FitchRatings

Banks
Universal Commercial Banks
Spain

Banco Santander, S.A.

Update

Key Rating Drivers

Geographic Diversification: Banco Santander, S.A.'s (Santander) ratings reflect Fitch Ratings' view that its international footprint is a key franchise and business-model strength, despite exposure to higher-risk emerging markets.

The ratings also reflect our expectation that the group's rigorous approach to risk control will mitigate asset quality pressures from the current uncertain operating environment, and that Santander will be able to maintain capital ratios, which are at the lower end of European peers' but commensurate with its ratings, helped by the group's resilient earnings-generation capacity through economic cycles.

Diversified Retail Franchise: Santander benefits from a broad and balanced geographic and business diversification, with solid retail banking franchises in several European and Latin American countries and, to a lesser extent, in the consumer finance segment in the US. This results in good pricing power and access to large, stable deposit bases. Combined with Santander's experience over several economic cycles in different markets, this has enabled it to manage periods of stress relatively well, including the economic fallout from the pandemic.

Wide Margins, Good Cost Efficiency: The wide margins in its emerging-market activities and a cost control-oriented culture (with a cost to income ratio consistently below 50% since 2007) provides an important first line of defence against periods of stress. For this reason, we believe Santander has rating headroom to afford second-order effects from the economic slowdown and inflation pressures that have emerged from the Russia/Ukraine conflict.

Asset Quality Is a Relative Weakness: Asset quality remains a weakness compared with some European peers. Exposure to emerging markets inherently results in a high impaired loan ratio (3.2% at end-September 2022) and loan-impairment charges (LICs) by European standards, although these are mitigated by higher net interest margins.

Loan performance has proved resilient so far owing to economic recovery and government support measures (particularly in Spain). We expect asset quality to modestly weaken over the next two years, with add-on risks to borrowers from higher inflation and borrowing costs.

Earnings Rebound to Remain: We anticipate most of the earnings rebound in 2021 will be maintained over the next two years despite the uncertain operating environment. Santander is well-placed to benefit from higher interest rates in the UK, Poland, the US and the eurozone. This should offset slower loan growth than expected. Fee income growth should continue to support revenues despite slowing business volumes. Inflation pressures will make cost-control challenging, but Santander should meet its medium-term cost-to-income ratio target of c.40%.

Adequate Capitalisation: We expect Santander will continue to operate with a fully loaded common equity Tier 1 (CET1) ratio at or above 12% in 2022 (12.1% at end-September 2022), despite Santander's capital-distribution plans. Our assessment of capital also considers the good capitalisation of foreign subsidiaries, the group's strong internal capital generation and proven access to equity markets.

Diversified Funding; Good Liquidity: We believe Santander's funding and liquidity management is good and benefits from large and stable deposit franchises in the core markets, and deep global capital market access both at the parent bank and at subsidiaries. Its approach requires foreign subsidiaries to be locally funded. Liquidity coverage (169%) and net stable funding (121%) ratios were sound at end-September 2022.

Ratings

Foreign Currency	
Long-Term IDR	A-
Short-Term IDR	F2
Derivative Counterparty Rating	A(dcr)
Viability Rating	a-
Government Support Rating	ns
Sovereign Risk	
Long-Term Foreign- and Local-Currency IDRs	A-
Country Ceiling	AAA
Outlooks	
Long-Term Foreign-Currency IDR	Stable
Sovereign Long-Term Foreign- and Local-Currency IDRs	Stable

Applicable Criteria

Bank Rating Criteria (September 2022)

Related Research

Spain's Support for Mortgage Borrowers Is Neutral for Bank Asset Quality (Nov 2022)

Global Economic Outlook (September 2022)

Large European Banks Quarterly Credit Tracker (September 2022)

Spanish Bank Levy Would Add Risks to the Sector (July 2022)

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Rating Sensitivities

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade:

Santander's ratings would come under pressure if its CET1 ratio declines sustainably below 12% without a credible plan to rebuild it in the short-term. In addition, a meaningful erosion of the bank's earnings resilience (i.e. operating profit/RWAs below 2% on a sustained basis) would likely result in a negative rating action. Santander's ratings remain sensitive to a downgrade of Spain (A-/Stable) or to the group's current operating environment score (a-), the latter being particularly sensitive to the economic and banking prospects of Santander's core markets.

