S&P Global Ratings

RatingsDirect®

Banco Santander S.A.

Primary Credit Analyst:
Elena Iparraguirre, Madrid (34) 91-389-6963; elena.iparraguirre@spglobal.com

Secondary Contact:
Antonio Rizzo, Madrid (34) 91-788-7205; Antonio.Rizzo@spglobal.com

Table Of Contents

Banco Santander S.A.

SACP	a

Anchor	bbb	
Business Position	Very Strong	+2
Capital and Earnings	Adequate	0
Risk Position	Strong	+1
Funding	Average	0
Liquidity	Adequate	

+

Support	0
ALAC Support	0
GRE Support	0
Group Support	0
Sovereign Support	0

+

Additional Factors	0

Issuer Credit Rating
A/Stable/A-1

Resolution Counterparty Rating
A+/--/A-1

Major Rating Factors

Strengths:	Weaknesses:
• Wide geographic diversification and solid market positions in the markets where it operates. • Focus on stable retail banking business, underpinning the bank's sound and resilient earnings. • Successful strategy and implementation. • Enough capital to accommodate adverse scenarios.	• Exposure to higher-than-average economic risk in some of the countries where it operates. • Proven appetite for acquisitions.

Outlook: Stable

S&P Global Ratings assumes that Banco Santander S.A. will deliver on the strategic priorities outlined in the bank's recently disclosed strategic plan, notably improving profitability and strengthening capital. Over the next few years, we expect operating performance to improve, with the bank benefiting from business growth in the Americas and cost savings in the mature European market. We expect return on equity (ROE) of 8.0%-8.5% in 2019-2020, and the bank's risk-adjusted capital (RAC) ratio to gradually increase to about 7.5%-8% by 2020. While asset quality indicators could deteriorate somewhat in some business segments or geographies, overall we expect the group will keep whittling down its stock of nonperforming assets (NPAs). We expect the bank to remain focused in its countries of operations. Our ratings therefore do not incorporate sizable acquisitions.

Wide geographic diversification will continue to benefit the bank, with economic momentum in Spain offsetting a potentially less favorable U.K. economy and economic policy uncertainty in Brazil and Mexico following recent changes in governments. Given that the bank is complying with its minimum requirement for own funds and eligible liabilities (MREL) and has no plans to issue further senior nonpreferred debt in 2019, we see it as unlikely that the buffer of bail-in-able debt will reach 400 basis points of its S&P Global Ratings risk-weighted assets (RWA), a level that would enable it to benefit from one notch of rating uplift.

Our base case is that the ratings will not change. However, we could consider taking a positive rating action if the bank shows a stronger buildup of loss-absorbing instruments than we currently expect. Conversely, the ratings could come under pressure if unexpected events undermine the bank's capital position, the bank engages in challenging acquisitions, or we lower our sovereign credit rating on Spain.

Rationale

The ratings on Banco Santander S.A. reflect its wide geographic and business diversification, strong franchises in most of the markets where it operates, its focus on stable retail banking activities, and strong management. Over the years, these factors have resulted in a solid and resilient profitability track record. Our ratings also reflect the bank's sound capitalization compared to the risks it undertakes, though we acknowledge that the bank operates in jurisdictions with higher-than-average economic risks. The bank's appetite for acquisitions also weighs on our assessment.

Santander is one of the most geographically diversified global banks, with no single country concentrating more than one quarter of the group's assets. It operates in a number of economies that face higher-than-average economic risks, in particular the Iberian Peninsula and Latin America. However, its footprint in economies that proved to be uncorrelated have allowed the bank to accommodate the ups and downs of the different economic cycles and achieve consistent, resilient profitability over time. We expect this to continue as the bank deals with a potentially more adverse economic scenario in the U.K., particularly if a no-deal Brexit materializes, and a soft and more uncertain outlook in Brazil and Mexico, both of which recently underwent government changes.

In addition to its wide geographic presence, we believe the bank's strong franchises in most of the countries where it is present also support the profitability of its business model as they provide the bank with pricing power and a loyal clientele, while its focus on retail banking supports business and earnings stability.

While the bank's regulatory capital measures are below those of many of its global peers, we consider that Santander's capital has the capacity to accommodate potentially adverse scenarios. This is because of the benefits of its wide geographic diversification and better-than-average asset quality track record in its main countries of operation. Furthermore, we expect the bank to gradually strengthen its capitalization in coming years, with the RAC ratio ranging around 7.5%-8.0% by 2020. Now that the regulatory additional Tier 1 (AT1) bucket has been fulfilled following active AT1 issuance since 2014, retained earnings will be the main source of capital buildup. We expect profitability to continue improving on the back of higher volumes and control over costs (including credit costs). We also expect to see the group reducing its stock of NPAs, primarily driven by positive developments in Spain.

We believe the group has a fairly balanced funding profile, primarily based on retail funding. Reliance on wholesale funding is manageable, well diversified by instrument, location, and maturity. During difficult times, the group proved successful in keeping market access open.

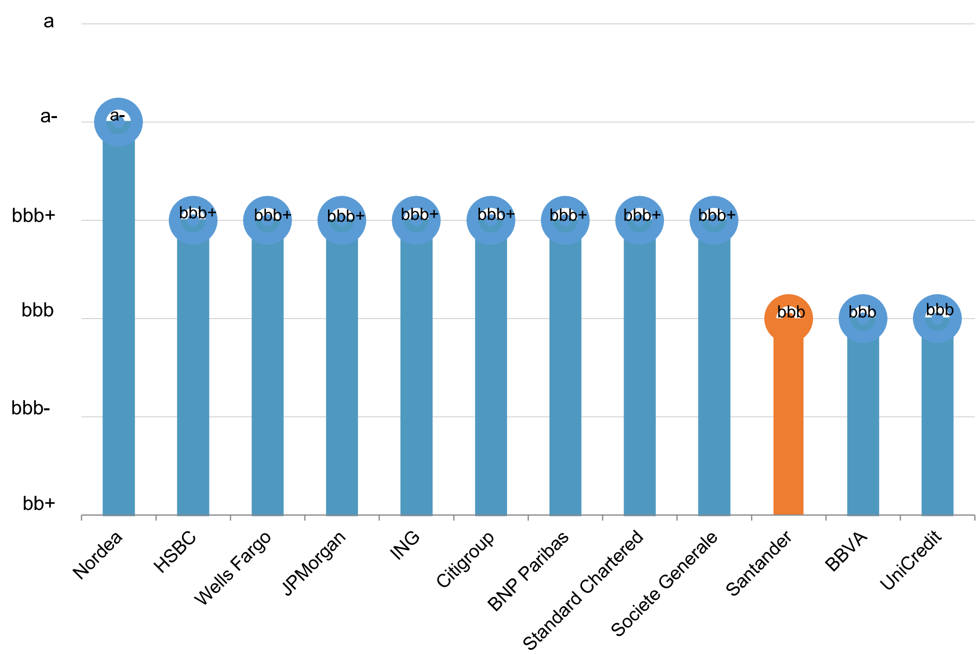
Our ratings on Banco Santander do not benefit from government support or support for additional loss-absorbing capacity (ALAC). However, we rate Santander one notch above the ratings on Spain, the bank's country of domicile. This reflects our view that there is an appreciable likelihood that Santander would not default in the hypothetical stress scenario of the Spanish sovereign defaulting. In such a scenario, Santander would likely face meaningful impairments that would erode a significant portion, but not all, of its capital base. The bank would also suffer sizable outflows of liquidity, but we believe it would be able to overcome liquidity pressures by resorting to European Central Bank (ECB) funding.

