

DBRS Morningstar Confirms Banco Santander SA's Long-Term Issuer Rating at A (high), Stable Trend

BANKING ORGANIZATIONS

DBRS Ratings GmbH (DBRS Morningstar) confirmed the ratings of Banco Santander SA (Santander or the Group), including the Long-Term Issuer Rating of A (high), and the Short-Term Issuer Rating of R-1 (middle). The trend on all ratings remains Stable. DBRS Morningstar also confirmed the Group's Intrinsic Assessment (IA) at A (high) and the Support Assessment at SA3. A full list of rating actions is included at the end of this press release.

KEY RATING CONSIDERATIONS

The confirmation of Santander's ratings reflects the strength of its globally diversified banking franchise, which contributes to resilient underlying earnings and a sustained ability to generate capital. The ratings also take into account the Group's strong market shares in its core geographies, which are well-balanced between developed and emerging economies. Santander benefits from its significant scale and technology, resulting in good efficiency levels. The ratings also incorporate Santander's solid funding and liquidity profile, as well as satisfactory capital levels, although DBRS Morningstar views that capital ratios remain at the lower end of its global peer group.

Nevertheless, DBRS Morningstar also notes that in FY 2021 Santander's profitability will reduce and its risk profile is likely to deteriorate due to the major economic slowdown in the Group's core markets, due to the Coronavirus Disease (COVID-19). However, we expect the effects of the economic downturn to be partly offset by the fiscal and monetary support measures introduced in response to COVID-19. DBRS Morningstar considers that the impact of the COVID-19 outbreak on the Santander in the medium to long-term will depend on the depth of the economic crisis. We will continue to monitor the developing situation and in particular the asset quality evolution of its large loan book under moratoria.

Santander's IA is positioned one-notch above DBRS Morningstar's rating of the Kingdom of Spain, reflecting the Group's strong franchise with a high degree of international diversification and ability to generate solid and consistent earnings.

RATING DRIVERS

An upgrade of the Long-Term Issuer Rating is unlikely in the near term, given the challenging economic outlook, and the current rating level of the Kingdom of Spain.

The ratings could be downgraded if there is a substantial deterioration in asset quality, potentially as a result of the economic fallout from COVID-19, or if capital levels reduce. A downgrade of Spain's sovereign rating would also have negative rating implications.

RATING RATIONALE

Santander's geographically diverse global retail banking franchise is a key strength underpinning its ratings. Santander follows a

strategy of universal, transactional banking with a focus on consumers and small- and medium-sized businesses (SMEs). With around 146 million customers worldwide and around EUR 1.6 trillion of assets as of end-June 2020, Santander is the largest Spanish banking group. Santander is well positioned in its core markets, where it has an aim to have a minimum market share of 10%. Core markets include Brazil, Spain, the United Kingdom (UK), Mexico, Poland, Portugal, Chile and Argentina. The COVID-19 economic shutdown, however, has led to significant deterioration in the operating environments in which the Group operates, and we expect the full impact of the COVID-19 crisis will only emerge in the coming quarters.

The wide scale of the economic and market disruption resulting from COVID-19 is posing significant challenges to Santander's profitability. In H1 2020, Santander reported a EUR 10.8 billion loss, substantially driven by goodwill impairments on some of their international subsidiaries, reflecting lower expectations for performance over the coming years. As regulatory capital ratios do not include goodwill, these impairments did not affect the Group's capital ratios. Excluding one-off items and at constant exchange rates, Santander's underlying net attributable income in H1 2020 was EUR 1.9 billion, down 47.5% YoY. This largely reflects lower net fees (down 2% YoY) coupled with higher loan loss provisions, up 78% YoY. Notably, the Group is recording a significant financial impact across all of its core markets, with only Mexico and Argentina recording an increase in underlying attributable profits YoY. Nevertheless, DBRS Morningstar considers that over time the economic trends in different areas will become less correlated, giving Santander's geographical diversification a more beneficial impact than in the first quarters of the crisis.

Santander's credit risk profile is highly diversified with no large risk concentration by geography or industry. DBRS Morningstar views that Santander benefits from its geographically diverse franchise and it has a sound risk management that permeates throughout the organisation. As of end-June 2020, gross loans to customers were up 3% YoY, driven by new state guaranteed loans and higher loans to corporates. Santander's Non-Performing Assets (NPAs) totalled around EUR 42 billion, and the NPA ratio stood at 4.3% at end-June 2020, down from around 4.5% at end-2019 (as calculated by DBRS Morningstar). By business area, five core markets reported a marginal increase in NPL ratios compared to end-2019. However, all jurisdictions posted higher trailing 12 month Cost of Risk (CoR) in H1 2020 compared to 2019 data, ranging from an increase of 74bps in Brazil to 13bps in the UK.

