ISSUER RATING

Long-term Rating

A+

Outlook: Stable

First rating date: 04/12/2018
Review date: 16/12/2019

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Content

Executive Summary

We confirm the credit rating of Grupo Santander (hereinafter, Santander) in A+ with a stable outlook based on its strong international presence, diversification and recurrent revenues, showing a profitability that, despite being one of its main challenges, on average continues to outperform its European counterparts due to its exposure to the Americas (accounting for 50% of last year's profit).

We also underline the growth policy observed in previous years, both organic and inorganic through strategic corporate operations, which boost their market share and improve efficiency. The Group's solvency and liquidity is sound, although our rating takes into account that its capital ratios remain below their global peers. Finally, we highlight its commitment to digitization and the integration of ESG principles into their corporate strategy, which places it in an advanced position to face future challenges, as well as the possible benefits that could be derived from lower capital requirements to fund sustainable assets.

On the contrary, our rating is constrained by the macroeconomic environment, not only by the lower growth that may result in an upturn in the high default rate, but also by the negative effect of the accommodative monetary policy on the profitability of the financial system, the new regulatory requirements and the technological investments required for its implementation, in addition to the banking union and its effects taking into account its exposure to sovereign debt, or the growing competition with fintechs.

Fundamentals

- High degree of geographical diversification that provides a relevant positioning of the business in Europe and Latin America.
- Business model based on commercial banking which ensures greater recurrence in terms of revenues throughout the economic cycle.
- Price-fixing power in most of the regions where it operates and European leader in the consumer business.
- Highly professionalised management based on a corporate culture common to all regions where it is active. Conservative risk management within the framework of a modest appetite for risk.
- Macroeconomic context of economic slowdown with uncertainties about future growth and the normalization of monetary policy, which can ultimately erode its ability to reap future benefits.
- Ongoing improvement in asset quality. Conservative coverage policy comparable to its international peers despite divergence in NPL ratios by region and exposure to the mortgage sector.
- Strong deposit base as main source of funding. Appropriate relationship between loans and deposits. Moderate refinancing risk due to deferred maturities. Full access to markets to comply with TLAC.
- Pioneered ESG practices in the banking sector with issuance and involvement in green bonds that imply great future potential in this area being prepared for increasingly intense future demands from society and political stakeholders.

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Sources of information

The credit rating issued in this report is unsolicited. The rated entity or a related third party have not participated in the process. The credit rating is based exclusively on public information, being the main sources the following:

1. Annual Audit Report.
2. Corporate Governance Report.
3. Corporate Website.
4. All the information published in the Official Bulletins.
5. Prudential Relevance Report.

The information was thoroughly reviewed to ensure that it is valid and consistent, and is considered satisfactory. Nevertheless, Axesor Rating assumes no responsibility for the accuracy of the information and the conclusions drawn from it."

Additional information

- The rating was carried out in accordance with Regulation (EC) N°1060/2009 of the European Parliament and the Council of 16 September 2009, on credit rating agencies, and in accordance with the Outlook Methodology and Banks Rating Methodology that can be consulted on www.axesor-rating.com/en/about-axesor/methodology and according to the Long-term Corporate Rating scale available at www.axesor-rating.com/en/about-axesor/rating-scale.
- Axesor publishes data on the historical default rates of the rating categories, which are located in the central statistics repository CEREP, of the European Securities and Markets Authority (ESMA).
- In accordance with Article 6 (2), in conjunction with Annex I, section B (4) of the Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009, it is reported that during the last 12 months axesor has provided ancillary services to the rated entity and its related third parties. However, according to our Conflict of Interest Policy, it does not involve a conflict of interest, since the aggregate sale does not exceed 5% of net turnover.
- The issued credit rating has been notified to the rated entity, and has not been modified since.

Financial figures

Main financial figures (€ mn)	2017	2018	sep.19
PROFITABILITY			
Net profit	8.207	9.315	4.972
ROA (annualized sep.19)	0,59%	0,64%	0,45%
ROE (annualized sep.19)	7,83%	8,70%	6,14%
(Pre-Imp. Op. Profit) / ATA (annualized sep.19)	1,61%	1,61%	1,56%
EFFICIENCY			
Cost-to-income	47,55%	47,04%	46,91%
Cost-to-income (recurrent)	49,69%	49,31%	48,49%
ASSET QUALITY			
Cost of risk	1,00%	1,00%	1,00%
NPL ratio	4,08%	3,73%	3,47%
Loan loss reserves/NPL	65,2%	67,4%	67,3%
LIQUIDITY			
Loan-to-Deposit	109%	113%	112%
Interbank ratio	45,3%	58,2%	n.a.
SOLVENCY			
CET1 *phased-in*	12,26%	11,47%	11,30%
CET1 *fully loaded*	10,84%	11,30%	11,30%
Solvency ratio *fully loaded*	14,48%	14,77%	14,68%
APR density	41,89%	40,59%	40,42%
Leverage	7,40%	7,36%	7,15%
MARKET VALUATION			
P/BV	0,94	0,66	0,62

Source: Santander, Axesor.