Anchor: 'bbb', reflecting the higher-than-average economic risk of the markets where the bank operates

Our anchor for Santander is currently 'bbb', weaker than that of most of its global peers (chart 1). The anchor results from our view of economic risk of the main countries where the bank has operations, and the industry risk in Spain, where the bank is legally incorporated and primarily regulated.

Chart 1

Santander Has A Lower Anchor Than Peers Because Of Higher Economic Risks Of Its Footprint



Source: S&P Global Ratings. Data as of September 2019.

The weighted-average economic risk to which Santander is exposed is currently marginally higher than the one faced by institutions operating primarily in Spain. The U.K. and Spain, both with economic risk of 4, account for the group's largest credit exposures, about one quarter each as of June 2019, followed by Brazil (economic risk 7) and the U.S. (economic risk 3), each accounting for about 10%. Remaining exposures, accounting for about 5% each, include Mexico (economic risk 5), Portugal (economic risk 6), Germany (economic risk 1), other Latin American countries (economic risk 7) and the rest of Europe (economic risk 4).

With regard to industry risk, our assessment of '4' reflects Spanish banks' currently more-balanced funding profiles. Customer deposits now fund the bulk of banks' loan books, funding costs are at historical lows, and external funding markets remain wide open. Banks have also accumulated significant liquidity and are in a comfortable position to meet the repayment of the ECB's targeted longer-term refinancing operations (TLTRO) II in 2020-2021. We still expect, however, that Spanish banks will rely more than peers on external funding. Our industry risk assessment also assumes the operating environment in Spain will remain competitive, and therefore banks, primarily midsize ones, will find it difficult to achieve returns in line with their cost of capital. Although the deleveraging phase has nearly ended, we do not expect banks' business volumes to grow enough over the next few years to compensate for the negative effect of prevailing low interest rates on earnings. Therefore, we see a risk that heightened competition to attract new business could threaten sensible pricing.

Table 1

Banco Santander S.A.--Key Figures

		--Year ended Dec. 31--			
(Mil. €)	**2019***	**2018**	**2017**	**2016**	**2015**
Adjusted assets	1,481,873.1	1,429,279.3	1,413,632.0	1,308,249.4	1,309,483.0
Customer loans (gross)	871,819.8	848,318.7	824,695.0	771,211.6	785,022.0
Adjusted common equity	71,031.1	68,677.5	66,542.0	61,334.0	65,281.0
Operating revenues	25,572.2	50,424.5	49,849.0	45,511.1	47,419.0
Noninterest expenses	12,723.6	23,410.0	23,080.0	21,274.9	21,533.0
Core earnings	5,285.7	12,277.0	12,600.8	10,513.1	11,989.5

*Data as of June 30.

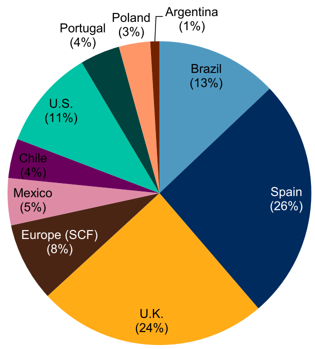
Business position: A powerful, geographically diversified and profitable retail banking franchise

In our view, Santander benefits from a robust business model (only two other banks in Europe, HSBC and BNP Paribas, have such a positive assessment) and is therefore very well placed to withstand the challenges posed by a potentially adverse operating environment, as demonstrated during the crisis years. The bank benefits from wide geographic diversification, strong market positions in most of the markets where it operates, significant business stability, and a track record of sound and resilient returns.

As a result of an intensive expansion strategy over the past two decades, Santander is currently one of the most geographically diversified banks in the world, with no single country concentrating more than one quarter of the group's net profits and credit. Presence in developed economies outweighs presence in emerging markets (accounting for 80% and 20% of loans at June 2019, respectively), but the split is fairly balanced when measured in terms of profit contribution (54% and 46% as of June 2019). The bank's presence in countries that are economically not directly correlated is also an important factor, as this allows it to accommodate the ups and downs of the different economic cycles and achieve consistent, resilient profitability over time. We expect this competitive advantage to continue to pay off, with the ongoing dynamism of the Spanish economy helping to offset a potentially more adverse economic scenario in the U.K. as the next Brexit deadline approaches, as well as increased economic policy uncertainties in Brazil and Mexico.

Chart 2

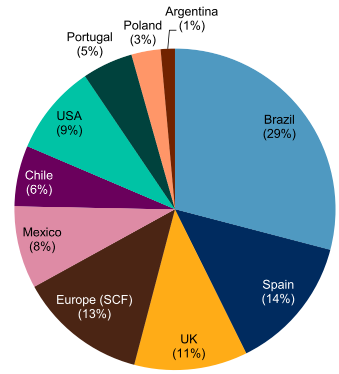
Santander Benefits From Wide Geographic Diversification, Weighted Toward Mature Economies
Geographical Distribution Of The Group's Asset Base As Of Q2 2019



Source: S&P Global Ratings and bank's reporting. Excluding corporate center.

Chart 3

Emerging Markets Are Key Contributors To The Group's Profitability
Geographical Contribution To Net Attributable Profits As Of Q2 2019



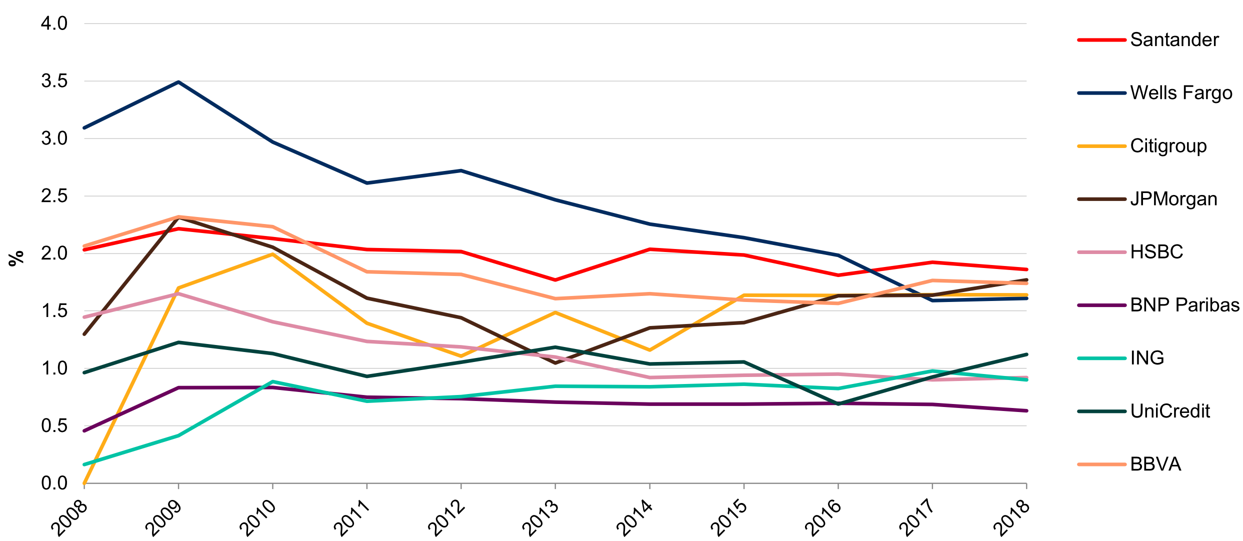
Source: S&P Global Ratings and Banks' Reporting. Excluding Corporate Centre.