DBRS Morningstar expects COVID-19 to have a negative impact on the Bank's asset quality, and in coming quarters we expect to see an increase in Santander's NPLs. The current slow pace of deterioration in credit quality, despite the significant economic shock, can largely be explained by the extraordinary measures applied by governments and banks to support the economy. In particular, a total of EUR 116 billion of applications for loan moratoria had been granted by end-June 2020 or around 12% of its loan portfolio. However, around 25% of the initial moratoria have already expired. As a result, at end-June 2020, around 7.5% of its total loan book was still under moratoria. Of note are the figures in Santander UK, where as of end-June 2020, around 12% of its total book was still under moratoria.

DBRS Morningstar considers Santander's funding and liquidity profile remains strong despite the COVID-19 crisis. Santander's funding and liquidity reflects the large deposit base that funds its lending activities, together with a broad range of wholesale funding. Santander follows an approach in which its subsidiaries are largely autonomous in managing their own funding and liquidity, including raising wholesale funding from their own local markets. Thus, while the Group employs considerable amounts of wholesale funding, a significant proportion is raised locally through its subsidiaries.

The Group reported a CET1 capital ratio of 11.84% at end-June 2020, up 19bps since end-2019, which provides a cushion of 246 bps over the minimum supervisory capital requirements. Santander's fully-loaded CET1 capital ratio stood at 11.46% at end-June 2020 (including the full impact from IFRS-9 accounting standards), improving around 5bps since end-2019. The Group has a CET1 ratio internal target ranging from 11% to 12%. While Santander's CET1 capital ratio remains at the low end of the global peer group, DBRS Morningstar views these levels as satisfactory given the Banks' solid risk profile.

DBRS Morningstar sees Santander as well positioned to meet its Total Loss Absorbing Capacity (TLAC) and Minimum Requirement for own funds and Eligible Liabilities (MREL) requirements. Santander's resolution strategy is that of a multiple point of entry (MPE)

approach, meaning the TLAC and MREL requirements are established at each resolution entity.

ESG CONSIDERATIONS

A description of how DBRS Morningstar considers ESG factors within the DBRS Morningstar analytical framework and its methodologies can be found at: <https://www.dbrsmorningstar.com/research/357792>.

The Grid Summary Grades for Banco Santander SA are as follows: Franchise Strength – Very Strong/Strong; Earnings – Strong/Good; Risk Profile – Strong/Good; Funding & Liquidity – Strong; Capitalisation – Strong.

Notes:

All figures are in Euros unless otherwise noted.

The principal methodology is the Global Methodology for Rating Banks and Banking Organisations (8 June 2020). <https://www.dbrsmorningstar.com/research/362170/global-methodology-for-rating-banks-and-banking-organisations>

For more information regarding rating methodologies and Coronavirus Disease (COVID-19), please see the following DBRS Morningstar press release: <https://www.dbrsmorningstar.com/research/357883>

The sources of information used for this rating include Company Documents, Santander 2019 & H1 2020 Presentations, Santander 2019 & H1 2020 Press Releases, Santander 4Q 2019 & 2Q 2020 Report, Santander 2019 Annual Accounts, European Banking Authority Risk Dashboard, Bank of Spain and S&P Global Market Intelligence. DBRS Morningstar considers the information available to it for the purposes of providing this rating to be of satisfactory quality.

DBRS Morningstar does not audit the information it receives in connection with the rating process, and it does not and cannot independently verify that information in every instance.

Generally, the conditions that lead to the assignment of a Negative or Positive trend are resolved within a 12-month period. DBRS Morningstar's outlooks and ratings are under regular surveillance.

For further information on DBRS Morningstar historical default rates published by the European Securities and Markets Authority (ESMA) in a central repository, see: <http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml>.

The sensitivity analysis of the relevant key rating assumptions can be found at: <https://www.dbrsmorningstar.com/research/367716>

Ratings assigned by DBRS Ratings GmbH are subject to EU and U.S. regulations only.

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Ratings

Banco Santander SA

Date Issued	Debt Rated	Action	Rating	Trend	Issued
01-Oct-20	Long-Term Issuer Rating	Confirmed	A (high)	Stb	
01-Oct-20	Short-Term Issuer Rating	Confirmed	R-1 (middle)	Stb	
01-Oct-20	Long-Term Senior Debt	Confirmed	A (high)	Stb	
01-Oct-20	Senior Non-Preferred Debt	Confirmed	A	Stb	
01-Oct-20	Short-Term Debt	Confirmed	R-1 (middle)	Stb	
01-Oct-20	Short-Term Deposits	Confirmed	R-1 (middle)	Stb	
01-Oct-20	Long Term Critical Obligations Rating	Confirmed	AA (low)	Stb	
01-Oct-20	Short Term Critical Obligations Rating	Confirmed	R-1 (middle)	Stb	
01-Oct-20	Subordinated Debt	Confirmed	A (low)	Stb	
01-Oct-20	Long-Term Deposits	Confirmed	A (high)	Stb	

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