Outlook

We maintain the stable trend of the rating based on the solid capacity shown by Santander in recent years to comply with its liabilities to third parties. In this regard, our credit rating underscores the recurrence of its revenues in all the regions in which it operates and its resilience to different adverse scenarios, which provides confidence in its future performance. However, our rating is constrained by the macroeconomic scenario, which mainly materializes in the global economic slowdown and the extension of accommodative monetary policy measures, although its strategic and risk management policies lead to a constant reduction of non-performing assets and improvements in the levels of capitalization that place it in a better position to face possible negative landscapes.

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1. Company profile

1.1. Business model

Figure 1: Operating regions.

Source: Santander, Axesor

High degree of geographical diversification that allows a relevant positioning of the business in Europe and Latin America. Business model based on commercial banking. Revenue recurrence throughout the economic cycle. Depositor base as the main source of financing. Decentralized risk management model.

Santander is Spain's largest bank and the largest in Europe in terms of market capitalization as of September 2019. In fact, its high level of internationalization in Europe and Latin America, based on a majority stake in the international subsidiaries acquired, is one of the positive elements considered by our rating of A+ with a stable outlook.

Despite its mainly retail focus, it has a high degree of diversification by business lines, developing its retail, corporate, consumer finance, asset management and digital banking activities (created in 2017) in all its broad geographical positioning by market share (minimum target of 10%).

The reported segmentation has changed in the second half of 2019 to reflect the current organizational and management structure:

- **Europe**

  It comprises all the businesses carried out in Spain, Portugal, Poland, the United Kingdom, Santander Consumer Finance and the rest of Europe. It includes the CIB activities of both branches of Banco Santander S.A. outside Spain and the Spanish treasury, as well as the Wealth Management & Insurance business of Private Banking in Switzerland, investment funds in Luxembourg and Insurance in Switzerland.

- **Northamerica**

  Constituted by Mexico and all the businesses developed in the United States including the holding company Santander Holding USA, the subsidiaries of Santander Bank, Santander Consumer USA, Banco Santander International, Santander Investment Securities and Santander's branch in New York. It has recently sold its Puerto Rico subsidiary.

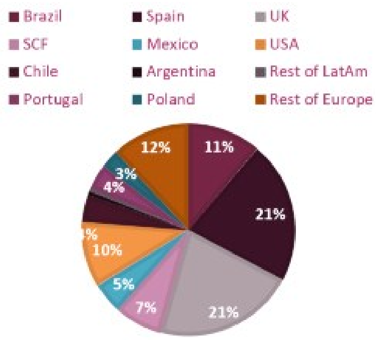
- **Latin America**

  Includes all the businesses developed in the region by the different business units and branches.

- **Santander Global Platform**

  This newly created segment encompasses the 100% digital business such as Openbank and Open Digital Services, Global Payment Services and Digital Assets.

Figure 2: Total assets by business area. Sep.19



Source: Santander, Axesor

Only 15% of consolidated net profit is accounted by Spain. Over 50% of the remaining net profit comes from developed countries. Santander has a strong position in the three areas of monetary influence in the world (euro, pound, dollar), highlighting Brazil, the UK, Spain and its consumer finance business in Europe.

The size of the Group requires the implementation of a simplified structure in the management of its geographical areas through common risk management systems. Santander maintains a decentralized liquidity, funding and capital, so that each region maintains its local committees in coordination with the global committees and in accordance with the regulatory and market requirements. Additionally, Santander has a high degree of technological innovation and operating systems where it will continue to invest more than 20,000 million over the next few years in order to maintain its position ahead of its European peers.

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1.2. Positioning

Pricing power in most of the regions where it is active and European leader in the consumer business. Successful management of acquisitions in Spain, Portugal and Poland in the last two years has boosted growth in the SME business without undermining regulatory capital levels.

Banco Santander is the largest bank in the Spanish banking system and one of the 15 largest European banks by volume of assets with €1.5 billion. It has more than 144 million customers with nearly 20% market share in Spain and Portugal, 19% in Chile, 13% in Mexico, 12% in Poland, 10% in the United Kingdom and Argentina, 9% in Brazil, 3% in the United States and is one of the top 3 banks in terms of market share in the Consumer Finance segment.