Santander also enjoys strong positions and franchises in most of its markets of operation, which provides it with pricing power and a loyal retail customer funding base. In addition to the now 17% market share in loans that the bank holds in Spain, Santander is the second-largest mortgage lender in the U.K. (holding about 11% of the market), and it owns the second-largest bank in Portugal, Poland, and Chile, and the third-largest bank in Mexico and Brazil (excluding public banks). It has also built up a consumer finance business, under Santander Consumer Finance S.A. (SCF), with widespread operations across Europe. Santander is also present in the U.S., where it benefits from decent, though regional, market positions in several strong Northeastern markets.

The group is primarily focused on retail banking activities, which supports the bank's business and earnings stability. Over time Santander has given proof of a strong, resilient profitability track record and outstanding efficiency (charts 4 and 5).

Chart 4

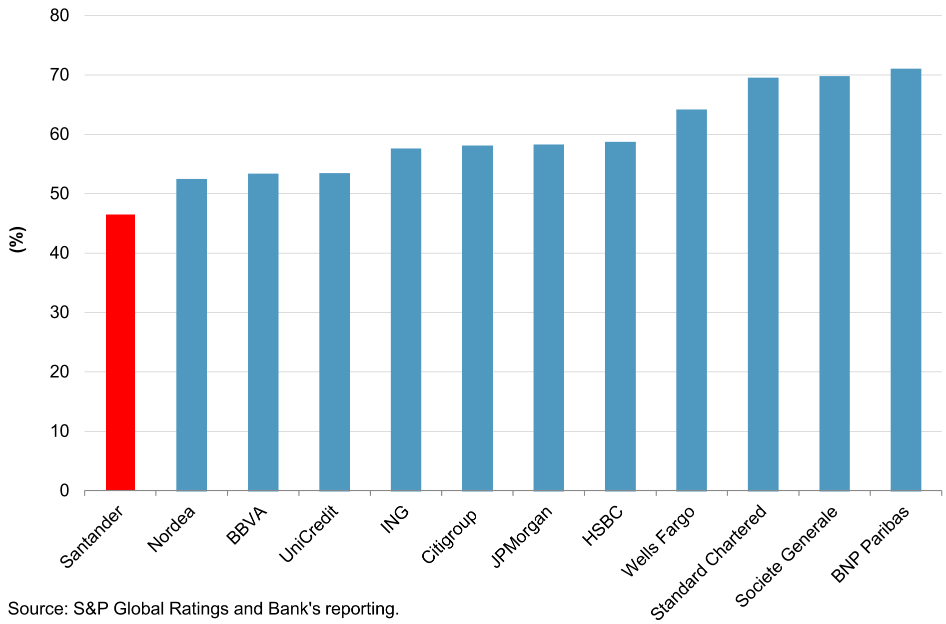
Santander Reports Higher And More Stable Preprovision Income Than Most Global Peers
Preprovision Income To Average Assets



Source: S&P Global Ratings and Banks' Reporting.

Chart 5

Strong Efficiency Is A Key Attribute For Santander
Cost-To-Income Ratio As Of December 2018



Source: S&P Global Ratings and Bank's reporting.

Santander benefits from a clear strategy that has resulted in its successful transformation from a domestic institution into a strong and well-diversified global banking group. Management has, in our opinion, appropriately selected the countries for expansion. It has focused on large markets, with an adequate combination of matured and developing economies, and has intentionally pursued the buildup of strong banking franchises in each of its core markets. The bank has aimed to benefit from competitive advantages and economies of scale, and spread its commercial banking skills across the network. Santander has prioritized commercial banking activities as a recurrent profit source, while limiting investment and wholesale banking to service clients in its core markets. Finally, the bank has proved quite successful in integrating and turning around the institutions it has acquired.

Acquisitions have been a key enabler of the bank's build up of a global franchise over the years, although more recently the bank had not embarked on large acquisitions until the acquisition of Popular. With a now stronger balance sheet and better economic prospects in its home market, we think that Santander may be more willing to participate in mergers and acquisitions (M&A) if opportunities were to arise, most likely to strengthen its business in markets where it already operates. Longer term, we would also expect Santander to participate in future consolidation moves in Europe if the Banking Union project progresses.

After closing its 2016-2018 strategic plan delivering on all its financial targets, the bank announced in early April a new plan for the next three years, which maintains the focus on:

- Expanding the business by engaging further existing clients;

- Accelerating the digitalization of the business (the bank remains committed to maintain investments of about €5 billion per year in IT and digital);
- Improving profitability, by increasing revenue and achieving further cost efficiencies; and
- Maintaining a solid capital base, with a higher bias toward the more profitable businesses. The Latin American region in particular will likely attract more of the group's capital.

Financial targets are ambitious in the context of now weaker global economic growth prospects and bearish expectations on the direction of interest rates in Europe and the U.S., which could challenge primarily earnings prospects. The group aims to improve underlying return on tangible equity to 13%-15% from 12% in 2018 and the cost-to income to 42%-45% from 47%). However, the plan contemplates sizable cost savings of over €1 billion, largely in Europe, which could help offset potential deviations on the earnings front. The novelties of the plan include the creation of a new global business segment focused on payments, which will gather (and further promote) the group's existing merchant services, global trade services and foreign exchange payments; as well as a commitment to operate more cohesively across units, fostering collaboration, avoiding duplications, and facilitating synergies. Despite the announcement of changes back in September 2018, Santander finally decided to maintain its top management. José Antonio Alvarez will thus remain the group's CEO and lead the implementation of the new plan, ensuring continuity.

The main headwind ahead relates to a no-deal Brexit, which could have a material impact on the performance of the U.K. economy and thus on the bank's operations in the country. In such a scenario, asset quality and profitability will certainly deteriorate, and the parent may have to write-down at least part of the goodwill generated at the time of the acquisition of the U.K. operations. However, the bank in the U.K. faces this challenge from a position of strength, namely low credit losses and a solid capital base. In response to the uncertain outcome of the Brexit deal, management has taken a cautious approach in the U.K., reduced its risk appetite and downscaled its operating infrastructure to reduce costs. In Brazil and Mexico the economic and political environment is also uncertain, but in our view manageable for the group, particularly if the performance of the Spanish operations continues strengthening, while the scale of the Argentinean operations is small in the group's context. In Spain, the integration of Popular continues according to plan. The bank completed the migration of all Popular branches to Santander's IT platform in mid July, and will focus in the second half of the year on the closing down of redundant branches (1,128 branches will be shut, a higher number than the one initially targeted, equivalent to about one-fifth of the combined branch network at the time of the acquisition). An agreement with the unions to reduce staff was also closed before the summer (about 4,000 employees will leave the bank by the end of the year), suggesting that the bank should be in a position to achieve the cost synergies envisioned. Before the summer, Santander also completed the reorganization of Popular's insurance joint-ventures.

Table 2

Banco Santander S.A.--Business Position					
		--Year ended Dec. 31--			
(%)	**2019***	**2018**	**2017**	**2016**	**2015**
Loan market share in country of domicile	17.5	17.6	18.3	0.0	13.2
Deposit market share in country of domicile	18.8	18.2	18.9	0.0	14.2
Total revenues from business line (currency in millions)	25,821.9	50,453.0	50,541.0	45,720.3	47,652.0

Table 2

Banco Santander S.A.--Business Position (cont.)					
		--Year ended Dec. 31--			
(%)	**2019***	**2018**	**2017**	**2016**	**2015**
Commercial banking/total revenues from business line	10.1	10.1	11.0	12.7	11.1
Retail banking/total revenues from business line	83.4	84.9	87.1	85.4	84.7
Commercial & retail banking/total revenues from business line	93.5	95.0	98.1	98.2	95.8
Other revenues/total revenues from business line	6.5	5.0	1.9	1.8	4.2
Return on average common equity	6.7	8.2	7.2	6.9	7.1

*Data as of June 30.

