S&P Global Ratings

RatingsDirect®

Banco Santander S.A.

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

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

Table Of Contents

Banco Santander S.A.

SACP	a

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

+

Support	0

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

+

Additional Factors	0

Issuer Credit Rating
A/Negative/A-1

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

Major Rating Factors

Strengths:	Weaknesses:
• Wide geographic diversification and solid market positions in the markets where it operates. • Focus on stable retail banking business, underpinning the bank's sound and resilient earnings. • Successful strategy and implementation. • Sound capitalization for the risks it faces.	• Exposure to higher-than-average economic risk in some of the countries where it operates. • Challenge posed by the synchronized global recession underway.

Outlook: Negative

The negative outlook reflects the possibility of a downgrade over the next 18-24 months if the bank's credit strength is materially damaged amid the COVID-19 fallout. This could happen if the bank's wide geographic diversification proves less effective than we thought, and the bank records massive provisions, or loses substantial earnings power, that impair its profits and potentially challenge its capital position. Santander's creditworthiness could also feel strain if the 2020 downturn is more profound or the 2021 economic recovery in the countries where the bank has meaningful operations is substantially weaker than expected or delayed.

We could revise the outlook to stable if the bank demonstrates resilience through the recession and downside risks to our macroeconomic forecasts ease. Even if that were not the case, and we continue to see pressure on the bank's stand-alone creditworthiness, we could consider affirming the ratings if Santander continues to build-up its buffer of minimum requirement for own funds and eligible liabilities, and looks likely to reach a cushion of bail-inable debt large enough to protect senior creditors in resolution.

Rationale

The ratings on Banco Santander S.A. reflect its robust, well-managed business model and sound risk-adjusted capital, while also factoring in the higher-than-average economic risks in the countries where it operates.

Santander is one of the most geographically diversified global banks, with no single country concentrating more than one fourth of the group's assets. Its footprint in economies that historically proved to be uncorrelated have allowed it to accommodate the ups and downs of the different economic cycles and achieve consistent, resilient profitability over time. The bank's strong franchises in most of the countries where it is present also support the profitability of its business model, providing the bank with pricing power and a sticky clientele, while its focus on retail banking supports business and earnings stability. In addition, its efficiency outperforms that of its peer group.

We believe that the synchronized deep recession that the world now faces will test the effectiveness of the group's geographic diversification, however.

Santander faces this cyclical shock from a position of strength. Its strong earnings (even if they will naturally weaken) provide substantial room to accommodate the likely material increase of credit costs that the bank will face, particularly in its consumer and small and midsize enterprise (SME) portfolios, and maintain positive underlying profitability. We are forecasting credit losses at 157 bp and 140 bp of average loans in 2020 and 2021, respectively. Although in emerging countries the bank could have some flexibility to reprice risk upwards, our expectation is that underlying profitability in 2020 will fall markedly (probably by half) compared with 2019, and stay below pre-COVID 19 levels in 2021. The recognition of huge goodwill and DTA impairments in the second quarter of 2020 will indeed push the bank into substantial losses in 2020. Nevertheless, capital should hold up well, particularly if earnings are fully retained, as recommended by authorities, or alternatively distributed in shares as the bank is considering. We project the bank's risk-adjusted capital (RAC) ratio to stand at around 7.5%over 2020-2021, potentially posting modest growth in 2022.

The benefits of Santander's geographic diversification are also reflected in our assessment of the strength of the bank's capital compared to the risks it faces, despite its regulatory capital measures lagging behind those of many of its global peers.

Unlike most of its global peers, our ratings on Santander do not benefit from ALAC (additional loss-absorbing capacity) support. This is because we don't think that the cushion of bail-inable buffers is strong enough to reduce the default risk of senior debt creditors in a resolution scenario. The cushion has improved over the recent past, however, moving closer to a threshold that would allow it to benefit from a one-notch ratings uplift.

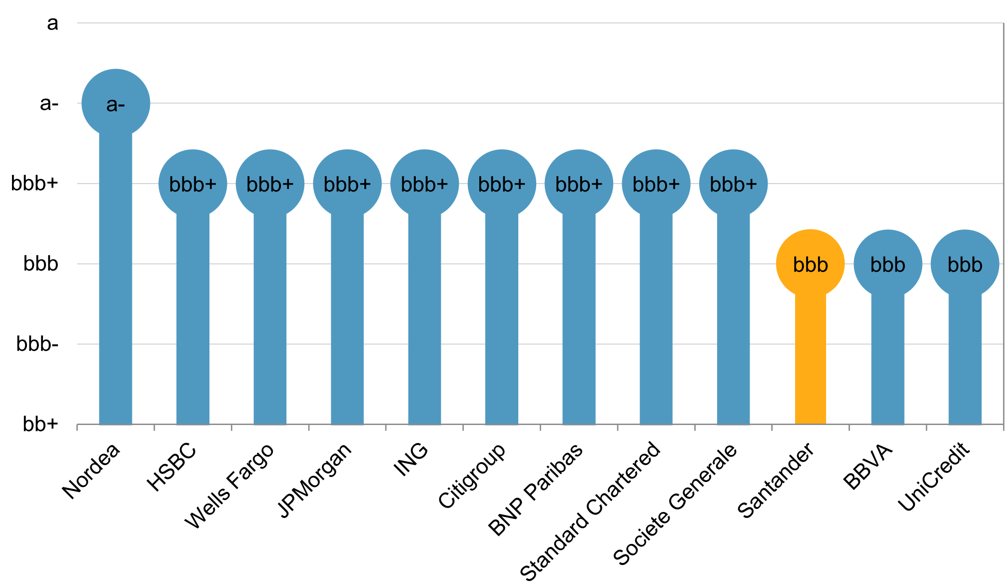
Unlike in the recent past, and following our upgrade of the sovereign credit rating on Spain in September 2019, the ratings on Santander no longer exceed that on the sovereign.

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

Our anchor for Santander is currently 'bbb', weaker than that of most of its global peers, as chart 1 shows. We generally compare Santander with the following peers: HSBC, BNP, JP Morgan, Citigroup, Standard Chartered, ING, Societe Generale, Wells Fargo, BBVA, Nordea, and Unicredit.

Chart 1

Santander's Lower Than Peers Anchor Reflects Higher Economic Risks Of Its Footprint



Data as of July 2020. HSBC--Hong Kong and Shanghai Banking Corporation. ING--International Netherlands Group. BBVA--Banco Bilbao Vizcaya Argentaria. Source: S&P Global Ratings.

The weighted-average economic risk to which Santander is exposed is currently marginally higher than that faced by institutions operating primarily in Spain. The U.K. and Spain, both with an economic risk score of 4, account for the group's largest credit exposures, about one fourth each at end-2019, followed by Brazil (economic risk of 7) and the U.S. (economic risk of 3), each accounting for about 10%. Remaining exposures, accounting for about 5% each, include Mexico (economic risk of 6, revised down in March 2020), Portugal (economic risk of 6), Germany (economic risk of 1), other Latin American countries (economic risk of 7) and the rest of Europe (economic risk of 4).