The factors that make Banco Santander different from its foreign and domestic peers are the same that determine its strength. Firstly, the high degree of diversification, which gives it a high level of recurrence and ability to generate income. This, along with cost efficiency despite the extraordinary expenses in the last two years due to the integration of Banco Popular, enables it to generate high levels of internal capital in the range of one percentage point on risk-weighted assets before dividends.

However, our credit rating of A+ with a stable outlook considers CET1 remain below their European counterparts due to exposure to emerging markets. Recent sales of non-performing assets have reduced the Group's risk profile.

1.3. Management and strategy

Highly professionalized management based on a common corporate culture in all the regions where it operates. Conservative risk management within a framework of modest risk appetite.

It has a broad shareholder base that exceeded 4 million shareholders as of September 2019, of which 75% were European. The distribution by shareholders is highly atomized. Institutional investors represent 60% of the share capital and the participation of the Group's board of directors is only 1.1%.

The Group carries out its activity under the same **brand** in most of the regions where it operates, so it maintains a strong corporate culture by harmonizing corporate values at a global level. The management quality minimizes the reputational risk to which it could be exposed.

Santander has a robust **corporate governance** based on a majority of independent directors (60%) of the board of directors. The board carries out an effective supervision in accordance with the strictest international quality standards of corporate social responsibility, with a high autonomy in terms of capital and liquidity of its main subsidiaries that minimizes intra-group transactions.

Management has a high degree of knowledge and experience with a common and standard career plan throughout the Group. Reliability in management is based on success in implementing corporate operations and stability of results throughout the economic cycle in accordance with strategic plans

In this regard, Santander has carried out different corporate operations such as the acquisition of Popular, the agreement in August 2017 with Blackstone to acquire 51% of Popular's real estate business for €10,000 million, the purchase of Deutsche Bank Polska in Poland to increase its market share in the country or the recent sale of the Puerto Rico subsidiary.

Figure 3: Breakdown by secs (€ mn.). Dec.18

Source: Santander, Axesor

Figure 4: Loan breakdown by type. Dec.18

Source: Santander, Axesor

The **risk profile** is low due to the fact that most of the activity takes place in the retail and commercial banking segment. Risk management is conservative and responds to an integration at all levels of the Group's modest appetite for risk, with robust monitoring that has allowed it to maintain adequate asset quality levels in recessive phases of the cycle, which positively affects the rating given..

The bank has a low exposure to market risks, representing 4% (€25,012m) of total risk-weighted assets in 2018, most of which are located in Spain. The majority of market risk is accounted by interest rate risk and more than 52% of capital requirements are calculated using IRB methods (trading portfolios of the units in Spain, Chile, Portugal, United Kingdom and Mexico).

In fact, our rating underlines that Santander reported at the end of 2018 an average VaR of 9.7 million euros considerably lower than that reported in previous years (21.5 million euros in 2017 and 18.3 million euros in 2016).

Foreign currency exposures are mainly represented by investments in foreign subsidiaries under the equity method and results. This foreign-exchange risk is managed centrally through hedges and management seeks to limit the impact on the capital ratio. In 2018 the level of coverage of the CET1 ratio remained at around 100%.

The assets and liabilities committee of each country is the decision-making body for structural risks. These local committees are coordinated with the central committee.

2. Macro and sectorial environment

2.1. Sovereign risk

The macroeconomic context of economic deceleration with lower expectations of future growth in the main regions where it is active. Sovereign risk mitigated in the domestic market due to the effectiveness of the central bank's unconventional policy and the improvement of the country's macromagnitudes.

The Bank's headquarters are in Spain (A / Stable), specifically in the city of Santander (Cantabria). Santander's rating is not constrained by the sovereign risk of its home country thanks to the high geographical diversification between Europe and Latin America, even operating in countercyclical regions, and the predominance of traditional banking activity in the retail segment with a stable deposit base and highly atomized as the main source of funds.

The current macroeconomic context facing Santander offers a scenario with greater uncertainties regarding world economic growth whose forecast for 2019 is 3% according to the IMF (the lowest figure since 2009) and a growth of 3.4% in 2020 which, although this expectation is more optimistic compared to this year, the forecast is lower than that estimated in previous months.

Uncertainty regarding Brexit and the upcoming elections in the United Kingdom, trade tensions between the United States and China or political instability in Spain pending the formation of a government and what measures it can undertake regarding possible new bank taxes, pose greater difficulties in the future if we compare it with the period that ended in 2018. In addition, it is necessary to add certain political and social instability in Latin America which, although it is still too early to determine the intensity and direction it may have, could have a negative impact on the group's profits in the region.