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade:

An upgrade would be contingent on an upgrade of Spain's sovereign rating, stronger capital ratios (CET1 ratio sustainably above 14%) and better asset-quality metrics – with an impaired loan ratio sustainably below 2%. 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.

Other Debt Rating and Issuer Ratings

Rating level	Rating
Deposits	A/F1
Senior preferred	A/F1
Senior non-preferred	A-
Subordinated debt	BBB
Additional Tier 1 notes	BB+
Legacy preferred shares	BB

Source: Fitch Ratings

Santander's senior non-preferred notes are rated at the same level as the bank's Long-Term Issuer Default Rating (IDR), reflecting Fitch's view that the default risk of the notes is equivalent to that of the IDR and that senior non-preferred obligations are viewed as having average recovery prospects.

Santander's long-term senior preferred debt and that of its issuing vehicle (Santander International Products PLC), deposit ratings and the DCR are rated one notch above Santander's Long-Term IDR to reflect the protection that accrues from buffers of junior and senior non-preferred debt, which exceed 10% of RWAs (after deconsolidating subsidiaries that are in different resolution groups, as Santander has a clear multiple-point-of-entry resolution strategy) on a sustained basis.

The short-term senior preferred debt and deposit ratings of 'F1' benefit from the fact that equivalent long-term senior debt and deposit ratings are notched up from the Long-Term IDR to reflect lower credit risks.

Subordinated debt issued by Santander is notched down from its Viability Rating (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 in case of default/non-performance of the bank.

We rate additional Basel III Tier 1 (AT1) debt with fully discretionary coupon payment four notches below the group's VR. This corresponds to two notches for loss-severity and two notches for non-performance risk. Our assessment is based on the bank operating with a CET1 ratio that is above maximum distributable amount thresholds and our expectation that this will continue. Our assessment is also underpinned by the group's track 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 loss severity risk of these securities when compared with average recoveries (two notches from the VR), as well as high risk of non-performance (an additional three notches) due to a profit test.

Issuer Ratings (Main Subsidiaries)

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-
Shareholder Support Rating	a-	bbb+	bbb+	bbb+	bbb+

