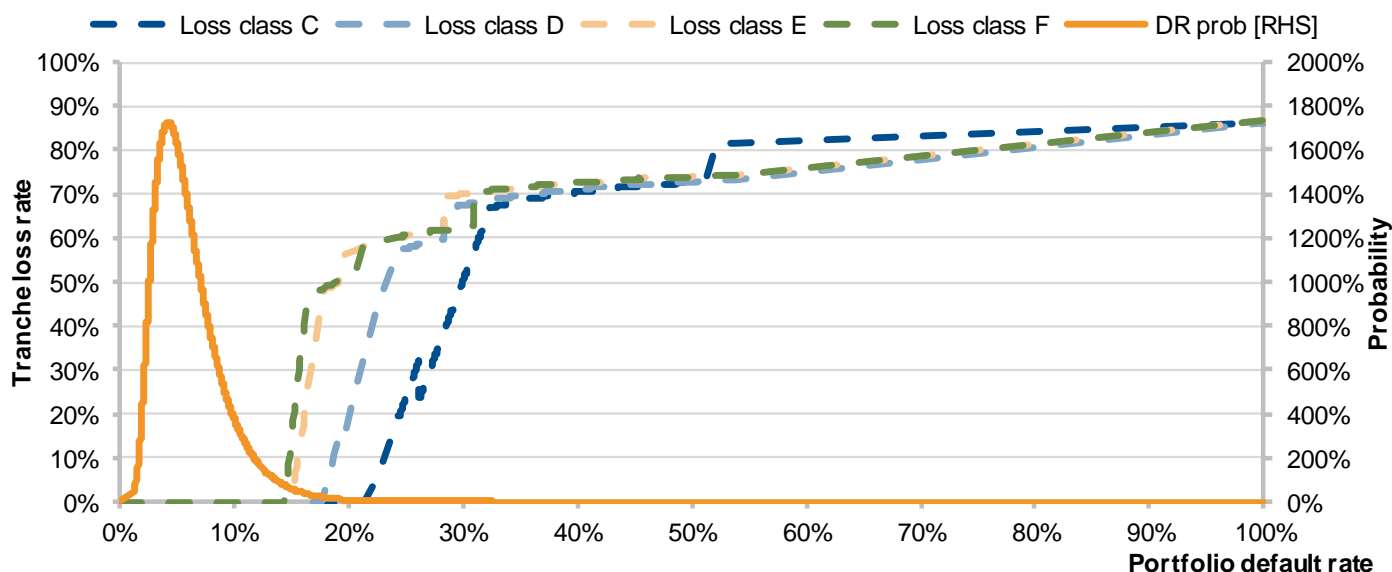
**Figure 10: Default-timing assumptions – front and back-loaded**



Ratings consider both front- and back-loaded default timings

Figure 11 shows the losses of the rated credit-linked notes at all portfolio default rates and how credit enhancement protects the notes and recovery proceeds in case of default.

Figure 11: Cash flow results for base case mean default rate and coefficient of variation and rating case recovery rate



Note: The probabilities displayed on the right hand side axis has to be considered in the context of the calculation of the probability density

## 8. Rating sensitivity

Rating stability is supported by: i) the structure's strong protective mechanisms; and ii) our use of rating-conditional recovery rate assumptions and a long-term performance reference for the assets.

We tested the sensitivity of the analysis to deviations from the main input assumptions: i) the mean default rate; ii) recovery rates; and iii) the mean default coefficient of variation.

- Class C: sensitivity to mean default rate + 50%, three notches; sensitivity to recovery rates – 50%, two notches; sensitivity to coefficient of variation + 50%, three notches
- Class D: sensitivity to mean default rate + 50%, one notch; sensitivity to recovery rates – 50%, one notch; sensitivity to coefficient of variation + 50%, one notch;
- Class E: sensitivity to mean default rate + 50%, one notch; sensitivity to recovery rates – 50%, zero notches; sensitivity to coefficient of variation + 50%, zero notches;
- Class F: sensitivity to mean default rate + 50%, one notch; sensitivity to recovery rates – 50%, one notch; sensitivity to coefficient of variation + 50%, zero notches;

## 9. Sovereign risk – USA

### Sovereign risk does not limit the instruments' ratings

Sovereign risk does not limit the rating. The risks of an institutional framework meltdown or legal insecurity are immaterial, especially given the short remaining risk-horizon of 4.5 years.