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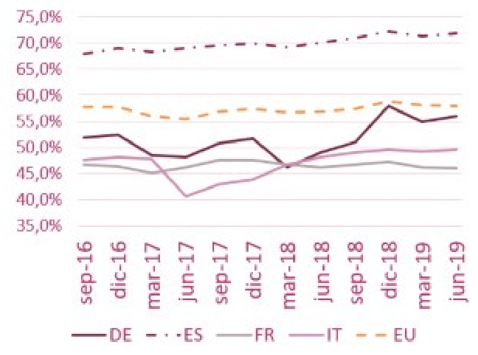
Considering these growth figures, looking at the countries with the greatest impact on Santander, the Spanish economy continues with its progressive slowdown, with an expected growth of 2% in 2019 (compared to 2.4% estimated for this year) and 1.6% in 2020 and 2021 with employment and housing market figures that interrupt the positive trend of recent years. In the United Kingdom, the second country in terms of assets, economic growth of 1.4% in 2018 was the lowest since 2012 and the latest forecasts put this figure below the next few years. In Brazil, meanwhile, they continue to recover at a slow pace of around 1% of the economic downturn in 2015 and 2016 while the United States has a more moderate growth projection after the strong growth in 2018 at 3%.

Figure 5: NII/Operating profits.



Source: EBA Risk Dashboard Q2 2019

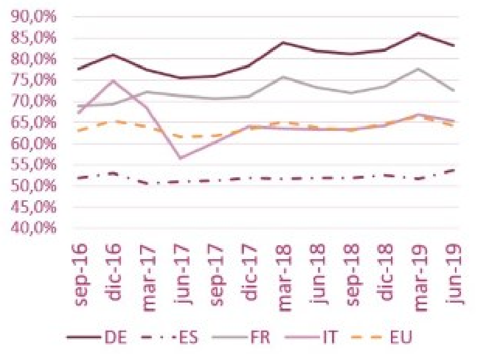
As for the exposure of banks to public debt, this has been reduced in recent years in favour of an increase in loans thanks to greater economic growth and lower continuous needs for issuing high volumes of public debt, also due to the widespread use of non-conventional monetary policies in the OECD environment. In this sense, sovereign debt levels have stabilised in recent years despite the fact that the debt stock is still at an all-time peak (157 billion euros according to IMF data) when compared to the first years of the 2007 financial crisis, reaching an average of 110% of gross public debt in 2017 according to the OECD.

2.2. Sector and regulation

Consolidation of the restructuring of the sector. Growth of the banking business in line with the macroeconomic context. Increasing volumes of new credit granted. Reduction of non performing assets as one of the main concerns of the supervisory bodies and the main threat to profitability.

Banco Santander, the only Spanish bank classified as of global systemic importance (G-SIB) by the Financial Stability Board, is under direct supervision of the European Central Bank and operates under the resolution rules of Pillar II in the Banking Union. Additionally, Santander is highly internationalized and its foreign subsidiaries are under local supervisors in each region other than the euro area..

Figure 6: Cost-to-income.



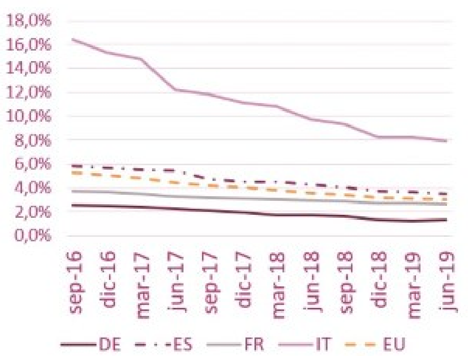
Source: EBA Risk Dashboard Q2 2019

In recent years, the Spanish banking system has undertaken a multitude of adjustments aimed at improving returns and asset quality in a highly competitive environment with falling margins and non-banking players emerging as digital operators (fintech, bigtech) as well as shadow banking which according to the European Systemic Risk Board (ESRB) accounts for 40% of the European Union's financial system after its strong growth in recent years.

In this context, the number of employees has decreased by 32% while the adjustment of branches has done so by 37% (Source: ECB, Eurostat). The most immediate consequence has been an increase in banking concentration, which is around 70% considering the assets of the top 5 entities in Spain, the largest of the four main countries in the euro area (Germany 31%, France 46%, Italy 43%).

Despite this adjustment in the sector and greater banking concentration, price competition remains high. Comparatively speaking, as shown in the graph of recurrence in income (understood as the percentage of operating income reflected by net interest income), it is above the European average and well above the main euro economies, which translates into greater exposure to interest rate movements in an environment of deflationary pressures in which it is necessary to capture income from off-balance sheet asset management and commissions. Moreover, it should be pointed out that not only within the euro zone has an accommodating monetary policy been promoted once again this year, but in the United States or Brazil, their respective central banks have lowered interest rates on several occasions this year, increasing the pressure on net interest income.

