FitchRatings

Banks
Universal Commercial Banks
Spain

Banco Santander, S.A.

Update

Ratings

Foreign Currency

Long-Term IDR	A-
Short-Term IDR	F2
Derivative Counterparty Rating	A(dcr)
Viability Rating	a-
Support Rating	5
Support Rating Floor	NF

Sovereign Risk

Long-Term Foreign-Currency IDR	A-
Country Ceiling	AAA

Outlooks

Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Foreign-Currency IDR	Stable

Applicable Criteria

Bank Rating Criteria (November 2021)

Related Research

Global Economic Outlook–December 2021

Fitch Ratings 2022 Outlook: Western European Banks (December 2021)

Large European Banks Quarterly Credit Tracker - December 2021

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Key Rating Drivers

Geographic Diversification: Banco Santander, S.A.'s (Santander) ratings reflect Fitch Ratings' view that the bank's international footprint is a key business model strength, despite exposure to higher-risk emerging markets. We expect that the group's rigorous approach to risk control will mitigate asset quality pressure from the pandemic, and that the group will be able to keep its capital ratios, which are at the lower end of peers but commensurate with its ratings, helped by resilient earnings-generating capacity through economic cycles.

Reaching Pre-Pandemic Earnings Levels: Higher business activity, lower loan impairment charges (LICs), and good cost management despite inflationary pressures (particularly in Latin America and the US) supported a recovery in earnings in 9M21. Santander continued delivering cost cuts driven by the cost-efficiency programmes in Europe. We expect Santander's pre-impairment earnings generation will remain strong and resilient (pre-impairment operating profit/risk-weighted assets (RWAs) of 4.3% in 9M21 compared with a 10-year average of 4.5%).

Asset Quality a Relative Weakness: Asset quality remains a relative weakness compared with some European peers. The group's exposure to emerging markets inherently results in above averages impaired loan ratio and LICs, which are mitigated by higher net interest margins. However, loan performance has been resilient to date.

Resilient Loan Performance: The group's impaired loan ratio remained stable at 3.4% at end-September 2021, with a coverage of 75%, which compares well with peers and provides a cushion against downside pressures. Asset quality in Spain is comparatively worse than in other regions and remains at risk, particularly in the most vulnerable SME segment.

Adequate Capital: We expect Santander will continue to operate with a common equity Tier 1 (CET1) ratio in the upper range of its 11%-12% target (11.85% CET1 ratio at end-September 2021) while economic uncertainty persists. The CET1 ratio should be maintained within the target range in the medium term despite the group resuming capital distribution. Our assessment of capital also considers that the group keeps its foreign subsidiaries well capitalised.

Diversified Funding; Good Liquidity: The group's funding and liquidity is stable, supported by its large deposit franchises in core markets. The group's approach requires foreign subsidiaries to be locally funded. The group also benefits from good liquidity and deep global capital markets access for wholesale funding, both at the parent bank and at the subsidiaries.

Rating Sensitivities

Sovereign Rating: An upgrade would be contingent on an upgrade of Spain's sovereign rating. This would have to be accompanied by stronger capital ratios and improved asset quality. Equally important would be the ability to preserve the group's earnings resilience, which means maintaining the sound earnings performance at the main international subsidiaries.

Capital Erosion: Santander's ratings would be pressured if its CET1 ratio declined below 11% without a credible plan to rebuild it rapidly. A significant erosion of its earnings resilience over time (i.e. operating profit/RWAs below 2% on a sustained basis) would also likely result in a negative rating action. Ratings remain sensitive to a downgrade of Spain or a significant weakening in the operating environments in its core markets.