Capital and earnings: Capital has strengthened and we now see it as adequate

Santander has gradually strengthened its capital over recent years, through the issuance of hybrid instruments since 2014 (the regulatory bucket is fully filled now), raising capital (€7 billion in mid-2017 to accommodate the acquisition of Popular) and retaining earnings. Thus, the bank managed to deliver on its commitment to raise the group's fully loaded common equity Tier 1 (CET1) capital ratio above 11% by 2018 (the end of its previous three-year strategic plan) from 9.8% in mid-2015, keeping its regulatory capital comfortably above the ECB's Supervisory Review and Evaluation Process requirements.

Our RAC measure improved accordingly, reaching 7.14% at end-2018 (7.4% taking into account Spain's improved economic risk). Our capital measure is weaker than the regulator's because of the higher risks that we see in economies where Santander operates, and the still-large balance of deferred tax assets (DTAs) resulting from timing differences outstanding on the bank's balance sheet (€23.6 billion in June 2019). Indeed, our calculation of Santander's RWA is about 80% higher than the regulatory one.

We expect Santander's capitalization to improve somewhat in coming years, with the RAC standing between 7.5% and 8.0% by the end of 2020, which is also consistent with management's revised capital target under the new strategic plan (CET1 of 11%-12%). As the bank has fully filled its regulatory AT1 bucket, future capital improvements will primarily come from retained earnings. We expect RWA growth of about 3.5% per year. The potential refinancing in the market at end-2019 of an AT1 instrument issued by the U.K. subsidiary and currently held by the parent could also boost the group's capital base. The bank estimates the impact of International Financial Reporting Standard (IFRS) 16 and potential further regulatory changes in the CET1 regulatory capital calculation at 20 and 30 basis points (bps), respectively. But it has also stated that it plans to take actions to minimize the impact.

We forecast the weight of hybrid instruments on Santander's capital structure will stand over 2019-2020 at an adequate 12% of total adjusted capital (TAC). Most hybrid instruments included in TAC are now AT1 instruments. The remaining balance of legacy preference shares placed in the market is just below €600 million. Santander surprised many investors early in the year when it decided not to exercise a call on an AT1 instrument, on the basis that economically it had little incentive to do so. While AT1s are by definition perpetual and no longer incorporate step ups to incentivize calls, European investors assume the instruments will be called. Indeed, only a handful of European banks had followed that path before, normally in situations of financial stress. While Santander's attempt to challenge the market norm took many by surprise, it did not last for long and certainly has not constrained the bank's ability to access the wholesale funding market afterwards at affordable prices. See "Will Santander's Decision Not To Call Reset The Market For AT1 Instruments?" published Feb. 13, 2019, on RatingsDirect.

The group's capital is evenly distributed across subsidiaries, standing higher than standard group level only in those geographies where host regulators require higher minimum capital requirements, as is the case in Poland, or where regulators have constrained dividend distribution, as has been the case in the U.S. recently.

Looking at the allocation of capital more broadly, we should expect a capital rebalance toward more profitable businesses and a lower exposure to the nonprofitable ones. The recent decision to buy back the existing minorities of the Mexican subsidiary and the agreement with French Credit Agricole to join forces in the custody business go in that direction. See bulletins: "Banco Santander Announces Plan To Acquire Remaining 25% Stake In Mexican Subsidiary" April 12, 2019 and "Credit Agricole Subsidiary CACEIS' Scale To Benefit From Santander Joint Venture" April 19, 2019.

On the profitability front, we see the bank's ROE standing at 8.0%-8.5% in 2019-2020, hovering around the 2018 mark, with revenues growing moderately (in line with volume growth), but still outpacing cost growth. Operations in emerging economies will benefit from better revenue prospects, while matured economies offer more potential on the cost side. In addition to the cost synergies from the Popular acquisition (which Santander quantified originally at €500 million by 2020 and raised recently by an additional €250 million--about half of Popular's cost base), the bank contemplates delivering sizable additional savings in IT and operating costs and shared services by managing the business more globally. Even taking into account increased investments in digitalization, which for example affected the cost performance of the U.K. operations in 2018, we believe that strong efficiency will remain a key feature of the bank. At the group level, we believe that credit provisions have bottomed and see limited room for them to decline further. We forecast the dividend payout at about 45% (in the middle of the 40%-50% range that the bank communicated).

Santander's earnings generation capacity is set to remain robust. We expect the bank's earnings buffer, which measures the capacity of the bank's earnings to cover normalized losses, to stand at 172 bps of our RWA over 2019-2020.

Table 3

Banco Santander S.A.--Capital And Earnings					
		--Year ended Dec. 31--			
(%)	**2019***	**2018**	**2017**	**2016**	**2015**
Tier 1 capital ratio	12.9	13.1	12.8	12.5	12.5
S&P Global Ratings' RAC ratio before diversification	N/A	7.1	6.7	6.3	N/A
S&P Global Ratings' RAC ratio after diversification	N/A	9.3	8.9	8.1	N/A
Adjusted common equity/total adjusted capital	88.6	87.9	89.0	90.9	91.3
Net interest income/operating revenues	69.0	68.1	68.8	68.3	69.2
Fee income/operating revenues	22.9	22.8	23.3	22.4	21.2
Market-sensitive income/operating revenues	2.0	3.6	3.3	4.6	5.0
Noninterest expenses/operating revenues	49.8	46.4	46.3	46.7	45.4
Preprovision operating income/average assets	1.7	1.9	1.9	1.8	2.0

Table 3

Banco Santander S.A.--Capital And Earnings (cont.)

	--Year ended Dec. 31--				
(%)	**2019***	**2018**	**2017**	**2016**	**2015**
Core earnings/average managed assets	0.7	0.8	0.9	0.8	0.9

*Data as of June 30. N/A--Not applicable.

Table 4

Banco Santander S.A.--Risk-Adjusted Capital Framework Data

(Mil. €)	**Exposure***	**Basel III RWA**	**Average Basel III RW(%)**	**S&P Global Ratings RWA**	**Average S&P Global Ratings RW (%)**
Credit risk					
Government & central banks	285,418.0	16,062.5	5.6	90,380.0	31.7
Of which regional governments and local authorities	23,616.0	500.0	2.1	6,479.7	27.4
Institutions and CCPs	78,512.0	17,600.0	22.4	33,057.3	42.1
Corporate	267,226.0	176,125.0	65.9	283,015.4	105.9
Retail	587,158.0	211,537.5	36.0	397,094.8	67.6
Of which mortgage	372,933.0	78,887.5	21.2	175,377.8	47.0
Securitization§	33,639.0	5,012.5	14.9	10,590.1	31.5
Other assets†	70,438.9	42,725.0	60.7	105,600.1	149.9
Total credit risk	1,322,391.9	469,062.5	35.5	919,737.8	69.6
Credit valuation adjustment					
Total credit valuation adjustment	--	2,087.5	--	8,153.3	--
Market Risk					
Equity in the banking book	3,468.0	14,937.5	430.7	30,656.5	884.0
Trading book market risk	--	25,012.5	--	39,127.5	--
Total market risk	--	39,950.0	--	69,784.0	--
Operational risk					
Total operational risk	--	60,037.5	--	96,659.7	--
	Exposure	**Basel III RWA**	**Average Basel II RW (%)**	**S&P Global Ratings RWA**	**% of S&P Global Ratings RWA**
Diversification adjustments					
RWA before diversification	--	592,325.0	--	1,094,334.8	100.0
Total Diversification/ Concentration Adjustments	--	--	--	(256,447.1)	(23.4)
RWA after diversification	--	592,325.0	--	837,887.7	76.6
		Tier 1 capital	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global Ratings RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		77,716.0	13.1	78,117.9	7.1
Capital ratio after adjustments‡		77,716.0	13.1	78,117.9	9.3

Table 4

Banco Santander S.A.--Risk-Adjusted Capital Framework Data (cont.)