Figure 7: NPL ratio.



The strong process of restructuring and banking concentration in Spain seems to be appreciated in terms of efficiency in graph 7, being one of the best countries in the European total and the best compared to the main European countries to a large extent caused by the severe adjustments in staff and branches following the last major financial crisis, standing at 55%. Particularly Santander's figures were 46.91% better than the national average, and ahead of other competitors such as BBVA (A+/ Stable), which stands at 48.7%.

However, the Spanish banking system continues to suffer from a problem of asset quality resulting in high rates of non-performing assets. The highest amount was recorded in 2013, reporting 274,000 million euros and has been reduced intensely to reach 113,000 million in 2018 but, despite this, Graph 8 shows Spain's position above the European average and considerably worse than countries such as France or Germany.

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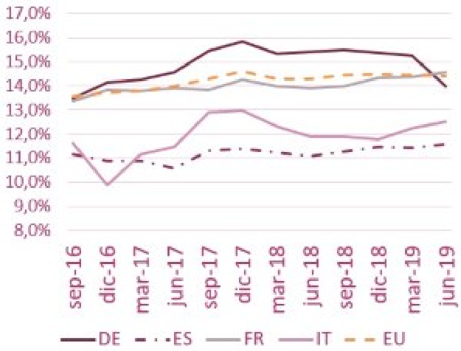
Source: EBA Risk Dashboard Q2 2019

Figure 8: CET1 *fully loaded*.



Source: EBA Risk Dashboard Q2 2019

As a result of the high risk profile of the Spanish banking sector over the last decade, the CET 1 ratio (graph 8) is the worst in European comparison. Despite maintaining leverage levels below those of the surrounding countries, the high risk weightings of its assets erode the CET1 fully loaded.

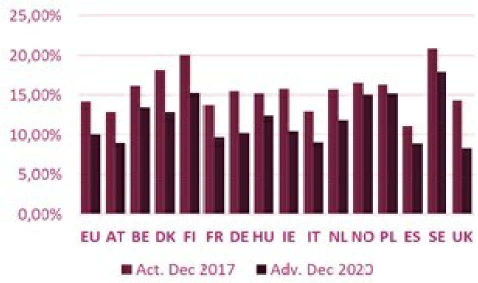
However, the Spanish banking system, starting from a tight situation in terms of falling returns and quality of its assets during the crisis, has been able to decrease their levels of overcapacity and restructure their institutions to be adapted to Basel III and, moreover, is prepared for the future as evidenced by the results of the 2018 stress test carried out by the EBA, which showed the resilience of the Spanish institutions analyzed (Santander, BBVA, Sabadell and Caixabank) in terms of solvency for an adverse scenario, positioning itself as one of the best (impact of -217pb to 2020) despite starting from lower capital levels than the European average.

In the analysis by entities, Banco Santander was the third with the least impact on CET1 in the test (SAN: -254 pb vs EU: -419pb) that justifies the good rating provided by Axesor. The most severely affected in terms of solvency were the German, British and Dutch entities.

	CET1 2017 FL	IFRS 9 adj.	CET1 2020 adv.	Impact	Total impact
Santander	10,84%	23 pb	9,20%	141 pb	164 pb
EU	14,22%	20 pb	10,05%	395 pb	415 pb

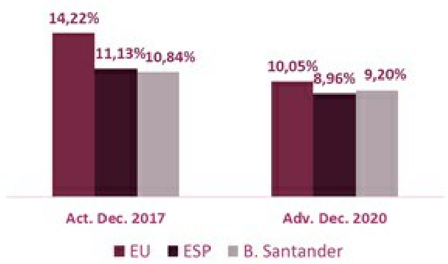
Source: EBA, Axesor

Figure 9: Stress test 2018. CET1 by country.



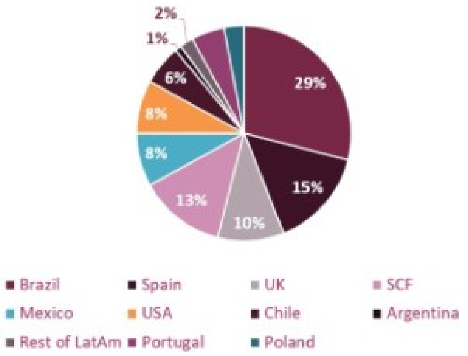
Source: EBA, Axesor

Figure 10: Stress test 2018. CET1 comparison.