* Shareholder Support Rating
Source: Fitch Ratings

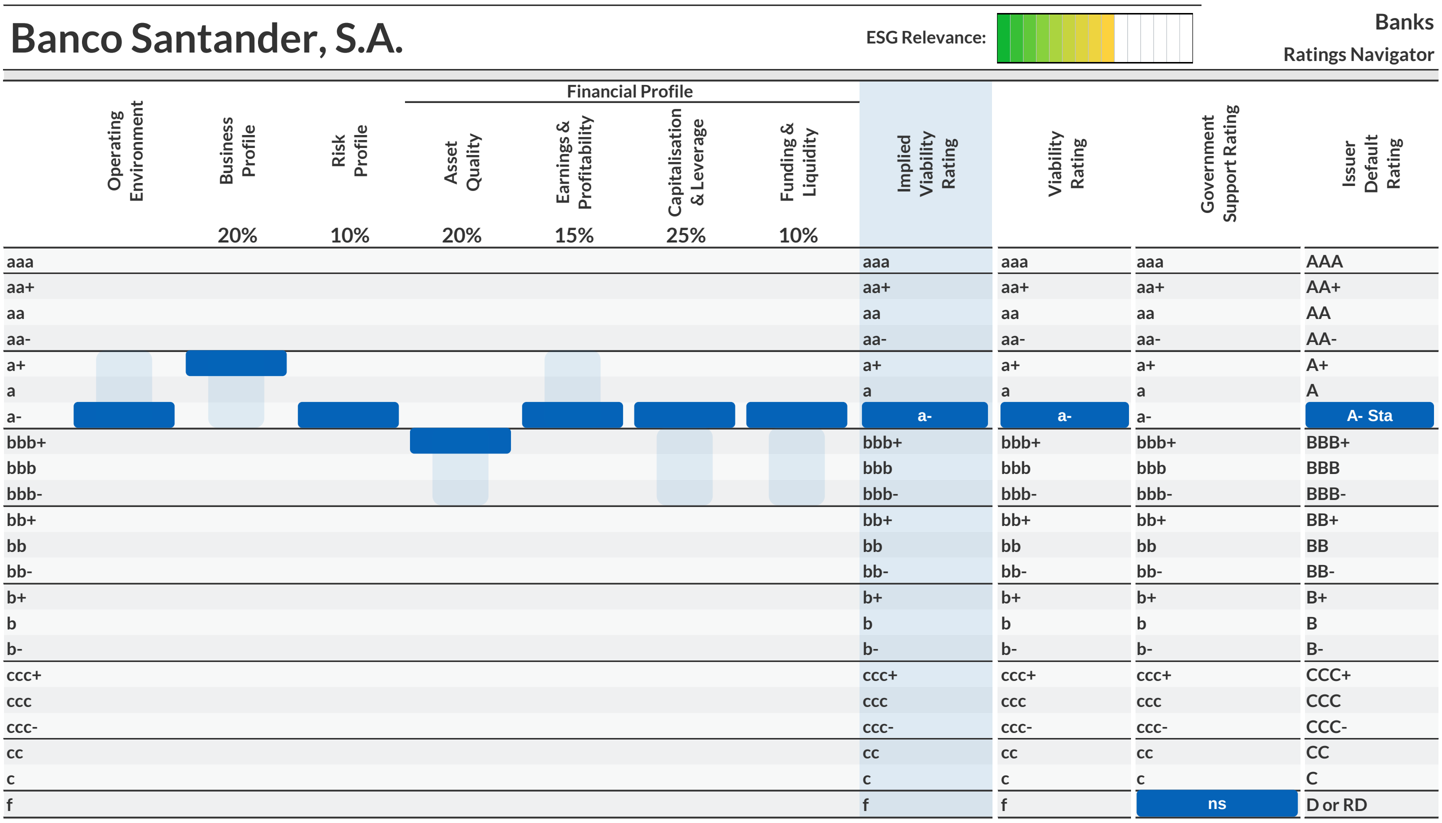
The Long-and Short-Term Issuer Default Rating (IDRs) of Santander Totta SGPS, S.A. (Totta), Santander Holdings USA, Inc. (SAN US) and Banco Santander Mexico, S.A., Institucion de Banca Multiple, Grupo Financiero Santander Mexico (SAN Mexico) are based on shareholder support from Santander. The Long-Term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

SCF's IDRs are 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 banks' performance is supported by strong synergies and integration with the parent, and 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, which weakens the group's profitability.

Ratings Navigator



The Key Rating Driver (KRD) weightings used to determine the implied VR are shown as percentages at the top. In cases where the implied VR is adjusted upwards or downwards to arrive at the VR, the KRD associated with the adjustment reason is highlighted in red. The shaded areas indicate the benchmark-implied scores for each KRD.

VR - Adjustments to Key Rating Drivers

The operating environment score of ‘a-’ is in line with the ‘a’ category implied score but above the ‘bbb+’ score assigned to domestic Spanish banks, reflecting the group’s geographic diversification.

The group’s strong internal capital generation and proven access to equity markets support the capitalisation & leverage score of ‘a-’, above the implied ‘bbb’ category score.

The funding & liquidity score of ‘a-’ is also above the implied ‘bbb’ category score to reflect Santander’s established market access and a solid deposit franchise in the bank’s core markets.

Significant Changes

Recent Sector Developments in Spain

A recently passed legislation protecting low-income households from rate rises on floating mortgage loans will not fundamentally change payment discipline or affect our expectations of modest asset quality deterioration for the banking sector in 2023. Eligible households could benefit from loan restructuring at a lower interest rate, with a grace period on principal repayments of up to two years, maturity extensions of up to seven years and payment freezes for up to 12 months. In addition, fees for converting floating-rate loans to a fixed rate, and for early repayment, will be reduced for all mortgage borrowers.

Banks will not be obliged to apply the measures, as they are recommendations in the country's code of good practices rather than law. But we expect banks will unanimously choose to do so, although the stringent eligibility criteria will limit the number of borrowers benefiting.

The Spanish parliament recently approved a temporary bank levy of 4.8% on the domestic core revenues. The levy, if final hurdles are overcome, is a profitability headwind for some domestic banks in Spain for 2023–2024. In its current form the impact could equate to about 10% of the sector's 2021 pre-tax profit.