*Exposure at default. §Securitization Exposure includes the securitization tranches deducted from capital in the regulatory framework. †Exposure and S&P Global Ratings' risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions. ‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. Sources: Company data as of 'Dec. 31 2018', S&P Global Ratings.

Risk position: Wide geographic and risk diversification and better asset quality record than peers in the markets where it operates

Despite Santander's comparatively lower capital ratios than peers (both by regulatory and S&P Global Ratings' measure), we believe its capital base is solid compared with the risks that it faces, mainly due to the benefits it derives from its wide geographic diversification in economies that have proved to be uncorrelated. The bank also enjoys good diversification by risk type, as well as a better-than-average asset quality track record--aspects that our RAC calculation does not fully capture.

The diversification benefit that we calculate for Santander is one of the highest in our sample of rated global banks, with our calculation of its RWA after diversification effects standing 23% below that of RWA before diversification effects. In addition to its wide geographic diversification, we consider that Santander's loan book has good diversification by client and product, which contributes to a reduced risk profile. Single-name concentration is manageable and falling--exposures to the top 20 creditors account for about half of TAC. Residential mortgages accounted for 35% of total loans in June 2019, consumer lending for 17%, other loans to individuals 11%, large international corporates 12%, midsize companies 14%, and SMEs 11%. The portfolios that structurally have higher risks (the Spanish real estate portfolio, which is in run off, corporate and consumer lending in Brazil, autofinance in the U.S., and SME lending in Brazil and Chile) do not meaningfully weigh on the overall portfolio, while mortgages, on the other hand, have a generally low risk profile across geographies, and particularly in the U.K. where most of Santander's mortgages are originated. In addition, SCF's consumer lending portfolio, which is mostly based in Germany, the Nordics, and Spain, also has a lower-than-average risk profile.

Compared with global peers, Santander generally reports higher problematic exposures and credit losses. But, we attribute the latter to the riskier nature of the markets where it operates, rather than its credit underwriting. Indeed our view is that Santander's asset quality track record has been better than banking industry averages in most of the main markets where it operates, thanks to the group's strong risk management, conservative underwriting standards, and close monitoring of risks.

Since 2013, the group's asset quality indicators have showed continuous improvement, primarily driven by the turnaround of the Spanish economy. The addition of €30 billion of problematic assets from Popular in June 2017 (which resulted in an increase in the NPA ratio to 9%) was quickly addressed by the sale of the book to a newly created joint venture with Blackstone, in which the bank retained a 51% stake. Thus, in June 2019, the group's nonperforming loan ratio stood, as per our calculations, at 3.95%, down from 6.1% at end-2013. Adding the remaining Spanish real estate assets, we estimate that the group's NPAs amounted to about 5%. Under IFRS 9, as of June 30, 2019, Stage 3 loans amounted to 3.5% and Stage 2 to 5.5%.

We expect the stock of problematic exposures to still decline somewhat in the years to come, as progress in Spain offsets likely deterioration in other areas, more notably in Argentina, currently under severe stress. Markets that could disrupt our base-case expectations are Brazil, whose economy is recovering only slowly and still faces a number of policy challenges, and the U.K., particularly if a no-deal Brexit materializes, pushing the economy into recession. The latter would lead to increased delinquencies (albeit from a very low base).

Contrary to our expectations, credit costs continued declining up to mid-2019 (reaching 102 bps of average loans), a trend that started back in 2012. However, we feel that they have reached a floor. We view the bank's coverage as comfortable, both on aggregate (at 66% of nonperforming loans and 50% for real estate assets in June 2019) and by geography (including those that have lower coverage levels than those of the group, like U.K and Spain).

Given the nature of its business, the bank's main risk exposure is to credit risk. Still, Santander is also structurally exposed to foreign currency risks due to its local currency investments in subsidiaries abroad. However, the bank actively hedges its exposure with a view to minimizing the impact of adverse movement in the group's regulatory capital ratio and subsidiaries' profit contribution to the group. Hedging has proved effective in recent years given the large devaluations of some foreign currencies. The group also actively manages its structural exposures to interest rate risk, through the build up of asset-liability committee (ALCO) portfolios or the use of swaps across geographies. At present, most operations, other than in Brazil, are positioned to benefit from interest rate increases.

Despite its large size, the bank does not have the complexity of other large banking groups. Both its business model, which is consistent across its network, and its organizational structure facilitate the bank's management. Financially, the group's organization abroad through self-financing subsidiaries and the parent's less supportive stance than other peers toward subsidiaries in adverse scenarios are also elements that we take into account, as they limit contagion risks across the group entities and set a threshold on risk-taking by the parent.

Table 5

Banco Santander S.A.--Risk Position					
		--Year ended Dec. 31--			
(%)	**2019***	**2018**	**2017**	**2016**	**2015**
Growth in customer loans	5.5	2.9	6.9	(1.8)	5.2
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	(23.4)	(24.3)	(23.1)	N/A
Total managed assets/adjusted common equity (x)	21.4	21.5	21.9	22.0	20.8
New loan loss provisions/average customer loans	1.0	1.1	1.2	1.2	1.4
Net charge-offs/average customer loans	1.3	1.3	1.5	1.4	1.4
Gross nonperforming loans/customer loans	3.9	4.2	4.6	4.2	4.6
Loan loss reserves/gross nonperforming loans	66.0	65.3	63.7	74.9	73.4

*Data as of June 30. N/A--Not applicable.

Funding and liquidity: A structurally balanced and resilient funding profile

Santander enjoys a fairly balanced funding profile, weighted toward retail deposits. The group's loan-to-deposit ratio stood at 108% in June 2019. It also holds a manageable amount of wholesale funding (diversified by instrument, market, and investors). We believe that refinancing risk is limited, since debt maturities are spread over several years and the bank has proved able to access market funding in times of market turbulence.

We calculated our measure of the bank's stable funding ratio at a solid 105% on June 30, 2019, having improved from

94.5% at end-2011. The improvement of Santander's structural funding profile over recent years has resulted from deleveraging and market-share gains in deposits in matured markets. In emerging countries, growth in deposits and loans has moved in tandem.

The bank operates abroad through subsidiaries that are independent from the parent for funding purposes. At present, only two subsidiaries receive funding from the parent: SCF and UCI (a joint-venture with BNP). Parent financing to SCF has increased over the recent past, as Santander found it more profitable to invest in SCF its high liquidity buffers that resulted from the accelerated issuance of total loss-absorbing capacity (TLAC). Over the medium to long term, however, we would expect this situation to reverse.

There are no significant differences in the funding profiles of subsidiaries within the group. The group entities that proportionally are more dependent on wholesale financing are SCF, Chile, and the U.S. consumer finance operations (SCUSA).