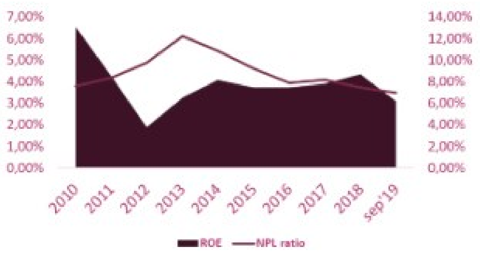
Source: EBA, Axesor

Figure 11: Attributable profit by business area. Sep.19



Source: Santander, Axesor

Figure 12: NPL ratio (left) y RoE (right). Sep.19



Source: Santander, Axesor

3. Financial profile

3.1. Earnings and profitability

Most revenues come from commercial banking, with adequate stability over the cycle that has allowed for the internal capital generation despite the impairment charges during the crisis. High operating margins in emerging markets is the main countercyclical element.

The stability of Santander's revenues throughout the economic cycle is based on its high degree of geographical diversification (balanced distribution of revenues between the Americas and Europe) and its activity mainly aimed at the retail and commercial segments. The recurrence in revenues, despite the significant impairment charges during the crisis, has enabled a high internal generation of capital that along with the high returns of the emerging business has kept the RoE at appropriate levels as shown in Chart 12. This profitability is above the European average thanks largely to its participation in markets whose interest rates do not so severely restrict the ability to generate profits.

In the first nine months of 2019 Santander recorded attributable profit of EUR 4,972 million (-27.7% year-on-year in constant euros). However, this decline compared to the same period of the previous year was affected by the impairment of goodwill in Santander UK amounting to 1,491 million euros or the restructuring costs in Spain of Banco Popular's commercial branch network which were higher than a year earlier (600 million euros compared to 320 million euros in the previous period). Eliminating these non-recurring operations, profits would have been 2% higher year-on-year with an increase in both interest margins (+4.6%) and net fees (+4.3%) in constant euros, consolidating its solid base of recurring revenues.

This growth in recurrent profit adopts different characteristics depending on the geographical area. In this sense, the Americas pushed forward in a general way, with the positive contribution of the US, 14.6% and 19% in gross and net income in constant euros respectively (7.9% and 12% excluding exchange rate effects), or 4.4% and 5.7% corresponding to the same metrics in Mexico in constant euros (6.5% and 7.8% respectively in local currency).

On the other hand, we observed a decline in margins in Europe which, in aggregate levels, fell 1,5% in gross margin and 1,9% in net margin due to the poor perfomance in the UK which was caused by competitive pressure in mortgage margins and the fall in the SVR (Standard Variable Rate). Aditionally its gross and net margins fell 9,8% and 21% respectively in constant euros (9,9% and 21% in local currency). The smaller volumes in Portugal and Poland meant that, despite their positive results, results decreased.

The main contributor in terms of attributable profit continues to be Brazil, with a share that is increasing and that reached 29% group profits thanks both to the increase in activity (which has resulted in higher volumes) and to the more favourable interest rates within the country that allow it to obtain higher yields on the volume of its operations compared to other markets.

Spain continues to be the second most important unit in this respect, highlighting that, despite a decline in the first three quarters of 2019 in net interest and fee income compared to the same period last year, it is managing to reduce its operating costs (7%) thanks to the entire integration and rationalization process following the incorporation of Popular. The United Kingdom continues to lose weight within the group due to market competition and the effects of Brexit, while the United States has advanced strongly in recent years, representing 8% of net attributable profit in the last accounts compared to only 4% in 2017.

The group's goal is to reach a RoTE of between 13% and 15% in the medium term, having ended 2018 at 11.7% and 11.86% at the latest available date (8.33% if impairments due to goodwill or restructuring are included), which places it in an advanced position within the European financial system. Meanwhile, its RoRWA has also advanced in recent years, marking 1.55% at the end of 2018 and 1.63% in the last financial statements published.

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Figure 13: Asset quality. Sep.19

Source: Santander, Axesor

3.2. Solvency

Asset quality

Continuous asset quality improvement. Prudent hedging policy in line with that of its international peers despite the divergence of non performing levels by region and mortgage exposure.

Santander's asset structure is dominated by a highly granular loan portfolio that represents more than 60% of the consolidated balance sheet as of September 2019. At the end of 2018, 62% of loans to customers were secured by collateral, while at the end of 2018, approximately 66% of these secured loans did not exceed a loan to value of 80%

Mortgages were the most category of customer loans, representing a 36% of the total. Despite maintaining a high degree of geographic diversification, by granting mortgages in local currency, 85% of mortgages maintain a loan to value below 80%, which reflects the conservative risk policy of the bank. In the mortgage market, it is worth highlighting possible setbacks in the result of future litigation, mainly in Spain via the European IRPH sentence and in Poland because of multi-currency mortgages.