Issuer Ratings (Main Issuing Entities)

Rating Level	Santander Consumer Finance, S.A.	Santander Totta SGPS, S.A.	Santander UK Group Holdings plc	Santander Holdings USA, Inc.	Banco Santander Mexico,S.A. , Institucion de Banca Multiple, Grupo Financiero Santander Mexico
Long-Term IDR	A-/Stable	BBB+/Stable	A/Stable	BBB+/Stable	BBB+/Stable
Short-Term IDR	F2	F2	F1	F2	F2
Viability Rating	a-	bbb-	a	bb+	bbb-
Support	a-*	2	2	2	bbb+*

* Shareholder Support Rating
Source: Fitch Ratings

The Long-and Short-Term Issuer Default Rating (IDRs) of Santander Totta SGPS, S.A. (Totta), Santander Holdings USA, Inc. (SAN US) and Banco Santander Mexico, S.A., Institucion de Banca Multiple, Grupo Financiero Santander Mexico (SAN Mexico) are based on institutional support from Santander. The Long-Term IDRs of Santander UK Group Holdings plc (SGH) and Santander Consumer Finance, S.A. (SCF) are driven by its standalone credit profile, reflected in its Viability Rating (VR).

SCF's IDRs are further underpinned by potential shareholder support. We believe Santander has strong incentives to provide support to fully-owned SCF as we consider it a core and integral part of the group, given that it manages most of Santander's consumer finance operations in Europe. SCF is also part of Santander's resolution group.

The Long-Term IDRs of Totta, SAN US and SAN Mexico are notched down once from Santander's to reflect Fitch's view that their activities are strategically important to the group. We also consider the strong ability (given the relative size to the group is unlikely to represent a constraint) and strong propensity of parent support. Also, the performance of the banks is supported by strong synergies and integration with the parent, as well as a wide range of shared risk-management and operational practices.

SGH's ratings are assessed on a consolidated basis. SGH acts as the holding company for the Santander group's UK entities, and its VR is equalised with that of the main operating subsidiary reflecting SGH's role in the group and low holding company double leverage. The VR is based on the group's conservative risk appetite, adequate capitalisation and stable funding and liquidity profile, as well as a less diversified business mix than larger UK peers, weakening the group's profitability.

Debt Ratings

The long-term senior preferred debt of Santander and that of its issuing vehicle (Santander International Products PLC), deposit ratings and the Derivative Counterparty Rating (DCR) are rated one notch above the group's Long-Term IDR. This is to reflect the protection that accrues from buffers of junior and senior non-preferred (SNP) debt, which exceeds 10% of RWAs (after deconsolidating subsidiaries in different resolution groups, as Santander has a clear multiple-point-of-entry resolution strategy) on a sustained basis. We expect Santander to continue to issue a significant volume of SNP and junior debt to maintain its minimum requirement for own funds and eligible liabilities (MREL) and subordination requirements.

Debt Rating Classes

Debt Level	Rating
Banco Santander, S.A.	
Deposits	A/F1
Senior preferred	A/F1
Senior non-preferred	A-
Tier 2 debt	BBB
Legacy hybrid preferred notes	BB
Additional Tier 1 notes	BB+

Source: Fitch Ratings

The short-term senior preferred debt and deposit ratings of 'F1' benefit from equivalent long-term senior debt and deposit ratings being notched up to reflect lower credit risks.