The group's wholesale debt outstanding in the market totaled €175 billion in June 2019, across a wide array of instruments (senior, covered bonds, senior nonpreferred, subordinated debt, and preferred securities). If securitizations are added, total wholesale debt would exceed €200 billion. Banco Santander S.A. and Santander UK are the more active issuers in the group, accounting for about 70% of the group's debt outstanding. The calendar of debt maturities is well spread and thus manageable.

Santander has opportunistically borrowed resources from the ECB's TLTRO program to take advantage of attractive terms. We don't consider this funding to be structural, but rather opportunistic, and believe the bank could comfortably repay it at maturity (the first big repayment is due in June 2020). In our view, the bank's decision to access TLTRO III will again depend on whether the facility is economically attractive.

Santander benefits from sound, growing liquidity. We estimate the group's liquidity ratio--by S&P Global Ratings' measure--at 1.6x on June 30, 2019, up from 1.0x at end-2011. Because of the accelerated issuance of TLAC-eligible instruments in 2017 and 2018 to comply with requirements on Jan. 1, 2019, the group accumulated ample liquidity. Over time, however, as some non-TLAC-eligible debt matures and is not refinanced, the liquidity position will return to more normal levels. Liquidity is held in cash and liquid securities portfolios. The latter are primarily invested in government securities. The largest portfolios are those of Spain, Brazil, the U.K., and the U.S.

Table 6

Banco Santander S.A.--Funding And Liquidity					
		--Year ended Dec. 31--			
(%)	**2019***	**2018**	**2017**	**2016**	**2015**
Core deposits/funding base	62.0	61.2	60.4	59.7	58.9
Customer loans (net)/customer deposits	108.9	110.3	110.5	115.2	117.5
Long-term funding ratio	83.8	83.5	81.4	81.0	79.8
Stable funding ratio	104.9	106.1	103.5	100.9	101.0
Short-term wholesale funding/funding base	17.3	17.6	19.9	20.4	21.6
Broad liquid assets/short-term wholesale funding (x)	1.6	1.6	1.5	1.4	1.3
Net broad liquid assets/short-term customer deposits	19.1	19.5	16.9	13.9	13.4
Short-term wholesale funding/total wholesale funding	44.7	44.5	49.3	49.8	51.8

Table 6

Banco Santander S.A.--Funding And Liquidity (cont.)					
		--Year ended Dec. 31--			
(%)	2019*	2018	2017	2016	2015
Narrow liquid assets/3-month wholesale funding (x)	3.8	2.2	2.1	2.1	2.0

*Data as of June 30.

External Support: No notches of uplift for ALAC or government support

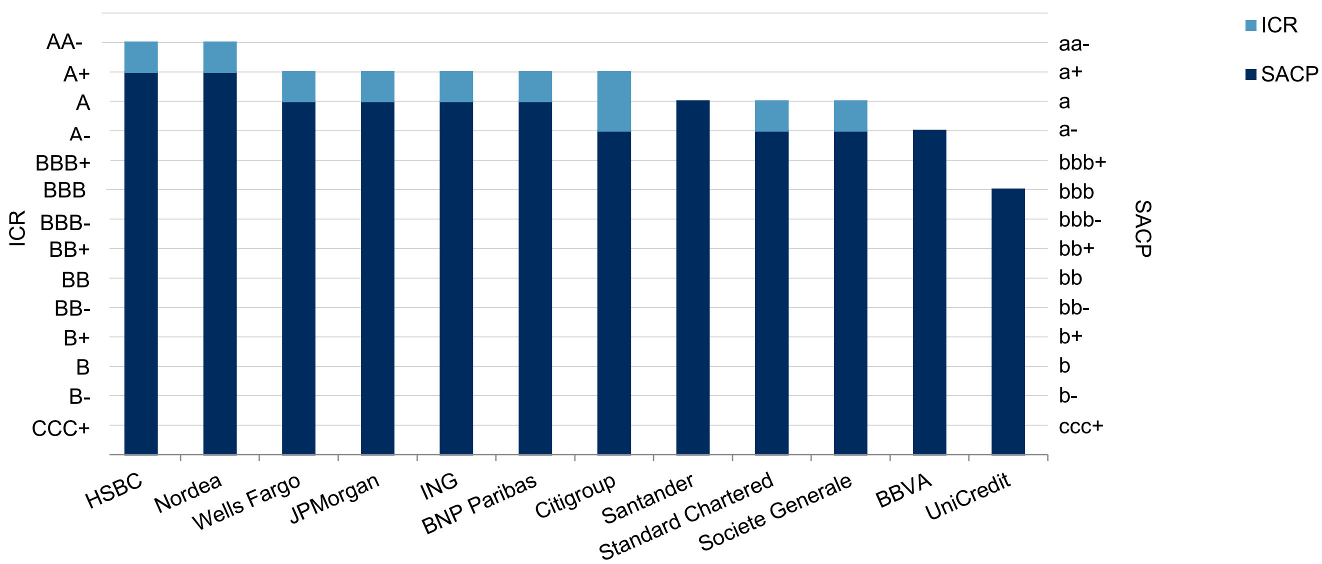
Although we consider Santander to have high systemic importance in the Spanish banking system, the bank is not eligible for rating uplift based on external government support as, following the implementation of a resolution framework in Spain, we now consider the prospect of support for banks from the Spanish government as uncertain.

Unlike in the past, the long-term rating on the Spanish sovereign does not constrain the ratings on Santander at their current level. Indeed, we rate Santander at the level of its stand-alone credit profile (SACP), which is one notch above the long-term rating on Spain. This reflects our view that there is an appreciable likelihood that Santander would not default in the stress scenario that would likely accompany a default of the Spanish sovereign. In such a scenario, we would expect Santander to face meaningful impairments, which would erode a significant portion of its capital base, but not all. Complying with minimum regulatory capital ratios post-impairments (based on our impairment assumptions over one year) would be challenging, but given the systemic importance of Santander, we think that regulators would likely accept some regulatory forbearance for some time at least. Similarly, we would expect Santander's Spanish operations to suffer sizable outflows of liquidity, but consider that the bank would be able to overcome liquidity pressures by resorting to ECB funding.

Unlike most of its global peers, the ratings on Santander do not benefit from ALAC uplift (see chart 6). Despite the issuance of a sizable amount of bail-in-able instruments in 2017 and 2018 (€16 billion of senior nonpreferred debt, on top of AT1 and subordinated debt issuance) to comply with TLAC requirements on January 2019, we believe that the bank's ALAC buffer will fall short of the minimum threshold to be eligible for a one-notch uplift, which we set at 400 bps of S&P Global Ratings' calculation of RWA. We estimate that the bank's ALAC threshold amounted to 237 bps of S&P RWA at end-2018, and forecast it will grow only moderately to about 300 bps by end-2020.

Chart 6

Unlike Most Of Its Global Peers, Santander's Ratings Do Not Benefit From ALAC Uplift
Comparison Of ICRs and SACPs



ALAC--Additional loss-absorbing capacity. ICR--Issuer credit rating. SACP--Stand-alone credit profile.
Source: S&P Global Ratings. Data as of September 2019.

The ALAC buffer mostly comprises Tier II and senior nonpreferred debt instruments, as excess TAC over 7% is limited. We have only included bail-in-able instruments issued by Banco Santander S.A., excluding those issued by subsidiaries abroad identified as separate points of entry in resolution (most notably, all instruments--including AT1s--issued out of the U.K. and U.S.). We have not included either the fidelity bonds granted in 2017 to Popular's retail clients in compensation for the money lost in the bank's resolution. We have assumed limited issuance of bail-in-able debt in coming years (other than to replace maturing instruments), as the bank is already meeting current MREL requirements. The bank itself communicated it does not plan to issue additional senior nonpreferred debt in 2019.