Our credit rating of A+ / Stable takes into account that the non-performing loan ratio has improved over the last three years excluding Popular's contribution (4.08% vs. 3.38% ex. Popular at December 2017) thanks to the improvement in asset quality linked to the better economic conditions. At the end of 2018, the group's NPLs amounted to €35,692 million (-5.1% with respect to the previous year), while in the first quarters of 2019 it fell again to €34,362 million, with significant progress in Portugal and the United States.

Spain is the region with the highest NPL ratio (above 7%), a situation aggravated with respect to previous years due to the integration of real estate activity within the Spanish segment, changes in the methodology that increase the ratio and the continuous assimilation of Popular's portfolios. However, the group expects to continue disposals of non-performing portfolios in order to offset the higher non-performing loan ratio compared to the national average.

Santander has a prudent hedging policy and comparable to its international peers despite the divergence in NPL levels by region and exposure to the mortgage sector. Coverage ratios in emerging markets and the US were very high. In the latter, due to the high exposure to consumer finance.

Figure 14: Capital composition.

Source: Santander, Axesor

Capitalization

Adequate levels of capital in line with its activity. Internal generation of capital based on revenue stability. Proven effectiveness in accessing capital markets following the acquisition of Popular and the purchase and sale of minority acquisitions.

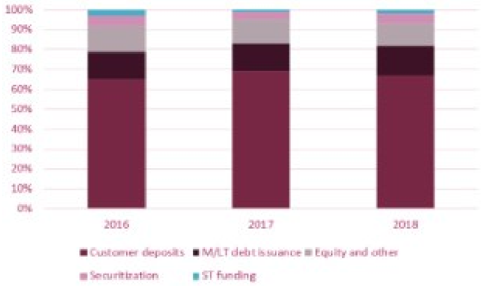
Despite having slightly lower capitalization than its European counterparts, the low risk profile associated with its activity means that Santander's capital levels are adequate and exceed the regulatory requirements faced by the entity (CET1 fully loaded of 11.30% in September 2019 vs. SREP 2018 requirements of 9.7%).

The evolution of CET1 shows that, although it remained at the same level in the last available financial statements compared to the end of 2018, this stability was maintained in spite of the impact of the regulation, mainly through the adoption of IFRS16 on leases and the revision of internal models (TRIM). This was offset by organic capital generation and small improvements through the sale of its stake in Prisma in Argentina and increasing the share in Mexico. In addition, in October the group sold its subsidiary in Puerto Rico which, according to the entity, could lead to an increase of several basis points in the capital ratio CET1.

3.3. Funding and liquidity

Sound deposit base as the main source of funding. Adequate relationship between loans and deposits. Moderate refinancing risk due to deferral of maturities. Recurrent appeal to the markets to fulfill the TLAC levels.

Figure 15: Funding.



Source: Santander, Axesor

Santander has a sound deposit base (€814,285 million in September 2019). The ratio between loans and deposits (LTD) remained stable at 112% at that time, showing the balance between assets and liabilities. The bank monitors funding and liquidity levels, but requires each region to cover their own requirements. This policy provides protection against sovereign risks in issues that are limited to particular regions.

Since January 2019, the liquidity coverage ratio (LCR) has been required to be above 100% of net outflows, an obligation that Santander complies with 155% and which has a positive influence on the credit rating. It also complies with the net stable funding ratio (NFSR), which, although, does not come into force until 2021, Santander, with 113% of the required stable funding, complies, once again exceeding the 100% obligation and consolidating long-term liquidity stability.

Santander maintains a strategy based on multiple entry points (MPE) in which both the parent company and its subsidiaries must comply with the requirements associated with the Total Loss-Absorbing Capacity (TLAC) that became effective in January 2019 and Minimum Required Eligible Liabilities (MREL). In 2018, the bank issued MREL/TLAC-eligible bonds worth 13,544 million euros, of which 10,284 million euros were senior non-preferred, 1,500 million euros to AT1 and 1,760 million euros to subordinated debt. In this line, during the first 9 months of this year, 2,599 million eligible for TLAC were reissued, of which 1,531 million euros were senior non-preferred debt and 1,068 million were preferred debt.

4. Adjustments

Santander is under the Bank Recovery and Resolution Directive and Single Resolution Mechanism. The directive requires to participate in credit losses (bail-in) in the event of non-viability of the bank. Therefore, it is considered unlikely to receive previous support under that scenario.

5. Environmental, Social & Governance

The rating process takes into account the commitment to the ESG (Environmental, Social and Governance) principles and on this matter Santander stands out for having launched in 2019 its last Responsible Banking Plan which shows a very ambitious programme with environmental, equality and social inclusion objectives, following the work of recent years which, according to the DJSI (Dow Jones Sustainability Index) placed it as the bank with the best performance in sustainable terms of the entire world banking industry in the last two years.