With regard to industry risk, our assessment of '4' reflects Spanish banks' balanced funding profiles and ample liquidity, as well as the profitability challenges ahead. Customer deposits now fund the bulk of banks' loan books, and at historically low costs. Reliance on wholesale market funding is therefore limited and markets remain open. In addition, through the TLTRO III program and the recently launched PELTRO facility, the European Central Bank will continue to ensure banks' access to funding, if needed, at attractive prices. The COVID-19 shock, however, will aggravate existing profitability challenges resulting from low rates, limited business growth, and intense competition. The prospect of banks achieving returns in line with their cost of capital was already remote, particularly for midsize banks, and much more so in the current environment. Banks' profitability will decline substantially in 2020, from the combination of weaker earnings and increased credit costs, and will only partially recover in 2021. However, we expect Spanish banks to remain fairly efficient compared to peers.

Table 1

Banco Santander S.A.--Key Figures					
	--Fiscal year ended Dec. 31--				
(Mil. €)	**2020***	**2019**	**2018**	**2017**	**2016**
Adjusted assets	1,511,734	1,492,966	1,429,279	1,413,632	1,308,249
Customer loans (gross)	869,150	882,815	848,319	824,695	771,212
Adjusted common equity	70,684	74,467	68,678	66,542	61,334
Operating revenues	12,260	51,367	50,425	49,849	45,511
Noninterest expenses	6,041	24,379	23,410	23,080	21,275
Core earnings	785	12,292	12,277	12,601	10,513

*Data as of March 31.

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

Santander benefits from a robust business model: a geographically diversified franchise, with leading market positions in the countries where it operates, focused on a stable retail banking business and with a proven track record of sound and resilient returns. The resilience of the latter will now be tested, however, as the bank faces a synchronized economic downturn in all the markets where it operates.

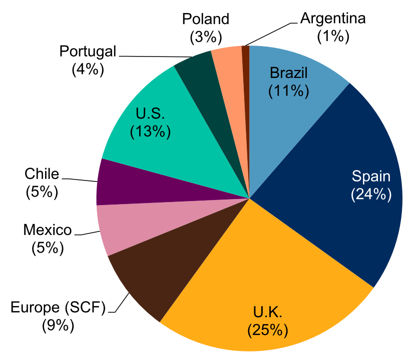
In Europe, only the ratings on French BNP Paribas benefit from these business model strengths to the same extent as Santander.

As a result of an intensive expansion strategy over the past two decades, Santander is currently one of the most geographically diversified banks in the world, with no single country concentrating more than 30% of the group's net profits and credit. Its presence in developed economies outweighs its presence in emerging markets (accounting for 83% and 17% of loans at March 2020, respectively), but it is fairly balanced when measured in terms of profit contribution (52% and 48% as of March 2020). Historically, the limited economic correlation of the countries in its footprint has allowed Santander to accommodate the ups and down of the different economic cycles and achieve consistent, resilient profitability over time.

Chart 2

Santander Benefits From Wide Geographic Diversification, Weighted Towards Matured Economies

Geographical distribution of the group's asset base as of 1Q2020

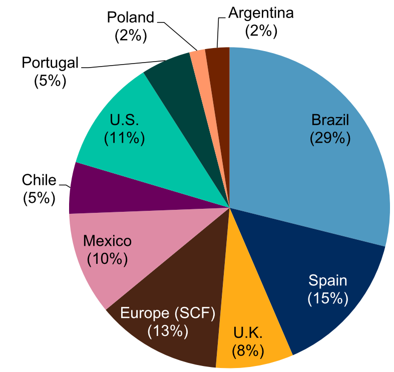


Q--Quarter. Source: S&P Global Ratings and banks' reporting, excluding corporate centre.

Chart 3

Emerging Markets Are Key Contributors To The Group's Profitability

Geographical contribution to net attributable profits as of 1Q2020



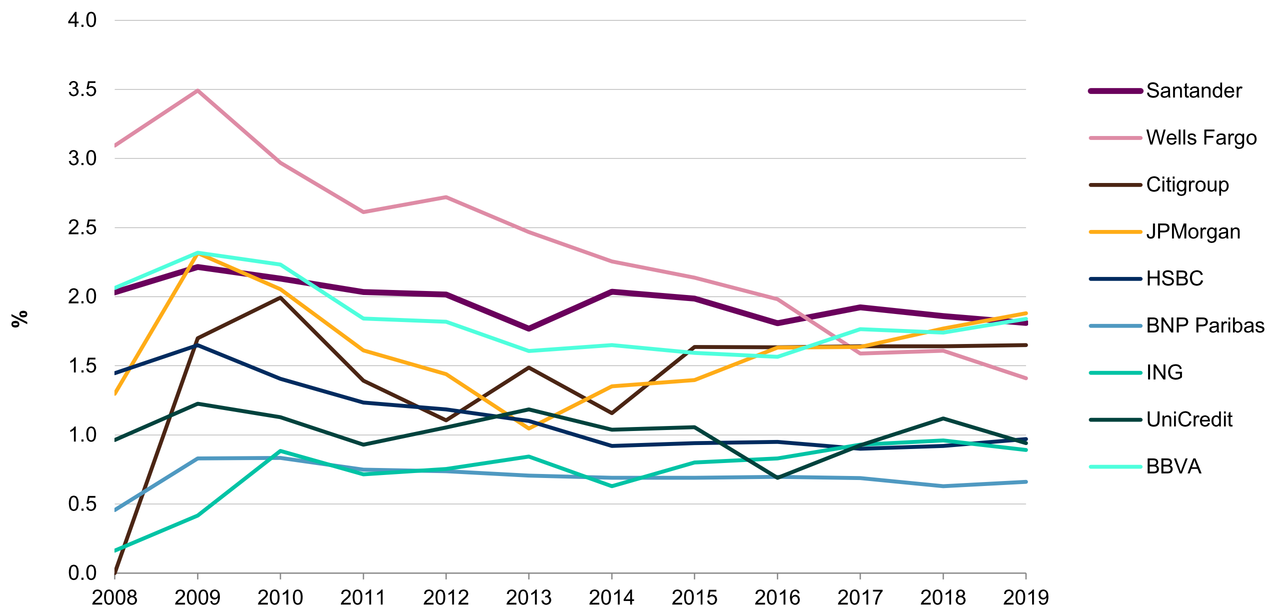
Q--Quarter. Source: S&P Global Ratings and banks' reporting, excluding corporate centre.

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

The group primarily focuses on retail banking activities, which supports the bank's business and earnings stability. Over time, Santander has built a track record of strong, resilient profitability and outstanding efficiency. The charts below show a relevant comparison versus peers.