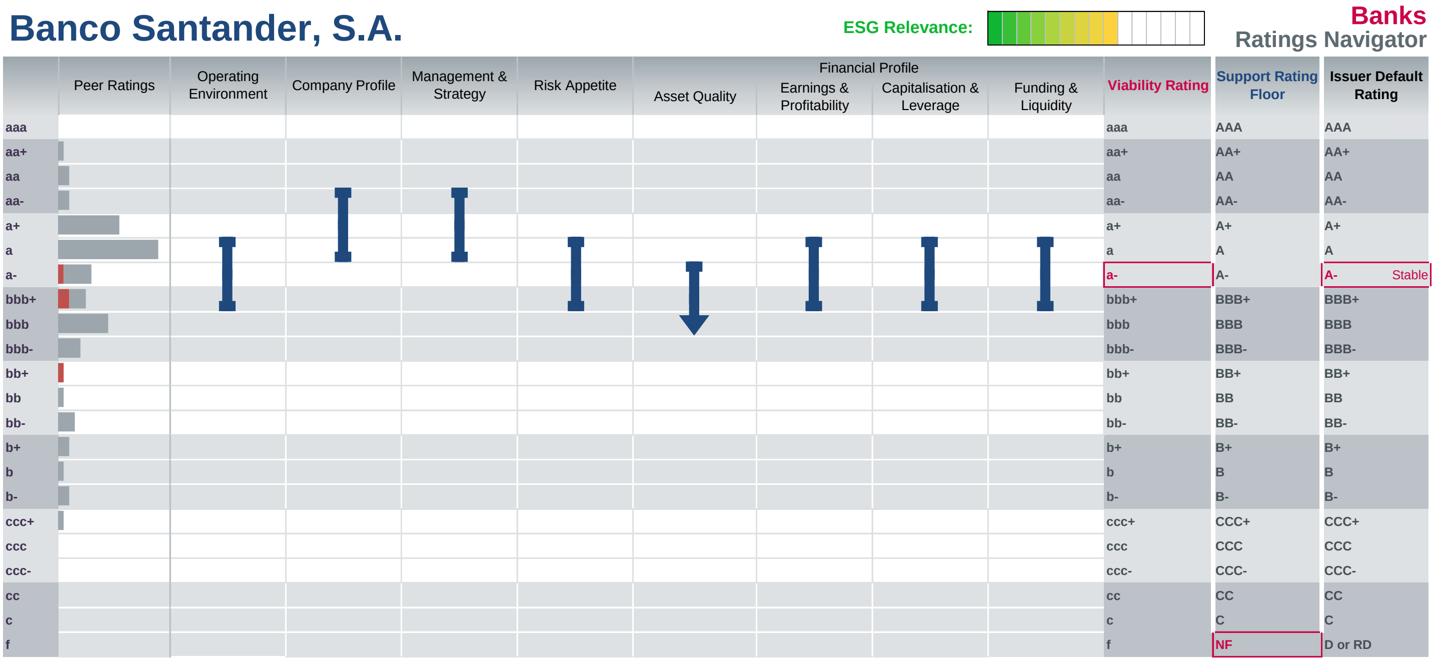
Santander's SNP notes are rated at the same level as the bank's Long-Term IDR, reflecting Fitch's view that the default risk of the notes is equivalent to that of the IDR and that SNP obligations are viewed as having average recovery prospects.

Subordinated debt issued by Santander is notched down from its VR in accordance with our assessment of each instrument's non-performance and relative loss-severity risk profiles. We rate the instruments two notches below the group's VR for loss severity as we expect recoveries to be poor for this type of debt in the event of default/non-performance of the bank.

We rate additional Tier 1 (AT1) debt with fully discretionary coupon payment four notches below the group's VR. This comprises two notches each for loss-severity and for non-performance risk. Our assessment is based on the bank operating with a CET1 ratio above maximum distributable amount thresholds and our expectation that this will continue. The assessment is also underpinned by the group's record of strong pre-provision earnings generation throughout the cycle and sound leverage ratio.

Legacy preferred shares are rated five notches below the bank's VR to reflect higher-than-average loss severity risk of these securities (two notches from the VR), as well as a high risk of non-performance (an additional three notches) due to a profit test.

Ratings Navigator



Significant Changes

Improved Operating Environment but Short-Term Risks Persist

The operating environment for Santander has benefited from an economic recovery across different regions, particularly in developed economies, despite the emergence of short-term risks (i.e. supply chain constraints, inflationary pressures and renewed mobility restrictions). Nevertheless, global expansion in 2021 will still be strong, driven by reopening dynamics and continued policy support. As a result, the outlooks for the operating environments of key markets (Spain, Germany, the US and the UK) for Santander are back to stable.

Fitch expects the eurozone's GDP to grow 5% and 4.5% in 2021 and 2022, respectively. The risk of a sharp deterioration in asset quality related to the pandemic has largely abated as the western European economies emerge from the crisis, given the material government support measures. Next Generation EU funds could also boost medium-term growth potential. Our recent downward revision to 2021 growth forecasts for the US has reflected disruptions to industrial production in recent months related to semiconductor and component shortages. As a result, we expect US GDP growth in 2021 to be 5.7% (down from 6.2%).

The outlooks of the operating environment score for Brazil and Mexico remain on negative. We have lowered our GDP growth projections in emerging markets, particularly in Brazil where we forecast GDP to grow 0.5% (from the previous 2.0% estimate) following a sharp tightening of financial conditions.