We lowered the threshold for the bank to benefit from one notch of ALAC uplift by 100 bps, the maximum possible, to 4.0% to reflect the multiple point of entry approach for the bank's resolution strategy. The Single Resolution Board identified nine different points of entry for the Santander group, which will be subject to a separate resolution process from that of the parent. Those separate points of entry are: Spain (which is the largest as it also includes the European operations of Santander Consumer Finance as well as all equity holdings in subsidiaries abroad), Portugal, the U.K., Poland, the U.S., Mexico, Brazil, Chile, and Argentina. Each point of entry would be required to build up its own cushions of bail-in-able instruments to face a potential resolution scenario, provided that it is required to do so by host authorities. Indeed, to our knowledge, the U.K., U.S., and Portuguese operations already have plans underway to build up their own TLAC/MREL cushions.

Group structure and rated subsidiaries

We rate six of Santander's operating subsidiaries globally. We consider three of them highly strategic for the group (Santander UK PLC, Banco Santander (Brasil) S.A., and Santander Consumer Finance S.A.) and the other three strategically important (Banco Santander Totta S.A., Santander Bank, N.A., and Banco Santander-Chile). Different from most other global banking groups, we no longer consider any of Santander's subsidiaries as core, not even the more sizable ones like the U.K. or Brazilian operations. This is because we think more likely that the group will provide support to those subsidiaries under almost all foreseeable circumstances, rather than under all foreseeable circumstances--a subtle difference. See "How We're Refining Our View Of The Strategic Importance Of Certain Spanish Bank Subsidiaries" published on Aug. 2, 2019.

At present the ratings of only three of Santander's subsidiaries benefit from group support and, as a result, have ratings that are higher than their SACPs. That is the case for SCF in Spain (whose ratings benefit from two notches of uplift), Banco Santander Totta, S.A. in Portugal (one notch of group support) and Banco Santander NA in the U.S. (three notches).

Conversely, we do not incorporate group support into the ratings on the remaining three subsidiaries. The reasons for this vary. In the case of Santander's Brazilian subsidiary, the sovereign creditworthiness of the host country limits any upside potential. The ratings on the other two benefit instead from ALAC uplift (Santander UK PLC) or government support uplift (Banco Santander Chile S.A.). That is because the U.K. operations have substantial ALAC cushions to absorb losses and get recapitalized in a resolution scenario, reducing the likelihood of default on senior obligations. In the case of Chile, the ratings on the subsidiary benefit from the likelihood of receiving financial support from the Chilean government, given the operations' high systemic importance and the supportive stance of Chilean authorities toward its banking system.

At present, the stand-alone creditworthiness of all subsidiaries is below the group's credit profile. Their ratings are also generally below the ratings of the parent, except for the U.K. and Chile, whose ratings stand at the same level.

Hybrid ratings

We consider senior nonpreferred debt, nondeferrable subordinated debt, and preference shares as hybrid instruments and arrive at their ratings by notching down from the bank's 'a' SACP. We thus rate Banco Santander S.A. senior nonpreferred debt at 'A-', one notch below the bank's SACP to reflect subordination versus senior obligations.

We rate nondeferrable subordinated debt at 'BBB+', two notches below the bank's SACP, since in addition to being subordinated, these instruments, which are capital instruments for regulatory purposes, could be written down to absorb losses ahead of resolution, that is before the institution reaches the point of nonviability.

We rate junior subordinated debt at 'BBB-', four notches below the bank's SACP. In addition to the above, the wider notching compared with nondeferrable subordinated instruments reflects the risk of coupon suspension and these instruments being considered as Tier 2 regulatory capital (one notch), as well as the existence of a mandatory trigger for coupon suspension linked to the availability of enough profits in prior year's reporting--as opposed to enough distributable reserves (an additional notch).

Finally, we rate the remaining legacy preference shares five notches below the bank's SACP, at 'BB+'. The additional notch difference relates to preference shares being considered as Tier 1 rather than Tier 2 capital.

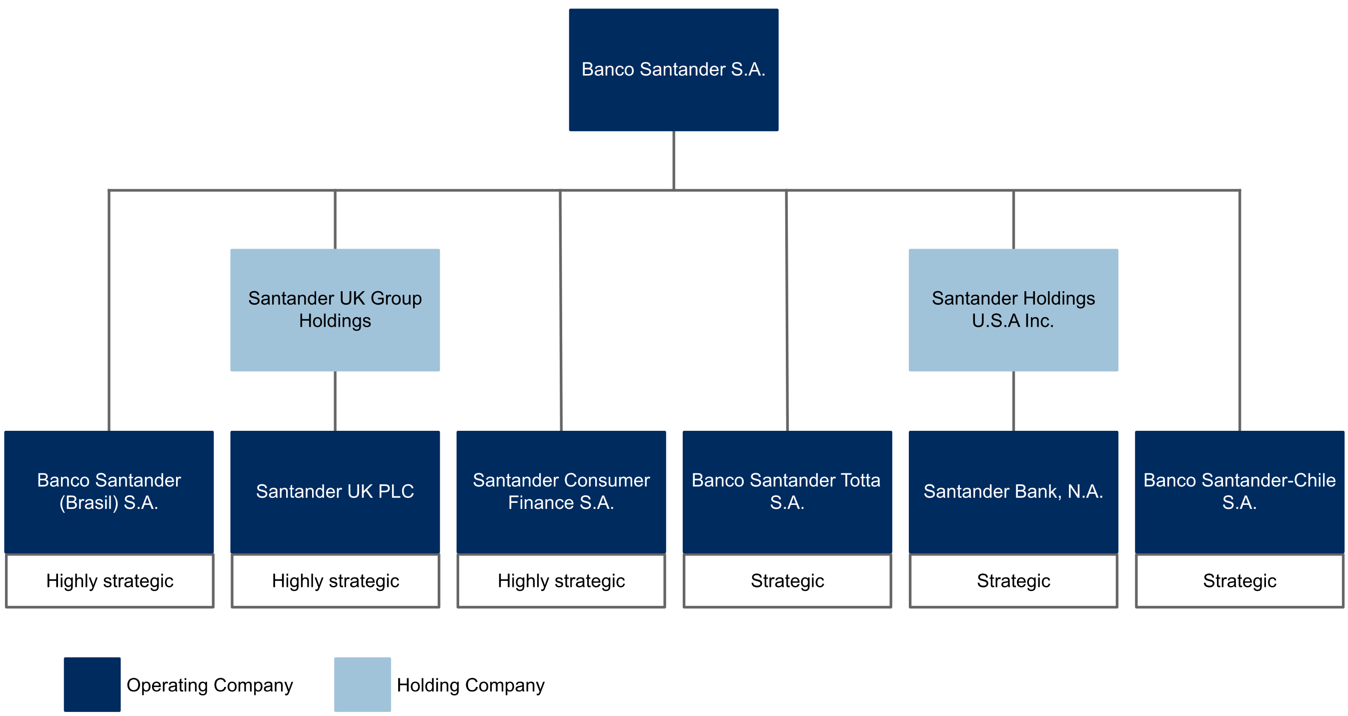
We do not have ratings assigned to the bank's AT1 Instruments issued in the past few years.