Chart 4

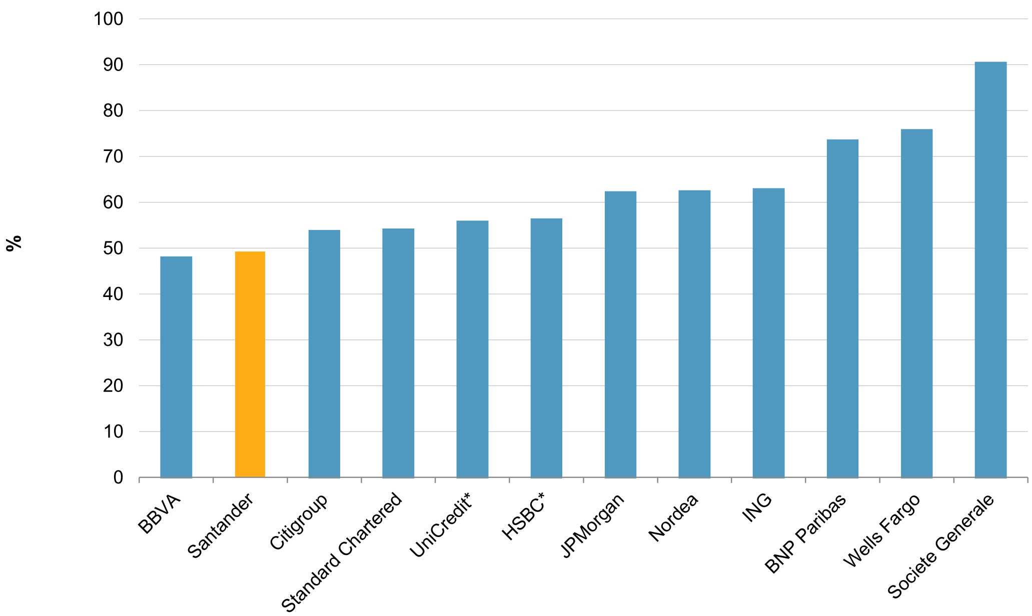
Santander Reports Higher And More Stable Preprovision Income Than Most Global Peers
Preprovision income to average assets



HSBC--Hong Kong and Shanghai Banking Corporation. ING--International Netherlands Group. BBVA--Banco Bilbao Vizcaya Argentaria. Source: S&P Global Ratings and banks' reporting.

Chart 5

Strong Efficiency Is A Key Attribute Of Santander
Cost to income ratio as of March 2020



*Data as of Dec. 2019. HSBC--Hong Kong and Shanghai Banking Corporation. ING--International Netherlands Group. BBVA--Banco Bilbao Vizcaya Argentaria. Source: S&P Global Ratings and banks' reporting.

Santander benefits from a clear, well-executed strategy, which has led to the transformation of what was once a domestic institution into a strong and well-diversified global banking group. Inorganic growth has been a key enabler of the bank's build up of a global franchise over the years, although in the recent past, and until the acquisition of Popular in 2017, the bank did not undertake large acquisitions. Still, we think Santander could in principle be willing to consider M&A if opportunities were to arise, most likely to strengthen its business in markets where it already operates. Equally, in the longer term, we would also expect Santander to participate in future consolidation moves in Europe as the Banking Union project progresses.

The COVID-19 outbreak has not altered the strategic priorities the bank set up for the next three years (the strategic plan was announced in April 2019), though its execution will be more complicated in light of the difficult macroeconomic scenario. The focus remains on:

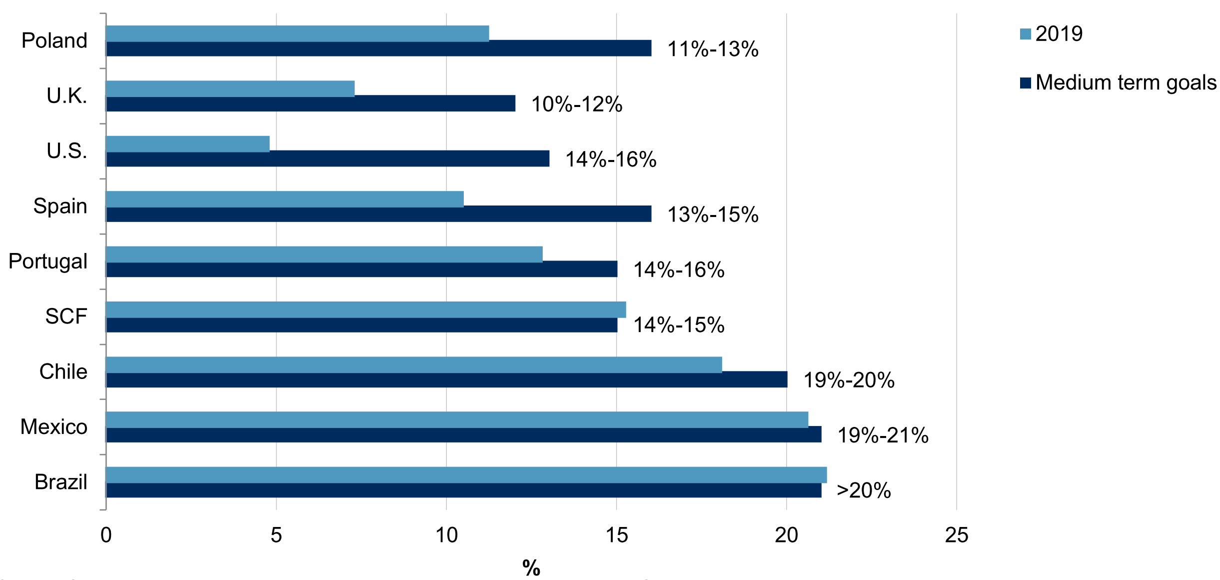
- Improving the bank's operating performance;
- Maintaining a solid capital base, improving the allocation of capital to the more profitable businesses;
- Growing the business by engaging further existing clients; and
- Accelerating the digitalization of the business.

The group also committed to operate more cohesively across units, fostering collaboration, avoiding duplications and facilitating synergies.

Achieving some of its financial targets, particularly on the profitability front, will clearly be challenging in light of the likely pressure on earnings and credit costs. The bank's pre-COVID-19 aim was to improve the group's underlying RoTE to 13%-15% from 12% in 2018 and cost-to-income ratio to 42%-45% from 47%. Pre-COVID-19, Spain, the U.K., and the U.S. were the three main units that lagged behind the bank's ambitions by a high margin for the close of its strategic plan (see chart 6). Others could join this group as the crisis deepens. Management has stated that it could take additional actions on top of those already contemplated to achieve its profitability targets. On the cost side, the original strategic plan already envisioned sizable cost savings of over €1 billion, largely in Europe. Part of these stemmed from the downsizing of the branch network and staff following the merger of Popular and Santander in Spain.

Chart 6

U.S., U.K., And Spain Are The Units That Are Further Off the Group's Medium-Term
Underlying RoTE



*RoTE of the U.S. and Poland at 2019 are penalized by their excess capital. Source: Banks' reporting.

Table 2

Banco Santander S.A.--Business Position					
	--Fiscal year ended Dec. 31--				
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Loan market share in country of domicile	17.4	17.6	17.6	18.3	--
Deposit market share in country of domicile	18.9	18.9	18.2	18.9	--
Total revenues from business line (mil. €)	12,278	52,658	50,453	50,541	45,720
Commercial banking/total revenues from business line	10.6	10.0	10.1	11.0	12.7

Table 2

Banco Santander S.A.--Business Position (cont.)					
	--Fiscal year ended Dec. 31--				
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Retail banking/total revenues from business line	81.2	82.7	84.9	87.1	85.4
Commercial & retail banking/total revenues from business line	91.8	92.7	95.0	98.1	98.2
Other revenues/total revenues from business line	8.2	7.3	5.0	1.9	1.8
Return on average common equity	1.4	6.7	8.2	7.2	6.9

*Data as of March 31.