Resilient 9M21 results

Santander reported another solid quarter in 3Q21 supported by the recovery of activity in all regions, particularly the UK and the US. This translated into good volume growth at the group level, with loans and deposits increasing at 4% and 6% yoy, respectively. Earnings were also supported by lower LICs and good cost management despite inflationary pressures (particularly in Latin America and the US). The group continued delivering cost reductions (-1% yoy, in constant euros) driven by the cost-efficiency programmes in Europe, in particular Portugal, Spain and the UK.

Bar Chart Legend

Vertical bars – VR range of Rating Factor
Bar Colors – Influence on final VR

- Higher influence
- Moderate influence
- Lower influence

Bar Arrows – Rating Factor Outlook

- ⇧ Positive
- ⇩ Negative
- ⇳ Evolving
- ▫ Stable

We expect the economic recovery to continue supporting business and revenue growth in the coming quarters, although pressure will continue in Europe. We expect Santander's pre-impairment earnings generation will remain strong and resilient (pre-impairment operating profit/RWAs of 4.3% in 9M21 compared with a 10-year average of 4.5%).

In 3Q21, Santander revised its LICs guidance to about 80bp of loans for 2021 from 100bp guided in 2Q21, due to better economic prospects and asset-quality trends. LICs were at 90bp in 9M21, and the impaired loan ratio was stable at 3.2% at end-September 2021, with a coverage of 74%, which compares well with peers and provides some cushion against downside pressures. Santander could release between EUR0.7 billion and EUR1 billion pandemic-related provisions in 4Q21, of a total overlay of EUR2.5 billion, based on better economic prospects.

Despite the announced pay-out for 2021 of 40% to be distributed equally between cash dividends and share buybacks, we expect the bank to operate in the upper range of its 11%-12% target until uncertainties on the impact of the pandemic on asset quality abate.

Summary Financials and Key Ratios

	30 Sep 2021		31 Dec 2020	31 Dec 2019	31 Dec 2018
	9 Months - 3rd Quarter	9 Months - 3rd Quarter	Year End	Year End	Year End
	USDm	EURm	EURm	EURm	EURm
	Unaudited	Unaudited	Audited - Unqualified	Audited - Unqualified	Audited - Unqualified
Summary Income Statement					
Net interest and dividend income	29,015	25,058.0	32,385.0	35,816.0	34,711.0
Net fees and commissions	9,043	7,810.0	10,015.0	11,779.0	11,485.0
Other operating income	2,036	1,758.0	1,879.0	1,634.0	4,228.0
Total operating income	40,094	34,626.0	44,279.0	49,229.0	50,424.0
Operating costs	18,269	15,778.0	21,130.0	23,280.0	24,779.0
Pre-impairment operating profit	21,824	18,848.0	23,149.0	25,949.0	25,645.0
Loan and other impairment charges	6,947	6,000.0	12,382.0	9,352.0	8,986.0
Operating profit	14,877	12,848.0	10,767.0	16,597.0	16,659.0
Other non-operating items (net)	-2,469	-2,132.0	-12,843.0	-4,054.0	-2,391.0
Tax	4,313	3,725.0	5,632.0	4,427.0	4,886.0
Net income	8,095	6,991.0	-7,708.0	8,116.0	9,382.0
Summary Balance Sheet					
Assets					
Gross loans	1,090,443	941,739.0	904,092.0	918,757.0	873,918.0
- of which impaired	36,623	31,629.0	30,815.0	32,559.0	34,218.0
Loan loss allowances	27,542	23,786.0	23,595.0	22,242.0	23,307.0
Net loans	1,062,901	917,953.0	880,497.0	896,515.0	850,611.0
Interbank	97,472	84,180.0	16,101.0	23,475.0	40,633.0
Derivatives	65,595	56,650.0	77,442.0	72,315.0	65,634.0
Other securities and earning assets	274,321	236,912.0	292,764.0	323,242.0	290,853.0
Total earning assets	1,500,289	1,295,695.0	1,266,804.0	1,315,547.0	1,247,731.0
Cash and due from banks	221,200	191,035.0	153,839.0	101,067.0	113,663.0
Other assets	106,023	91,565.0	87,607.0	106,081.0	97,877.0
Total assets	1,827,513	1,578,295.0	1,508,250.0	1,522,695.0	1,459,271.0
Liabilities					
Customer deposits	1,000,899	864,406.0	814,836.0	785,454.0	747,736.0
Interbank and other short-term funding	273,270	236,004.0	219,153.0	200,517.0	175,368.0
Other long-term funding	282,856	244,283.0	223,208.0	263,746.0	279,553.0
Trading liabilities and derivatives	70,990	61,309.0	92,762.0	87,340.0	79,763.0
Total funding and derivatives	1,628,014	1,406,002.0	1,349,959.0	1,337,057.0	1,282,420.0
Other liabilities	88,775	76,669.0	59,348.0	66,949.0	59,428.0
Preference shares and hybrid capital	n.a.	n.a.	7,784.0	8,176.0	10,296.0
Total equity	110,723	95,624.0	91,159.0	110,513.0	107,127.0
Total liabilities and equity	1,827,513	1,578,295.0	1,508,250.0	1,522,695.0	1,459,271.0
Exchange rate		USD1 = EUR0.86363	USD1 = EUR0.821963	USD1 = EUR0.89015	USD1 = EUR0.873057