Strong Performance Expected for 2022

We expect Santander will end 2022 with an outstanding performance (operating profit/RWAs of 2.9% in 9M22) compared to European peers despite the uncertain economic environment and inflationary pressures.

Santander's 3Q22 results were boosted by loan volumes (3% growth qoq) and rising interest rates. Interest rates had just started to increase in the domestic market, while this materialised earlier in other countries such as the UK, US, Mexico and Poland. NII growth (5% qoq) offset inflationary pressures on costs, particularly in Latin America, allowing for an improvement of the cost/income ratio to close to the 45% target level for 2022. We expect Santander to continue benefitting from higher interest rates (notably in Europe) and business growth in 2023, particularly in Latin America. However, we expect increased pressures on costs if inflation becomes structurally high. In 3Q22, Santander incurred a EUR175 million (net of tax) charge due to the Polish mortgage payment holiday scheme.

LICs marginally increased in 3Q22 to 86bp of gross loans (as reported), but remained below the bank's 2022 guidance (around 100bp). For the group, the impaired loans ratio was stable at 3.1%, supported by improved asset quality in Spain, Mexico and Portugal. The impaired loan coverage ratio remained stable at around 70%.

Summary Financials

	30 Sep 22		31 Dec 21	31 Dec 20	31 Dec 19
	9 months - 3rd quarter (USDm)	9 months - 3rd quarter (EURm)	Year end (EURm)	Year end (EURm)	Year end (EURm)
	Unaudited	Unaudited	Audited - unqualified	Audited - unqualified	Audited - unqualified
Summary income statement					
Net interest and dividend income	28,154	28,882.0	33,883.0	32,385.0	35,816.0
Net fees and commissions	8,644	8,867.0	10,502.0	10,015.0	11,779.0
Other operating income	824	845.0	2,019.0	1,879.0	1,634.0
Total operating income	37,621	38,594.0	46,404.0	44,279.0	49,229.0
Operating costs	17,152	17,595.0	21,415.0	21,130.0	23,280.0
Pre-impairment operating profit	20,470	20,999.0	24,989.0	23,149.0	25,949.0
Loan and other impairment charges	7,639	7,836.0	7,407.0	12,382.0	9,352.0
Operating profit	12,831	13,163.0	17,582.0	10,767.0	16,597.0
Other non-operating items (net)	-1,367	-1,402.0	-3,035.0	-12,843.0	-4,054.0
Tax	3,449	3,538.0	4,894.0	5,632.0	4,427.0
Net income	8,016	8,223.0	9,653.0	-7,708.0	8,116.0
Summary balance sheet					
Assets					
Gross loans	1,014,240	1,040,458.0	962,382.0	904,092.0	918,757.0
- Of which impaired	32,877	33,727.0	31,645.0	30,815.0	32,559.0
Loan loss allowances	23,478	24,085.0	22,964.0	23,595.0	22,242.0
Net loans	990,762	1,016,373.0	939,418.0	880,497.0	896,515.0
Interbank	99,804	102,384.0	71,983.0	16,101.0	23,475.0
Derivatives	81,141	83,238.0	59,463.0	77,442.0	72,315.0
Other securities and earning assets	257,115	263,761.0	227,625.0	292,764.0	323,242.0
Total earning assets	1,428,821	1,465,756.0	1,298,489.0	1,266,804.0	1,315,547.0
Cash and due from banks	240,321	246,533.0	210,689.0	153,839.0	101,067.0
Other assets	100,895	103,503.0	86,657.0	87,607.0	106,081.0
Total assets	1,770,037	1,815,792.0	1,595,835.0	1,508,250.0	1,522,695.0
Liabilities					
Customer deposits	919,399	943,165.0	881,987.0	814,836.0	785,454.0
Interbank and other short-term funding	294,150	301,754.0	237,546.0	219,153.0	200,517.0
Other long-term funding	277,851	285,033.0	246,163.0	223,208.0	263,746.0
Trading liabilities and derivatives	91,404	93,767.0	71,513.0	92,762.0	87,340.0
Total funding and derivatives	1,582,804	1,623,719.0	1,437,209.0	1,349,959.0	1,337,057.0
Other liabilities	90,424	92,761.0	61,573.0	59,348.0	66,949.0
Preference shares and hybrid capital	n.a.	n.a.	152.0	7,784.0	8,176.0
Total equity	96,809	99,312.0	96,901.0	91,159.0	110,513.0
Total liabilities and equity	1,770,037	1,815,792.0	1,595,835.0	1,508,250.0	1,522,695.0
Exchange rate		USD1 = EUR1.02585	USD1 = EUR0.884173	USD1 = EUR0.821963	USD1 = EUR0.89015