Capital and earnings: Capital has strengthened and we expect it to be resilient

Santander faces COVID-19 with a strengthened capital position, which we believe it will be able to preserve as it navigates through the COVID-19 downturn. Its RAC ratio stood at 7.8% at end-2019, having improved from 6.26% in 2016. During these years, the bank issued hybrid instruments, raised capital (€7 billion in mid-2017 to accommodate the acquisition of Popular), retained earnings, and more recently proactively managed its risk assets through securitizations. The easing of economic risks in its home market, as well as the nonpayment of the remaining projected dividends on its 2019 results (in line with regulators' recommendations), also contributed to the improvement in the RAC ratio. The recently announced decision to distribute it in shares will also be capital-neutral.

Equally, regulatory capital ratios are also higher now than previously, standing comfortably above SREP requirements. The bank managed to deliver on its commitment to raise the group's fully loaded common equity Tier 1 (CET1) capital ratio above 11% at end-2018 (up from 9.8% in mid-2015), and raised its target to 11%-12%. At June 2020, the bank's fully loaded CET1 ratio stood at 11.84% and its total capital ratio at 15.46%, compared to the updated requirements of 8.86% and 13.02%, respectively.

While earlier this year we expected that capitalization would continue to improve, primarily through retained earnings, the big hit to profits that we now expect post-COVID-19 means that, at best, the bank's RAC ratio will remain around current levels in 2020-2021, likely only improving in 2022. That is assuming the bank will not pay dividends this year, otherwise it could be lower. We assume the bank will resume dividend payments in 2021, with a 40% pay-out, while we project S&P Global Ratings' RWA inflation at 4.5% in 2020 and 3% thereafter.

The COVID-19 crisis has meaningfully altered our previous expectations around profitability. We now believe that the bank's underlying results (excluding the extraordinary impairment of goodwill and DTAs recorded in the second quarter of 2020) could well halve this year compared to those of 2019 and only recover to pre-COVID-19 levels in 2022. In 2020, the bank's profit and loss account will suffer from significantly higher credit impairments, which we see as 50% higher than those of 2019, equivalent to a cost of risk of 157bp of average loans, and loss of revenues (both net interest income and other revenues). Results as of June 2020 confirm these trends.

We expect the bank to manage costs down and maintain comparatively sound efficiency (with the cost-to-income peaking at 50%, still a much better indicator than that of most other European banks), but its impact on the bottom line will be limited. Returns could improve in 2021, despite provisioning remaining elevated, on the back of better earnings--primarily fees but also higher net interest income from higher business volumes. However, we expect to see net income returning to its 2019 mark in 2022 only. Even so, 2019 was not one of the bank's best performing years as it undertook the write-off of part of the U.K. business goodwill and some extraordinary restructuring costs. Indeed, before the outbreak of COVID-19 we had expected returns to recover, with RoE returning to 8%. Following the sizable goodwill impairments in second-quarter 2020, we now expect the bank to report losses this year, although the underlying RoE could be at 3.5%. For 2021 and 2022, we see RoE improving to 4.5% and 6%-6.5% respectively.

Certainly this year and next will represent a material challenge for the bank's performance. Although for different reasons and potentially in different magnitudes, we expect all its core business lines and markets will suffer from the impact of COVID-19. Equally, we feel that the bank has different levers to try to mitigate the impact. In Latin America, it could have more room to maneuver on the revenue side, while in developed Europe focus on costs will become a priority, trying to achieve higher savings than those already planned (remaining synergies from the Popular merger, downsizing the U.K. network, and rationalizing IT, operating, and share services costs). For that reason, while we expect the bank's earnings buffer (which measures the capacity of the bank's earnings to cover normalized losses) to decline, we expect it to remain at a still-sound 145bp of S&P Global Ratings' RWAs over 2020-2022, compared to the robust 172 bp average reported in the prior three years.

We forecast hybrid instruments to account for about 10% of Santander's total adjusted capital (TAC) over 2020-2022. Hybrid instruments included in TAC are now largely AT1 instruments issued by the parent and U.K. subsidiary. The remaining legacy preference shares included in TAC are minimal--€337 million. The recent widening of AT1 and Tier II regulatory buckets, to 1.78% and 2.38% respectively, has left some room for Santander to issue more AT1 instruments, but not in a magnitude that will change our capital assessment.

The group's capital is reasonably distributed across subsidiaries, and is only higher than standard group levels in those geographies where host regulators require higher minimum capital requirements, as is the case in Poland, or where regulators have constrained dividend distribution, as has been the case in the U.S. recently. During the pandemic we could see host authorities restricting or at least recommending a limit on dividend upstreaming to the parent. This could complicate the bank's strategic decision to allocate more capital resources to higher profitable business areas, at least temporarily.

Our capital measure is weaker than the regulator's, reflecting the higher risks that we see in economies where Santander operates, and the still-large balance of deferred tax assets (DTAs) resulting from timing differences outstanding on the bank's balance sheet (€19 billion at end-2019). Indeed, our calculation of Santander's RWAs is almost 80% higher than the regulatory one.

Table 3

Banco Santander S.A.--Capital And Earnings

	--Fiscal year ended Dec. 31--				
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Tier 1 capital ratio	13.2	13.1	13.1	12.8	12.5
S&P Global Ratings' RAC ratio before diversification	N/A	7.8	7.1	6.7	6.3
S&P Global Ratings' RAC ratio after diversification	N/A	9.7	9.3	8.9	8.1
Adjusted common equity/total adjusted capital	88.7	89.2	87.9	89.0	90.9
Net interest income/operating revenues	69.2	68.7	68.1	68.8	68.3
Fee income/operating revenues	23.3	22.9	22.8	23.3	22.4

Table 3

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

	--Fiscal year ended Dec. 31--				
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Market-sensitive income/operating revenues	2.3	3.0	3.6	3.3	4.6
Noninterest expenses/operating revenues	49.3	47.5	46.4	46.3	46.7
Preprovision operating income/average assets	1.6	1.8	1.9	1.9	1.8
Core earnings/average managed assets	0.2	0.8	0.8	0.9	0.8

*Data as of March 31. N/A--Not applicable. RAC--Risk-adjusted capital.