Source: Fitch Ratings, Fitch Solutions, Santander

Summary Financials and Key Ratios

	30 Sep 2021	31 Dec 2020	31 Dec 2019	31 Dec 2018
Ratios (annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	3.0	1.9	2.7	2.8
Net interest income/average earning assets	2.6	2.5	2.8	2.8
Non-interest expense/gross revenue	46.0	47.6	47.6	49.9
Net income/average equity	10.0	-7.9	7.4	8.9
Asset quality				
Impaired loans ratio	3.4	3.4	3.5	3.9
Growth in gross loans	4.2	-1.6	5.1	6.0
Loan loss allowances/impaired loans	75.2	76.6	68.3	68.1
Loan impairment charges/average gross loans	0.9	1.4	1.1	1.1
Capitalisation				
Common equity Tier 1 ratio	12.3	12.3	11.7	11.5
Fully loaded common equity Tier 1 ratio	11.9	11.9	11.7	11.3
Tangible common equity/tangible assets	4.3	4.2	5.5	5.2
Basel leverage ratio	5.2	5.3	5.1	5.2
Net impaired loans/common equity Tier 1	11.1	10.4	14.6	16.1
Funding and liquidity				
Gross loans/customer deposits	109.0	111.0	117.0	116.9
Liquidity coverage ratio	164.0	165.0	147.0	158.0
Customer deposits / total non-equity funding	64.3	63.4	61.6	60.8
Net stable funding ratio	n.a.	120.0	112.0	114.0

Source: Fitch Ratings, Fitch Solutions, Santander

Sovereign Support Assessment

Support Rating Floor			Value
Typical D-SIB SRF for sovereign's rating level (assuming high propensity)			
Actual country D-SIB SRF			NF
Support Rating Floor:			**NF**
Support Factors	Positive	Neutral	Negative
Sovereign ability to support system			
Size of banking system relative to economy			✓
Size of potential problem		✓	
Structure of banking system		✓	
Liability structure of banking system		✓	
Sovereign financial flexibility (for rating level)		✓	
Sovereign propensity to support system			
Resolution legislation with senior debt bail-in			✓
Track record of banking sector support		✓	
Government statements of support		✓	
Sovereign propensity to support bank			
Systemic importance		✓	
Liability structure of bank		✓	
Ownership		✓	
Specifics of bank failure		✓	

Sovereign Support not Reliable

Santander's Support Rating of '5' and Support Rating Floor of 'No Floor' reflect Fitch's belief that senior creditors of the banks can no longer rely on receiving full extraordinary support from the sovereign in the event that Santander becomes non-viable. The EU's Bank Recovery and Resolution Directive and the Single Resolution Mechanism for eurozone banks provide a framework for resolving banks that is likely to require senior creditors participating in losses, instead of, or ahead of, a bank receiving sovereign support.

Environmental, Social and Governance Considerations

FitchRatings **Banco Santander, S.A.**

Banks
Ratings Navigator

Credit-Relevant ESG Derivation

Banco Santander, S.A. has 5 ESG potential rating drivers

- Banco Santander, S.A. has exposure to compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security) but this has very low impact on the rating.
- Governance is minimally relevant to the rating and is not currently a driver.