As part of these Responsible Banking commitments for the period 2019-2025, it is to provide 120,000 million euros of green funding in that period (220,000 million between 2019 and 2030), eliminate unnecessary single-use plastics in all the group's buildings, increase the consumption of renewable energies to reach 100% in those countries where it is possible to certify their origin and increase equality and parity in management positions.

At the end of the third quarter, on 1 October, it issued its first green bond worth 1,000 million under its global sustainable emissions strategy to fund solar and wind energy projects. This is a further step in the activity carried out in 2018 in which it participated in green emissions reaching 730 million euros and in syndicated ESG loans valued at 2,017 million euros. Santander Asset Management also launched a new range of sustainable funds that combine financial and non-financial criteria.

At the institutional level, it is one of the founding members of the Responsible Banking Principles signed at the last climate summit in New York, it is one of the 30 signatory banks of the Principles to announce a Collective Climate Action Commitment setting targets to align its business with the United Nations Sustainable Development Goals and the Paris Agreement on climate change and, within the corporate structure, the Responsible Banking, Sustainability and Culture Commission has been created to comply with the strategy formulated to meet their objectives in terms of sustainability.

From Axesor we consider these aspects very important not only as a way to help the international community meet the objectives of Agenda 2030 for Sustainable Development, but we also believe that the transformation towards a new banking model will improve the solvency of financial institutions, with the resulting strengthening of the financial system.

6. Annexes

6.1. Scorecard

BANCO SANTANDER, S.A.	sep.19		A+
		Weight	Subtotal
MACRO&SECTORIAL ENVIRONMENT	**Strong**	**15,0%**	**0,47**
Sovereign risk		**10%**	
Sovereign rating			
Sector and regulation		**5%**	
Corruption perception index			
Legal System			
Concentration			
COMPANY PROFILE	**Very strong -**	**45,0%**	**1,01**
Business model		**12%**	
Business model			
Positioning		**15%**	
Market share			
Asset size			
Peer Analysis			
Management and strategy		**18%**	
Governance			
Management quality			
Execution			
Market risk			
Growth			
Brand and reputation			
FINANCIAL PROFILE	**Strong -**	**40,0%**	**1,82**
Earnings&Profitability		**10%**	
ROA			
ROE			
Cost to income			
Pre-Imp. Operating Profit / Avg. Total Assets			
Interest margin/Avg. Total Assets			
Solvency		**15%**	
Equity/total assets			
CET1			
Non performing loans/gross loans			
NPL/Equity + reserves			
Total loan loss reserves/total problem loans			
Off balance sheet items/total assets			
Funding&Liquidity		**15%**	
Loan to deposits			
Interbank ratio			
Liquidity Coverage Ratio			
Net Stable Funding Ratio			

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6.2. Peer comparison

FINANCIALS (€ mn)	BANCO SANTANDER, S.A.		BBVA, S.A.		UNICREDIT, S.p.A		DEUTSCHE BANK, A.G.	
	2018	sep.19	2018	sep.19	2018	sep.19	2018	sep.19
PROFITABILITY								
Net profit	9.315	4.972	6.784	3.667	3.892	2.165	-52	-4.116
ROA	0,64%	0,45%	0,99%	0,71%	0,47%	0,55%	0,00%	-0,27%
ROE	8,70%	6,14%	12,78%	8,90%	6,97%	7,47%	-0,08%	-7,05%
EFFICIENCY								
Cost to income (ordinary)	47,04%	46,91%	49,28%	48,66%	54,20%	53,00%	92,70%	104,90%
ASSET QUALITY								
Cost of risk	1,00%	1,00%	1,01%	1,01%	0,58%	0,50%	0,20%	0,12%
NPL ratio	3,73%	3,47%	3,94%	3,90%	7,67%	5,70%	2,25%	n.a.
Loan loss reserves/NPL	67,41%	67,26%	73,11%	75,42%	60,98%	61,00%	43,60%	n.a.
LIQUIDITY								
Loan to Deposit	113%	112%	115%	116%	104%	110%	72%	74%
SOLVENCY								
CET1 fully loaded	11,30%	11,30%	11,30%	11,60%	12,07%	12,60%	13,60%	13,40%
Solvency ratio	14,77%	14,68%	15,70%	16,20%	15,80%	17,11%	17,50%	17,40%
RWA density	40,59%	40,42%	52,20%	50,75%	44,52%	44,93%	25,99%	22,92%
Leverage	7,36%	7,15%	7,81%	8,04%	6,72%	6,96%	4,64%	3,89%
MARKET VALUATION								
P/BV	0,94	0,66	0,56	0,55	0,40	0,39	0,22	0,22

**Annualized intermediate data*

Source: Companies, Axesor

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