Table 4

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

(Mil. €)	**Exposure***	**Basel III RWA**	**Average Basel III RW(%)**	**S&P Global Ratings RWA**	**Average S&P Global Ratings RW (%)**
Credit risk					
Government & central banks	279,392	15,513	5.6	84,749	30.3
Of which regional governments and local authorities	18,049	313	1.7	3,933	21.8
Institutions and CCPs	76,900	16,713	21.7	28,928	37.6
Corporate	267,317	173,713	65.0	255,981	95.8
Retail	613,244	221,288	36.1	378,940	61.8
Of which mortgage	395,246	83,725	21.2	168,919	42.7
Securitization§	43,448	6,625	15.2	15,907	36.6
Other assets†	62,898	53,738	85.4	89,171	141.8
Total credit risk	1,343,199	487,588	36.3	853,677	63.6
Credit valuation adjustment					
Total credit valuation adjustment	--	987.5	--	3,857	--
Market Risk					
Equity in the banking book	11,335	12,463	109.9	96,952.8	855.3
Trading book market risk	--	21,813	--	32,533	--
Total market risk	--	34,275	--	129,485	--
Operational risk					
Total operational risk	--	59,663	--	86,012	--
	Exposure	**Basel III RWA**	**Average Basel II RW (%)**	**S&P Global Ratings RWA**	**% of S&P Global Ratings RWA**
Diversification adjustments					
RWA before diversification	--	605,250	--	1,073,030	100.0
Total Diversification/ Concentration Adjustments	--	--	--	(208,093)	(19.4)
RWA after diversification	--	605,250	--	864,937	80.6
		Tier 1 capital	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global Ratings RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		79,536	13.1	83,471	7.8

Table 4

Banco Santander S.A.--Risk-Adjusted Capital Framework Data (cont.)				
Capital ratio after adjustments‡	79,536	13.1	83,471	9.7

*Exposure at default. §Securitization Exposure includes the securitization tranches deducted from capital in the regulatory framework. †Exposure and S&P Global Ratings' risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions. ‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. Sources: Company data as of 'Dec. 31 2019', S&P Global Ratings.

Risk position: Wide geographic and risk diversification benefits to be tested by the COVID-19-induced global recession

Despite Santander's comparatively lower capital ratios than peers (both by regulatory and S&P Global Ratings' measure), we believe its capital base is solid compared to the risks that it faces, which, because of the countries where it operates, are higher than average. That is mainly due to the benefits it derives from its wide geographic diversification in economies that historically proved to be uncorrelated; good diversification by risk and client type; and sound, better than average asset quality track record in its main markets of operation due to strong risk management, underwriting standards, and close monitoring of risks--aspects that our RAC calculation does not fully capture.

Santander, however, now faces an unprecedented scenario that will primarily test the benefits of the group's wide geographic footprint, as all its markets of operation face a deep recession at the same time, hence our current negative outlook on the bank. The diversification benefit that we calculate for Santander is one of the highest in our sample of rated global banks, with our calculation of RWAs after diversification standing 19% below that of RWAs before diversification effects.

After several years of continuous improvement, asset quality metrics are set to deteriorate. We see credit costs increasing to 157bp of average loans in 2020 and remaining elevated, at 140 bp, in 2021. While credit costs will increase from the 110-120 bp level recorded in the prior three years, we expect them to be lower than those recorded in 2012--when Spain's real estate bubble burst and pushed the country into a deep recession. At that time, mandatory provisioning requirements pushed credit losses to 2.7% of average loans. The short-term nature of this economic shock and the massive support measures taken primarily by governments to help companies and individuals navigate through the most difficult months of the pandemic will help contain the damage on banks' balance sheets. Santander has strong earnings, which in our view can accommodate the likely increase in credit costs. However, we also acknowledge that prospects remain uncertain. Economies may not rebound as fast or in the magnitude that we expect, and the success of government's fiscal measures may prove not fully effective, so there is a risk of weaker asset quality performance than what we expect, requiring additional provisions.

We generally consider that this crisis will more likely affect the performance of loans to companies, particularly SMEs, and consumer lending facilities, while mortgages should remain resilient. Santander's portfolio is fairly diversified. Its exposure to companies accounted for 37% of the total loan book at March 2020, with large international corporates accounting for 13%, midsize companies for 13%, and SMEs for 11%. Single-name concentration is manageable and reducing--exposures to the top 20 private creditors account for about 36% of TAC at December 2019.

The group's exposure to consumer lending (28% of the loan book) is higher than that of peers, due to its large auto-lending business in Europe and the U.S. The latter has a higher-risk profile, as it is mostly subprime. The residential mortgage book (35% of total credit), primarily low-risk (particularly in the U.K. where most of Santander's mortgages are originated), will provide stability in this downturn.

We expect asset quality deterioration across the board. However, given the relative size of the portfolios and macroeconomic challenges, we consider that the following units will require closer monitoring: Spain (in particular, the SME lending book and exposures to the most problematic sectors, like hotels, leisure, and CRE); SCF and SCUSA (both the stock financing provided to car dealers and the auto loans to companies and individuals, particularly the subprime share in the U.S.); and Brazil.

Due to government support measures in place, including the debt moratorium, we will likely only start to see the stock of NPAs increasing by the end of 2020, or the beginning of 2021. At March 2020, the group's NPLs stood at 3.7% (4.7% if the remaining Spanish real estate assets are added), while Stage 3 and Stage 2 exposures amounted to 3.4% and 5.4%, respectively. All metrics barely changed compared to end-2019. Reserves coverage was comfortable, both on aggregate (at 69% of NPLs, including the €1.6 billion overlay in first-quarter 2020, and 49% for real estate assets at March 2020) and by units. By geographies, Spain is probably the only country that faces this shock with a still-high stock of NPAs, though appropriately provisioned, as the divestment of legacy assets from the previous crisis was still ongoing when the COVID-19 outbreak started.

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

Given its large size and operations in multiple jurisdictions, managing the group entails some complexity. However, we consider this to be manageable. We believe that Santander's retail business model, consistently replicated across its network, and its organizational structure, facilitate the bank's management.

Table 5

Banco Santander S.A. Risk Position

	--Fiscal year ended Dec. 31--				
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Growth in customer loans	(6.2)	4.1	2.9	6.9	(1.8)
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	(19.4)	(23.4)	(24.3)	(23.1)
Total managed assets/adjusted common equity (x)	21.8	20.7	21.5	21.9	22.0
New loan loss provisions/average customer loans	1.8	1.1	1.1	1.2	1.2
Net charge-offs/average customer loans	1.1	1.3	1.3	1.5	1.4
Gross nonperforming loans/customer loans	3.8	3.8	4.2	4.6	4.2
Loan loss reserves/gross nonperforming loans	69.3	65.8	65.3	63.7	74.9

*Data as of March 31. N/A--Not applicable. RWA--Risk-weighted assets.

Funding and liquidity: A structurally balanced and resilient funding profile.

Santander enjoys a fairly balanced funding profile, weighted toward retail deposits (the group's loan-to-deposit ratio stood at 109% at March 2020). It also holds a manageable amount of wholesale funding (diversified by instrument, market, and investors), is exposed to limited refinancing risk (as debt maturities are spread over several years), and has proved able to access market funding in times of market turbulence.

We do not think that the pandemic will pose significant funding risks for the bank. Market sentiment returned to normal quite rapidly after the shock, supported by the overwhelming response of central banks. Although access to the market remains open, some of the bank's original issuance plans may be amended, with the bank resorting more to central bank funding under attractive terms. We do not think the bank will make use of the flexibility provided by regulators to run the bank with tighter liquidity.