We believe the above-average credit profile of the obligors limits the impact on the reference portfolio of a potential US economic slowdown. A severe increase in unemployment is likely to affect weaker obligors first.

Scope's AA rating with Stable Outlook on the US reflects the country's wealthy and diversified economy and the status of the US dollar as global reserve currency. High and rising public debt, a weakening potential economic growth outlook as well as policy uncertainties reflect negatively on the credit profile of the country.

## 10. Counterparty risk

The CLN investors fund the collateral account held at Santander, up to their committed amount under the notes. This collateral is available to cover credit losses from the reference portfolio. Santander is also the payer of the coupon.

The counterparty risk exposure to Banco Santander SA does not constrain the ratings, currently. However, should positive rating-change drivers materialise, the ratings would be limited at the credit quality of Banco Santander SA (AA-/Stable Outlook/S-1+).

We consider the counterparty exposure to Santander to be excessive, i.e. a crystallisation of counterparty risk is likely to result in the instruments' default.

Upon loss of BBB-, Santander has to pay the collateral into an account at Bank of New York Mellon London Branch (NR). The replacement mechanism is insufficient to mitigate the counterparty exposure to Santander.

### 10.1. Operational risk from servicer

Operational risk from the servicer role is marginal, given SCUSA's integration into the Santander group.

## 11. Legal structure

### 11.1. Legal framework

The credit-linked notes are governed by English law and represent a synthetic transfer of the credit risk inherent in the reference portfolio to the risk-takers underwriting the credit-linked notes.

The credit-linked notes are governed by their terms and conditions and constitute the direct and general unsubordinated obligations of Banco Santander SA.

### 11.2. Restructuring

The documentation allows the issuer to reclassify failure-to-pay and bankruptcy events as restructuring, which would maintain the restructured asset in the reference portfolio. The extent of that use is limited by both SCUSA and Santander's standard servicing principles and procedures.

## 12. Monitoring

We will monitor the ratings based on performance reports from Santander 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 these instruments are exposed and the ongoing monitoring of the ratings.

## 13. Applied methodology and data adequacy

For the analysis of these credit-linked notes, we applied our Consumer and Auto ABS Rating Methodology, available at [www.scooperatings.com](http://www.scooperatings.com).

Net loss vintage data provided by SCUSA referenced a 120dpd default definition and covered a period from 2013 to 2019, a period of average stress in the US auto loan market. The bank did not provide role-rate information for the period between 90dpd and 120dpd. The bank also provided recovery information from five previous securitisation transactions with similar loan pools, covering a period from 2015 to 2019.

The data was very granular, both for net losses and recovery information.

Servicer replacement unlikely

Standard operating procedures limit the flexibility of credit event management

Scope analysts are available to discuss the rating analysis



## I. Summary of portfolio characteristics

The analysis considers the reference portfolio from 28 February 2019.