Resolution counterparty ratings (RCRs)

We set the RCR of Banco Santander at 'A+', one notch above the bank's long-term issuer credit rating and two notches above our sovereign rating on Spain. The RCR applies to certain senior liabilities of the bank that we expect would be excluded from bail-in in a resolution scenario. We thus rate them at a higher level than traditional senior obligations to show their lower relative default risk.

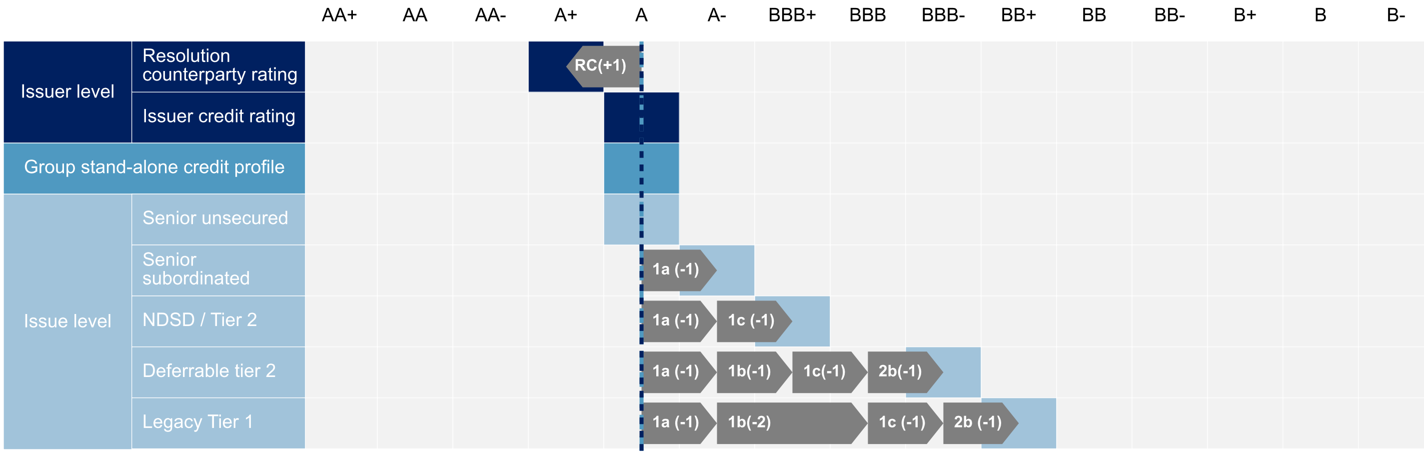
Chart 7

Santander's Simplified Organization Chart Including Rated Subsidiaries Only
Data as of September 2019



Source: Banco Santander S.A., S&P Global Ratings.

Banco Santander S.A.: Notching



Key to notching

- - - - - Group stand-alone credit profile

- - - - - - Issuer credit rating

RC	Resolution counterpartyliabilities (senior secured debt)
1a	Contractual subordination
1b	Discretionary or mandatory nonpayment clause and whether the regulator classifies it as regulatory capital
1c	Mandatory contingent capital clause or equivalent
2b	Other nonpayment or default risk not captured already

Note: The number-letter labels in the table above are in reference to the notching steps we apply to hybrid capital instruments, as detailed in table 3 of our "Hybrid Capital: Methodology And Assumptions" criteria, published on July 1, 2019.
NDSD—Non-deferrable subordinated debt.

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- Criteria - Financial Institutions - General: Methodology For Assigning Financial Institution Resolution Counterparty Ratings, April 19, 2018
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- Criteria | Financial Institutions | Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013

- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria | Financial Institutions | Banks: Commercial Paper I: Banks, March 23, 2004

Related Research

- How We're Refining Our View Of The Strategic Importance Of Certain Spanish Bank Subsidiaries, Aug. 2, 2019
- Ratings On Two Spanish Banks Raised, Most Affirmed On Receding Economic Risks, May 31, 2019
- Credit Agricole Subsidiary CACEIS' Scale To Benefit From Santander Joint Venture, April 19, 2019
- Banco Santander Announces Plan To Acquire Remaining 25% Stake In Mexican Subsidiary, April 12, 2019
- Will Santander's Decision Not To Call Reset The Market For AT1 Instruments? Feb. 13, 2019

Anchor Matrix

Industry Risk	Economic Risk									
	1	2	3	**4**	5	6	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	**bbb**	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

Ratings Detail (As Of September 19, 2019)*	
Banco Santander S.A.	
Issuer Credit Rating	A/Stable/A-1
Resolution Counterparty Rating	A+/--/A-1
Senior Subordinated	A-
Senior Unsecured	A
Short-Term Debt	A-1
Subordinated	BBB+
Issuer Credit Ratings History	
06-Apr-2018	A/Stable/A-1
09-Jun-2017	A-/Stable/A-2

Ratings Detail (As Of September 19, 2019)*(cont.)	
09-Feb-2017	A-/Positive/A-2
06-Oct-2015	A-/Stable/A-2
Sovereign Rating	
Spain	A-/Positive/A-2
Related Entities	
Banco Santander (Brasil) S.A.	
Issuer Credit Rating	BB-/Stable/B
Brazil National Scale	brAAA/Stable/brA-1+
Banco Santander-Chile S.A.	
Issuer Credit Rating	A/Stable/A-1
Commercial Paper	
Foreign Currency	A-1
Senior Unsecured	A
Subordinated	A-
Banco Santander SA (London Branch)	
Certificate Of Deposit	
Local Currency	A-1
Banco Santander S.A. (New York Branch)	
Commercial Paper	
Local Currency	A-1
Banco Santander Totta S.A.	
Issuer Credit Rating	BBB/Positive/A-2
Resolution Counterparty Rating	BBB/--/A-2
Senior Unsecured	BBB
PSA Banque France	
Issuer Credit Rating	BBB+/Stable/A-2
Commercial Paper	A-2
Senior Unsecured	BBB+
Santander Bank, N.A.	
Issuer Credit Rating	A-/Stable/A-2
Senior Unsecured	A-
Short-Term Debt	A-2
Subordinated	BBB+
Santander Consumer Bank AG	
Issuer Credit Rating	A-/Stable/A-2
Resolution Counterparty Rating	A/--/A-1
Commercial Paper	A-2
Senior Subordinated	BBB+
Santander Consumer Finance S.A.	
Issuer Credit Rating	A-/Stable/A-2
Resolution Counterparty Rating	A/--/A-1
Commercial Paper	
Local Currency	A-2
Senior Subordinated	A-2

Ratings Detail (As Of September 19, 2019)*(cont.)	
Senior Subordinated	BBB+
Senior Unsecured	A-
Short-Term Debt	A-2
Subordinated	BBB
Santander Holdings U.S.A Inc.	
Issuer Credit Rating	BBB+/Stable/A-2
Preferred Stock	BB+
Senior Unsecured	BBB+
Santander Totta SGPS, S.A.	
Senior Unsecured	BBB
Santander UK Group Holdings PLC	
Issuer Credit Rating	BBB/Stable/A-2
Junior Subordinated	B+
Senior Unsecured	BBB
Short-Term Debt	A-2
Subordinated	BB+
Santander UK PLC	
Issuer Credit Rating	A/Stable/A-1
Resolution Counterparty Rating	A+/--/A-1
Junior Subordinated	BB
Junior Subordinated	BB+
Preference Stock	BB
Senior Secured	AAA/Stable
Senior Unsecured	A
Senior Unsecured	A-1
Short-Term Debt	A-1
Subordinated	BBB-
Sovereign Real Estate Investment Trust	
Preferred Stock	BB+

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.