The bank's stable funding, according to our calculations, which are different from regulators', stood at a solid 103% at March 2020, having improved from 94.5% at end-2011, particularly due to deleveraging and market-share gains in deposits in matured markets over the last decade.

The bank operates abroad through subsidiaries that are independent from the parent for funding purposes. Only two subsidiaries recurrently receive funding from the parent: SCF and UCI (a joint-venture with BNP).

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

The group's wholesale debt outstanding in the market totaled €180 billion at March 2020, across a wide array of instruments: senior (35%), covered bonds (32%), senior nonpreferred (21%), subordinated debt (7%), and preferred securities (5%). If securitizations are added, total wholesale debt would exceed €200 billion. Banco Santander S.A. and Santander UK are the more active issuers in the group, accounting for over 70% of the group's wholesale debt outstanding. The calendar of debt maturities is well spread and thus manageable.

Over recent years Santander has opportunistically borrowed resources from the European Central Bank (ECB)'s TLTRO programs to take advantage of attractive terms and did it again under the TLTRO III facility. The group reported in June almost €74 billion of TLTRO III funds, out of a total authorized amount of €81 billion. Similarly, some of Santander's subsidiaries could access central bank facilities from host countries, though proportionally to a lower extent than what we expect from the ECB.

Santander benefits from sound liquidity. We estimate the group's liquidity ratio--by S&P Global Ratings' measure (broad liquid assets to short term wholesale funding)--at 1.35x at March 2020, up from 1.0x at end-2011. The group's regulatory liquidity coverage ratio (LCR) stood at 175% at June 2020, and was fairly consistent across the subsidiary network. Broad liquid assets also amounted to 48% of customer deposits as of the same date. Liquidity is held in cash and liquid securities portfolios. The latter are primarily invested in government securities. The largest portfolios are those of Brazil, U.K., the U.S., and Spain.

Table 6

Banco Santander S.A.--Funding And Liquidity					
	--Fiscal year ended Dec. 31--				
(%)	**2020***	**2019**	**2018**	**2017**	**2016**
Core deposits/funding base	61.0	62.0	61.2	60.4	59.7
Customer loans (net)/customer deposits	109.2	109.6	110.3	110.5	115.2
Long-term funding ratio	79.4	80.3	83.5	81.4	81.0
Stable funding ratio	102.7	101.6	106.1	103.5	100.9
Short-term wholesale funding/funding base	22.0	21.0	17.6	19.9	20.4
Broad liquid assets/short-term wholesale funding (x)	1.3	1.4	1.6	1.5	1.4
Net broad liquid assets/short-term customer deposits	13.0	13.1	19.5	16.9	13.9
Short-term wholesale funding/total wholesale funding	55.5	54.3	44.5	49.3	49.8
Narrow liquid assets/3-month wholesale funding (x)	2.1	2.2	2.2	2.1	2.1

*Data as of March 31.

Environmental, Social and Governance

We see ESG credit factors for Santander as broadly in line with those of industry and domestic peers.

Santander's governance, control standards, and transparency are high, which is very much needed given that its presence in several countries exposes the group to diverse risks. In recent years, it has been under the regulatory scrutiny of the U.S. authorities and was required to make meaningful adjustments to its risk management in the country. Major issues have now being addressed. The bank also has large exposures to markets such as those in Latin America, where governance practices may be weaker than in Spain, Santander's domestic market, and therefore requires constant monitoring. So far, the bank has managed those risks well. For instance, the bank was not affected by the ramifications of the "Lava Jato" corruption scandal in Brazil. Santander's board of directors is diverse, fairly international, and includes several independent members. The representation of the Botín family, founder of the bank, looks high compared with the economic interest the family holds. Of the two seats the family holds, however, one belongs to Ana Botín in her role as executive chairman. Recently, the decision-making process at the board level has raised questions from stakeholders. In particular, when the board announced a new CEO, only to reconsider three months later, suggesting that the decision was perhaps premature.

Social factors are increasingly relevant for a retail-focused bank like Santander. However, the bank has experienced fewer client claims or conduct issues than several other global banks in the past decade. It was not affected by Spanish customers' claims on mortgage interest rate floors and the bank managed to proactively reduce the risk of claims in other instances (arranging solutions to private banking clients affected by Bernie Madoff's case or to retail clients of Popular who lost their investment when the bank was resolved). In the U.K., misconduct originated from the bank that Santander acquired before the financial crisis.

Environmental factors do not overly affect the bank's credit quality, and related risks are very much in line with those faced by peers. Of note, Santander is a large provider of auto loans (15% of the group's loan exposure), so the business and financial challenges that the auto industry faces could indirectly affect its business prospects. A substantial change in consumer preferences, such as favoring renting over ownership, could force the bank to adapt its product offer.

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

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

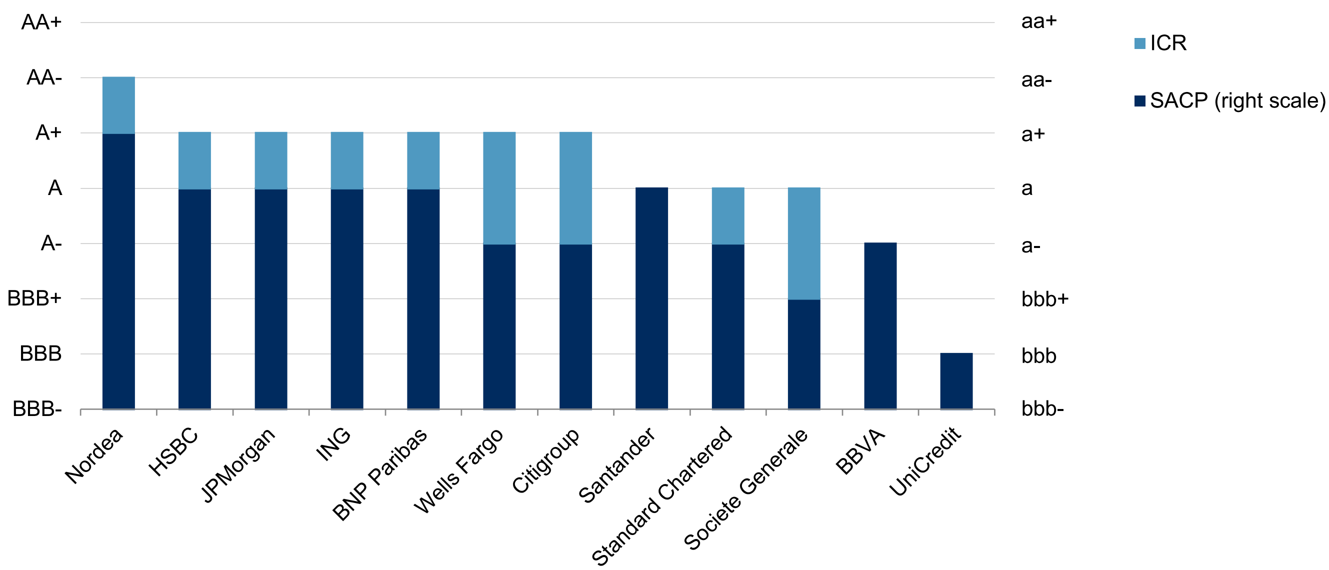
Unlike most of its global peers, the ratings on Santander do not benefit from ALAC uplift either (see chart 7). In our view, its buffer of bail-inable instruments is still not large enough to reduce the default risk of senior debt holders. However, the bank announced in early 2020 its plans to resume issuance of senior nonpreferred (SNP) debt, after a year away from that market, targeting €7 billion-€8 billion in 2020 and an additional €4 billion-€5 billion in 2021. Although part of the new issuance will replace maturing SNP instruments, the rest will contribute to improving Santander's ALAC buffer to 343 bp of S&P Global Ratings' RWAs by the end of this year, remaining at similar levels in 2021. The bank's ALAC buffer will still fall short of the minimum threshold to be eligible for a one-notch uplift, which we set at 400 bps of S&P Global Ratings' calculation of RWAs, but just by a margin.