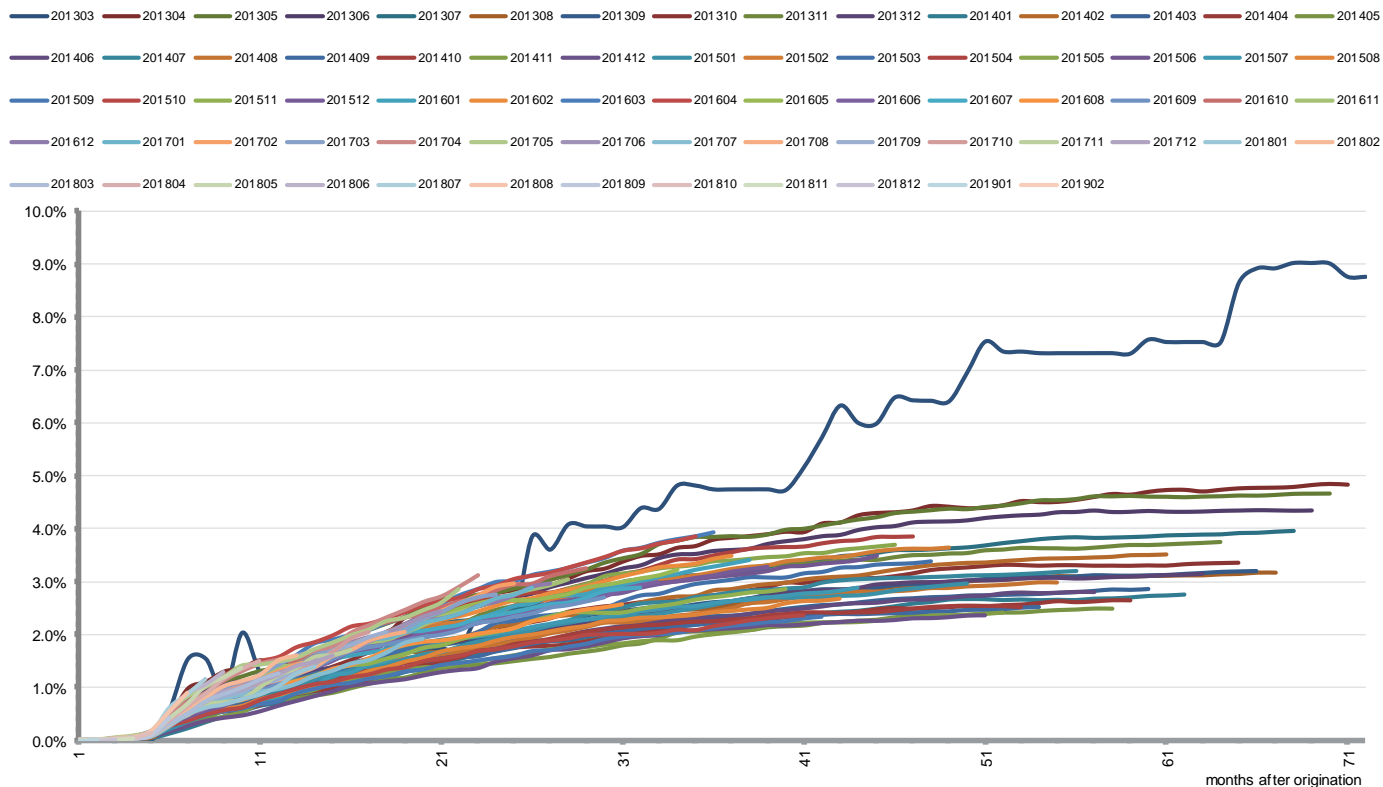
Key features	Preliminary reference portfolio as of 28 February 2019	Closing portfolio as of 28 June 2019
Originator (% of balance)	Santander Consumer USA Inc	Santander Consumer USA Inc
Closing date	NA	28 June 2019
<b>Portfolio balance (USD m)</b>	<b>1,540.1</b>	<b>1,381.5</b>
Number of assets	62,977	59,771
Average asset size (USD)	24,455	23,112
Maximum asset size (USD)	118,990.90	NA
Minimum asset size (USD)	13.20	NA
Weighted average life (contractual) (years)	3.1	NA
Weighted average seasoning (years)	1.4	1.7
Weighted average remaining term (years)	4.5	4.3
Largest obligor	0.01%	NA
Top 20 obligors	0.12%	NA
Largest region	13.4% (Texas)	13.4% (Texas)
Top 5 regions	37.6%	37.8%
Current weighted average coupon	4.84%	NA
Weighted average loan-to-value	96.4%	96.7%
Amortising loans	100.0%	100.0%

## II. Vintage data provided by the originator

SCUSA provided 120dpd net loss performance data for the product types in the reference portfolio, split by FICO segments and by whether the financed vehicle is new or used. This information together with the recovery information in our analysis formed the foundation for the calibration of point-in-time default rates, coefficients of variation and base case recovery rates.

Vintage data is granular and representative of the portfolio.

**Figure 12: All loans - 120dpd net loss vintage data presented by SCUSA**





## Banco Santander SA

Auto ABS – US

### Scope Ratings GmbH

#### Headquarters Berlin

Lennéstraße 5  
D-10785 Berlin

Phone +49 30 27891 0

#### London

Suite 301  
2 Angel Square  
London EC1V 1NY

Phone +44 20 3457 0444

#### Oslo

Haakon VII's gate 6  
N-0161 Oslo

Phone +47 21 62 31 42

#### Frankfurt am Main

Neue Mainzer Straße 66-68  
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

#### Madrid

Paseo de la Castellana 95  
Edificio Torre Europa  
E-28046 Madrid

Phone +34 914 186 973

#### Paris

1 Cour du Havre  
F-75008 Paris

Phone +33 1 8288 5557

#### Milan

Via Paleocapa 7  
IT-20121 Milan

Phone +39 02 30315 814

[info@scoperatings.com](mailto:info@scoperatings.com)

[www.scoperatings.com](http://www.scoperatings.com)

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