Sources: Fitch Ratings, Fitch Solutions, Santander

Key Ratios

	30 Sep 22	31 Dec 21	31 Dec 20	31 Dec 19
Ratios (annualised as appropriate)				
Profitability				
Operating profit/risk-weighted assets	2.9	3.0	1.9	2.7
Net interest income/average earning assets	2.8	2.6	2.5	2.8
Non-interest expense/gross revenue	46.2	46.6	47.6	47.6
Net income/average equity	11.2	10.2	-7.9	7.4
Asset quality				
Impaired loans ratio	3.2	3.3	3.4	3.5
Growth in gross loans	8.1	6.5	-1.6	5.1
Loan loss allowances/impaired loans	71.4	72.6	76.6	68.3
Loan impairment charges/average gross loans	1.0	0.8	1.4	1.1
Capitalisation				
Common equity Tier 1 ratio	12.2	12.5	12.3	11.7
Fully loaded common equity Tier 1 ratio	12.1	12.5	11.9	11.7
Basel leverage ratio	4.6	5.2	5.3	5.1
Net impaired loans/common equity Tier 1	12.8	12.0	10.4	14.6
Funding and liquidity				
Gross loans/customer deposits	110.3	109.1	111.0	117.0
Liquidity coverage ratio	169.0	164.0	165.0	147.0
Customer deposits/total non-equity funding	61.7	64.0	63.4	61.6
Net stable funding ratio	121.0	126.0	120.0	112.0

Sources: Fitch Ratings, Fitch Solutions, Santander

Government/Shareholder Support

Commercial Banks: Government Support	
Typical D-SIB GSR for sovereign's rating level (assuming high propensity)	BBB+ or BBB
Actual jurisdiction D-SIB GSR	ns
Government Support Rating	ns
Government ability to support D-SIBs	
Sovereign Rating	A-/ Stable
Size of banking system	Negative
Structure of banking system	Neutral
Sovereign financial flexibility (for rating level)	Neutral
Government propensity to support D-SIBs	
Resolution legislation	Negative
Support stance	Neutral
Government propensity to support bank	
Systemic importance	Neutral
Liability structure	Neutral
Ownership	Neutral

The colours indicate the weighting of each KRD in the assessment.
Higher influence Moderate influence Lower influence

No Government Support Factored into Ratings

We believe that Santander's senior creditors cannot expect to receive full extraordinary support from the sovereign if the bank becomes non-viable. This is because, the EU's Bank Recovery and Resolution Directive and the Single Resolution Mechanism for eurozone banks provide a framework for the resolution of banks that requires senior creditors to participate in losses, if necessary, instead of, or ahead of, a bank receiving government 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	Business Profile (incl. Management & governance); Risk Profile; Asset Quality	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.

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	Business Profile (incl. Management & governance); Risk Profile	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; Business Profile (incl. Management & governance); Risk Profile	4
Labor Relations & Practices	2	Impact of labor negotiations, including board/employee compensation and composition	Business Profile (incl. Management & governance)	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	Business Profile (incl. Management & governance); Financial Profile	1

Governance (G)

General Issues	G Score	Sector-Specific Issues	Reference	G Scale
Management Strategy	3	Operational implementation of strategy	Business Profile (incl. Management & governance)	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	Business Profile (incl. Management & governance); Earnings & Profitability; Capitalisation & Leverage	4
Group Structure	3	Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership	Business Profile (incl. Management & governance)	3
Financial Transparency	3	Quality and frequency of financial reporting and auditing processes	Business Profile (incl. Management & governance)	2
				1

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, if present, is a score of '3'. This means ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or to the way in which they are being managed by the entity. 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.