While Santander was already compliant with TLAC and MREL requirements at end-2019, higher TLAC requirements ahead drove the bank's decision to tap the SNP market again. The bank's TLAC requirement will increase from 16% of RWAs at end-2019 to 19.5% at end-2020 and 21.5% at end-2021. As of March 2020, the bank reported TLAC--19.71% (including senior eligible debt)--was already compliant with the amount that will be required at year-end. The latest MREL requirement was €109 billion, equivalent to 28.06% of RWAs and 16.81% of total liabilities and own funds of its resolution group. Of this, €74 billion should take the form of subordinated liabilities.

Chart 7

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

Comparison of SACPs and ICRs



Data as of July 2020. HSBC--Hong Kong and Shanghai Banking Corporation. ING--International Netherlands Group. BBVA--Banco Bilbao Vizcaya Argentaria. SACP--Stand-alone credit profile. ICR--Interest coverage ratio. ALAC--Additional loss absorbing capacity. Source: S&P Global Ratings.

The ALAC buffer comprises senior nonpreferred and subordinated debt instruments, and, to a lesser extent, excess capital over the 7% threshold. We have only included bail-inable instruments issued (or to be issued) by Banco Santander S.A., excluding those issued by subsidiaries abroad identified as separate points of entry in resolution (most notably, all instruments--including AT1s--issued out of the U.K. and U.S.). We have not included the fidelity bonds granted in 2017 to Popular's retail clients in compensation for the money lost in the bank's resolution.

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

Group structure and rated subsidiaries

We rate six of Santander's operating subsidiaries globally. We consider three of them to be highly strategic for the group (Santander UK PLC, Banco Santander (Brasil) S.A., and Santander Consumer Finance S.A.) and the other three strategically important (Banco Santander Totta S.A., Santander Bank, N.A., and Banco Santander-Chile).

Different from most other global banking groups, we do not consider any of Santander's subsidiaries as core, even the more sizable ones such as the U.K. or Brazilian operations. That is because we think it more likely that the group will provide support to those subsidiaries under almost all foreseeable circumstances, rather than under all foreseeable circumstances. See "How We'Re Refining Our View of The Strategic Importance Of Certain Spanish Bank Subsidiaries" published on Aug. 2, 2019.

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

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

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

Hybrid ratings

We consider senior nonpreferred debt, nondeferrable subordinated debt, and preference shares as hybrid instruments and arrive at their ratings by notching down from the bank's 'a' SACP.

We therefore rate Banco Santander S.A.'s senior nonpreferred debt at 'A-', one notch below the bank's SACP to reflect subordination versus senior obligations.

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

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

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

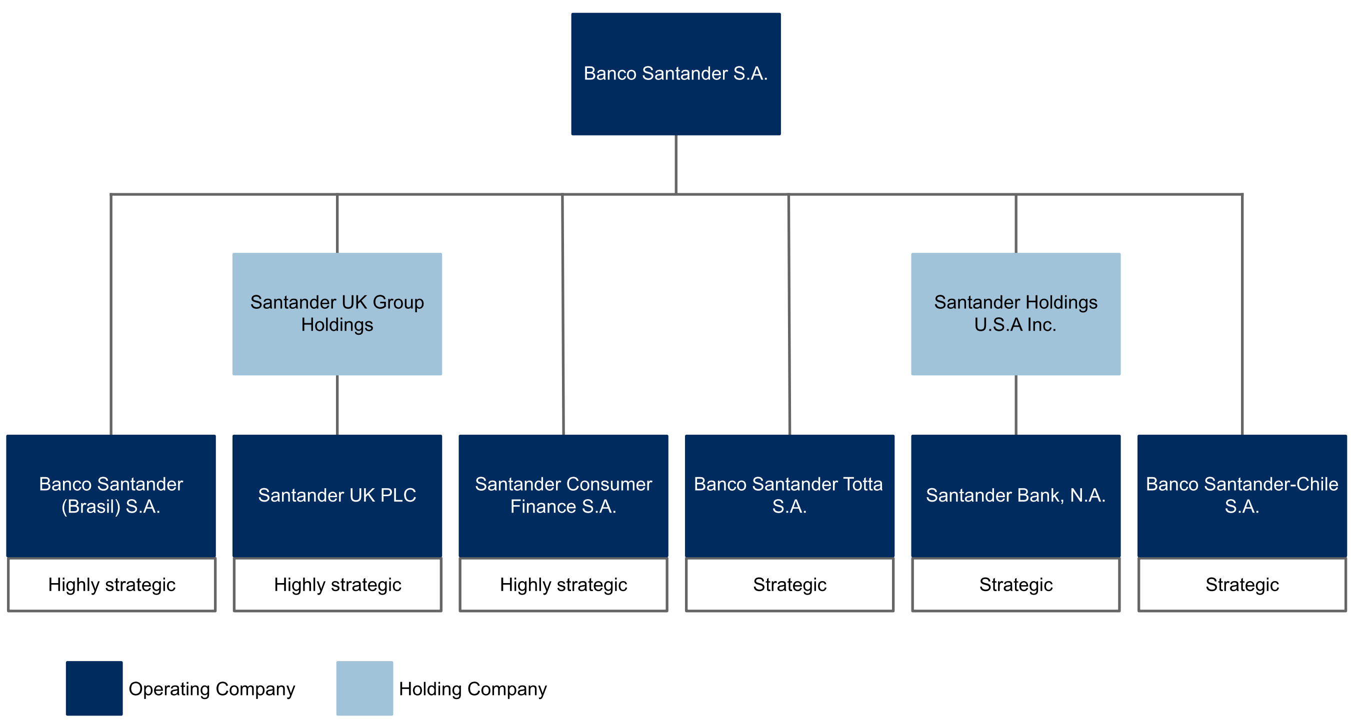
We do not rate the bank's AT1 Instruments issued in the past few years.