			Overall ESG Scale
key driver	0	issues	5
driver	0	issues	4
potential driver	5	issues	3
not a rating driver	4	issues	2
	5	issues	1

Environmental (E)

General Issues	E Score	Sector-Specific Issues	Reference	E Scale
GHG Emissions & Air Quality	1	n.a.	n.a.	5
Energy Management	1	n.a.	n.a.	4
Water & Wastewater Management	1	n.a.	n.a.	3
Waste & Hazardous Materials Management; Ecological Impacts	1	n.a.	n.a.	2
Exposure to Environmental Impacts	2	Impact of extreme weather events on assets and/or operations and corresponding risk appetite & management; catastrophe risk; credit concentrations	Company Profile; Management & Strategy; Risk Appetite; Asset Quality	1

Social (S)

General Issues	S Score	Sector-Specific Issues	Reference	S Scale
Human Rights, Community Relations, Access & Affordability	2	Services for underbanked and underserved communities: SME and community development programs; financial literacy programs	Company Profile; Management & Strategy; Risk Appetite	5
Customer Welfare - Fair Messaging, Privacy & Data Security	3	Compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security)	Operating Environment; Company Profile; Management & Strategy; Risk Appetite	4
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Company Profile; Management & Strategy	3
Employee Wellbeing	1	n.a.	n.a.	2
Exposure to Social Impacts	2	Shift in social or consumer preferences as a result of an institution's social positions, or social and/or political disapproval of core banking practices	Company Profile; Financial Profile	1

Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference	G Scale
Management Strategy	3	Operational implementation of strategy	Management & Strategy	5
Governance Structure	3	Board independence and effectiveness; ownership concentration; protection of creditor/stakeholder rights; legal /compliance risks; business continuity; key person risk; related party transactions	Management & Strategy; Earnings & Profitability; Capitalisation & Leverage	4
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Company Profile	3
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Management & Strategy	2
				1

How to Read This Page
ESG scores range from 1 to 5 based on a 15-level color gradation. Red (5) is most relevant and green (1) is least relevant.

The Environmental (E), Social (S) and Governance (G) tables break out the individual components of the scale. The right-hand box shows the aggregate E, S, or G score. General Issues are relevant across all markets with Sector-Specific Issues unique to a particular industry group. Scores are assigned to each sector-specific issue. These scores signify the credit-relevance of the sector-specific issues to the issuing entity's overall credit rating. The Reference box highlights the factor(s) within which the corresponding ESG issues are captured in Fitch's credit analysis.

The Credit-Relevant ESG Derivation table shows the overall ESG score. This score signifies the credit relevance of combined E, S and G issues to the entity's credit rating. The three columns to the left of the overall ESG score summarize the issuing entity's sub-component ESG scores. The box on the far left identifies some of the main ESG issues that are drivers or potential drivers of the issuing entity's credit rating (corresponding with scores of 3, 4 or 5) and provides a brief explanation for the score.

Classification of ESG issues has been developed from Fitch's sector ratings criteria. The General Issues and Sector-Specific Issues draw on the classification standards published by the United Nations Principles for Responsible Investing (PRI) and the Sustainability Accounting Standards Board (SASB).

Sector references in the scale definitions below refer to Sector as displayed in the Sector Details box on page 1 of the navigator.

CREDIT-RELEVANT ESG SCALE

How relevant are E, S and G issues to the overall credit rating?

5	Highly relevant, a key rating driver that has a significant impact on the rating on an individual basis. Equivalent to "higher" relative importance within Navigator.
4	Relevant to rating, not a key rating driver but has an impact on the rating in combination with other factors. Equivalent to "moderate" relative importance within Navigator.
3	Minimally relevant to rating, either very low impact or actively managed in a way that results in no impact on the entity rating. Equivalent to "lower" relative importance within Navigator.
2	Irrelevant to the entity rating but relevant to the sector.
1	Irrelevant to the entity rating and irrelevant to the sector.

The highest level of ESG credit relevance, is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on Santander, either due to their nature or to the way in which they are being managed by Santander. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

The ratings above were solicited and assigned or maintained at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

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