Resolution Counterparty Ratings (RCRs)

We set the RCR of Banco Santander at 'A+', one notch above the bank's long-term ICR. The RCR applies to certain senior liabilities of the bank that we expect would be excluded from bail-in in a resolution scenario. We therefore rate them at a higher level than traditional senior obligations to show their lower relative default risk. Santander's RCR stands one notch above the long-term sovereign credit rating on Spain, indicating that we see a considerable likelihood of a sovereign default not immediately triggering a default on the bank's RCR liabilities.

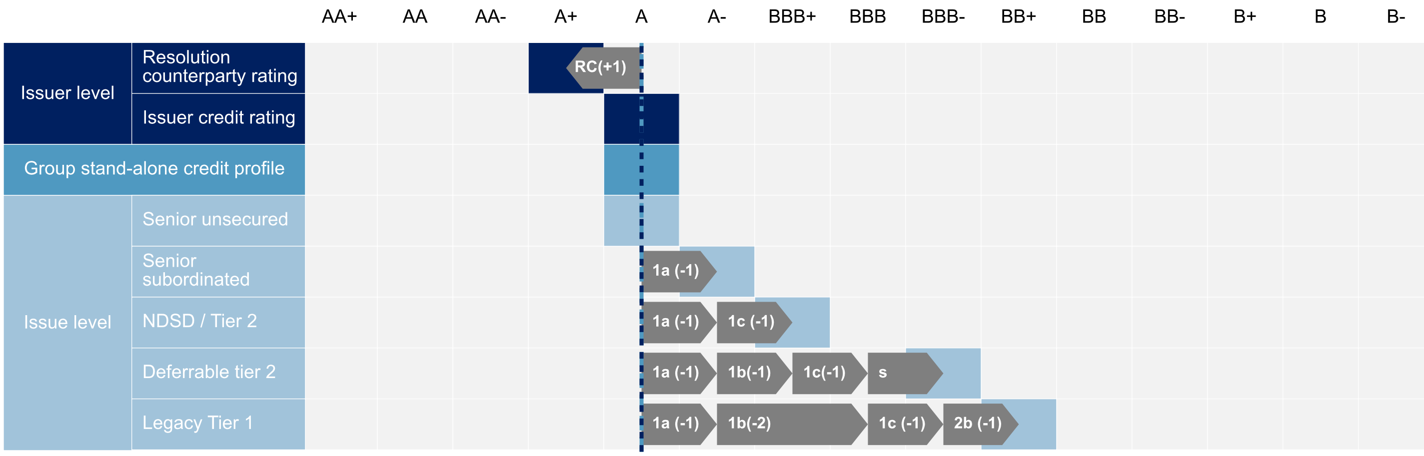
Santander's Simplified Organization Chart Including Rated Subsidiaries Only

Data as of December 2019



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

Banco Santander S.A.: Notching



Key to notching

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

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

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Methodology For Assigning Financial Institution Resolution Counterparty Ratings, April 19, 2018
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- Criteria | Financial Institutions | Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Criteria | Financial Institutions | Banks: Assessing Bank Branch Creditworthiness, Oct. 14, 2013
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And

Assumptions, July 17, 2013

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

Related Research

- Bulletin: Banco Santander S.A.'s €12 Billion Of Goodwill And DTA Impairments May Signal Weaker Long-Term Profit Expectations, July 30, 2020
- SLIDES: Spanish Banks:COVID-19 Changes Everything, July 24, 2020 EMEA Financial Institutions Monitor 3Q2020: Low Profitability Lingers On, July 24 ,2020
- Global Banks Outlook Midyear 2020: Temporary Shock, Profound Implications , July 9, 2020
- Credit Conditions Europe: Curve Flattens, Recovery Unlocks, June 30, 2020
- Banking Industry Country Risk Assessment Spain, June 18, 2020
- Spain's Banco Santander Outlook Revised To Negative On Global Economic Downturn; 'A/A-1' Ratings Affirmed, April 29, 2020
- Spain, March 20, 2020

Anchor Matrix

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

Ratings Detail (As Of August 5, 2020)*	
Banco Santander S.A.	
Issuer Credit Rating	A/Negative/A-1
Resolution Counterparty Rating	A+/--/A-1

Ratings Detail (As Of August 5, 2020)*(cont.)	
Senior Subordinated	A-
Senior Unsecured	A
Short-Term Debt	A-1
Subordinated	BBB+
Issuer Credit Ratings History	
29-Apr-2020	A/Negative/A-1
06-Apr-2018	A/Stable/A-1
09-Jun-2017	A-/Stable/A-2
09-Feb-2017	A-/Positive/A-2
06-Oct-2015	A-/Stable/A-2
Sovereign Rating	
Spain	A/Stable/A-1
Related Entities	
Banco Ole Bonsucesso Consignado S.A.	
Issuer Credit Rating	
Brazil National Scale	brAAA/Stable/brA-1+
Banco Santander (Brasil) S.A.	
Issuer Credit Rating	BB-/Stable/B
Brazil National Scale	brAAA/Stable/brA-1+
Banco Santander-Chile S.A.	
Issuer Credit Rating	A/Negative/A-1
Commercial Paper	
Foreign Currency	A-1
Senior Unsecured	A
Subordinated	A-
Banco Santander SA (London Branch)	
Certificate Of Deposit	
Local Currency	A-1
Banco Santander S.A. (New York Branch)	
Commercial Paper	
Local Currency	A-1
Banco Santander Totta S.A.	
Issuer Credit Rating	BBB/Stable/A-2
Resolution Counterparty Rating	BBB/--/A-2
Senior Unsecured	BBB
PSA Banque France	
Issuer Credit Rating	BBB+/Negative/A-2
Commercial Paper	A-2
Senior Unsecured	BBB+
Santander Bank, N.A.	
Issuer Credit Rating	A-/Negative/A-2
Senior Unsecured	A-
Short-Term Debt	A-2

Ratings Detail (As Of August 5, 2020)*(cont.)	
Subordinated	BBB+
Santander Consumer Bank AG	
Issuer Credit Rating	A-/Negative/A-2
Resolution Counterparty Rating	A/--/A-1
Commercial Paper	A-2
Senior Subordinated	BBB+
Senior Unsecured	A-
Santander Consumer Finance S.A.	
Issuer Credit Rating	A-/Negative/A-2
Resolution Counterparty Rating	A/--/A-1
Commercial Paper	
Local Currency	A-2
Senior Subordinated	BBB+
Senior Unsecured	A-
Short-Term Debt	A-2
Subordinated	BBB
Santander Holdings U.S.A Inc.	
Issuer Credit Rating	BBB+/Negative/A-2
Senior Unsecured	BBB+
Santander Totta SGPS, S.A.	
Senior Unsecured	BBB
Santander UK Group Holdings PLC	
Issuer Credit Rating	BBB/Negative/A-2
Junior Subordinated	B+
Senior Unsecured	BBB
Short-Term Debt	A-2
Subordinated	BB+
Santander UK PLC	
Issuer Credit Rating	A/Negative/A-1
Resolution Counterparty Rating	A+/--/A-1
Junior Subordinated	BB
Junior Subordinated	BB+
Preference Stock	BB
Senior Secured	AAA/Stable
Senior Unsecured	A
Senior Unsecured	A-1
Short-Term Debt	A-1
Subordinated	BBB-

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