Credit Rating Announcement

13 September 2021

# Scope affirms Santander’s cédulas hipotecarias at AAA with a Stable Outlook

**The issuer rating of AA- combined with fundamental credit support results in the highest achievable ratings for the mortgage covered bonds. The cover pool provides additional rating stability.**

## Rating action

Scope Ratings GmbH (Scope) has today affirmed the ratings assigned to the Spanish mortgage covered bonds (cédulas hipotecarias) issued by Banco Santander SA (Santander) at AAA. All ratings have a Stable Outlook.

## Key rating drivers

**Solid issuer rating (positive)**[1]. Santander has a solid issuer rating of AA-. The rating reflects the bank’s strong, seasoned business model in retail and commercial banking, which produces a reliable and well-diversified earnings stream.

**Fundamental credit support (positive)**[2]. Fundamental credit support is the primary rating driver for the programme. It provides the covered bonds with six notches of uplift above the issuer rating. As such, only three notches are needed to raise the covered bond ratings to the highest achievable level.

**Cover pool support (positive)**[3]. The cover pool analyses support additional rating stability. This is reflected by:

1. **The Cover Pool Complexity Score (positive)**. Scope has assigned a Cover Pool Complexity Score of 3 to the issuer’s management of the interplay between complexity and the transparency. This allows for a maximum uplift of one notch on top of the fundamental uplift.

2. **Over-collateralisation (positive)**. As of 30 June 2021, the programme has 94.1% of over-collateralisation. These levels can shield the current AAA ratings against an issuer downgrade of up to five notches.

3. **Sound credit quality (positive)**. The cover pool comprises well-diversified domestic residential (79.1%) and commercial (20.9%) mortgage loans. The cover assets benefit from a moderate average loan-to-value ratio of 63.7% for residential and 74.1% for commercial loans.

4. **Market risks (negative)**. Market risks are high, with 81.1% of floating-rate loans compared to 19.4% of

floating-rate liabilities. Existing asset-liability mismatches are not mitigated by either extendable maturities or substitute assets. Foreign currency risk is limited, however, as 99% of loans and 100% of bonds are in euro. Available over-collateralisation also mitigates such risks.

## Rating-change drivers

Scope's Stable Outlook on the covered bonds reflects a rating buffer of five notches, including one notch provided by the cover pool. The ratings may be downgraded upon: i) an issuer rating downgrade by more than four notches; ii) a deterioration in Scope's view on fundamental support factors relevant to the issuer and Spanish mortgage covered bonds in general as well as on the interplay between complexity and transparency; and/or iii) an inability of the cover pool to provide an uplift if the issuer rating is downgraded by more than three notches.

## Quantitative analysis and assumptions

Scope's cash flow analysis projected defaults for the cover pool assuming an inverse Gaussian distribution. Scope derived an effective weighted-average lifetime mean default rate of 15% and a coefficient of variation of 60%.

Scope also assumed asset-recovery rates ranging between 94.0% in the base scenario and 75.0% in the stressed scenario for the residential loans and between 88.9% and 42.5% for respective scenarios for the commercial loans.

Scope established total security-value haircuts (including liquidation costs) for the properties securing the mortgage loans of 30%-43% in the base scenario and 35%-77.5% in the stressed scenario, with the level depending on the location and type of property.

Scope used the resulting loss distributions and default timings to project the covered bond programme's losses and reflect its amortisation structure. The analysis also incorporated the impact of rating-distance-dependent interest-rate and forex stresses as well as different prepayment scenarios. Scope tested for low (1%) and high (up to 15%) prepayments to stress the programme's sensitivity to unscheduled repayments.

The programme is most sensitive to a low interest rate scenario in combination with low prepayments as well as an appreciation of foreign currencies against the base currency (euro). Scope applied forex stresses ranging between -45% and +100%.

Recovery lag assumptions were 24 months for residential loans and 36 months for commercial loans. Scope assumed an annual average servicing fee of 25bp for residential and 50bp for commercial mortgage loans.

Scope calculated the cover pool's net present value in the event of an asset sale by adding a refinancing premium to the rating-distance and scenario-dependent discount curve of 375bp for residential mortgage loans and 500bp for commercial mortgage loans.

The assets and bonds interest rates were based on public information, supplemented by historical market-wide mortgage rates in Germany considering the programme's seasoning split and a representative sample of Spanish mortgage and public sector covered bonds.

**Rating driver references**

1. Banco Santander SA – issuer rating
2. Fundamental support assessment Spain

3. Confidential and public quarterly cover pool reporting, complementary annual performance updates

## Stress testing

No stress testing was performed.

## Cash flow analysis

The Credit Rating uplift is based on a cash flow analysis using Scope Ratings' covered bond model (CobEL version 1.0). The model applies Credit Rating distance-dependent stresses to scheduled cash flows to simulate the impact of increasing credit and market risks. The model outcome is the expected loss for a given level of overcollateralisation.

## Methodology

The methodologies used for these Credit Ratings and Outlooks, (Covered Bond Rating Methodology, 18 May 2021, General Structured Finance Rating Methodology 14 December 2020), are available on https://www.scoperatings.com/#!methodology/list.
The model used for this Credit Rating and Outlook is (Covered Bonds Expected Loss Model version 1.0) available in Scope Ratings' list of models, published under https://www.scoperatings.com/#!methodology/list.
Scope Ratings GmbH and Scope Ratings UK Limited apply the same methodologies/models and key rating assumptions for their credit rating services, while Scope Hamburg GmbH's methodologies/models and key rating assumptions are different from those of Scope Ratings GmbH and Scope Ratings UK Limited.
Information on the meaning of each Credit Rating category, including definitions of default, recoveries, Outlooks and Under Review, can be viewed in 'Rating Definitions – Credit Ratings, Ancillary and Other Services', published on https://www.scoperatings.com/#!governance-and-policies/rating-scale. Historical default rates of the entities rated by Scope Ratings can be viewed in the Credit Rating performance report at https://www.scoperatings.com/#governance-and-policies/regulatory-ESMA. Also refer to the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope Ratings' definitions of default and Credit Rating notations can be found at https://www.scoperatings.com/#governance-and-policies/rating-scale. Guidance and information on how environmental, social or governance factors (ESG factors) are incorporated into the Credit Rating can be found in the respective sections of the methodologies or guidance documents provided on https://www.scoperatings.com/#!methodology/list.
The Outlook indicates the most likely direction of the Credit Rating if the Credit Rating were to change within the next 12 to 18 months.

## Solicitation, key sources and quality of information

The Credit Ratings were not requested by the Rated Entity or its Related Third Parties. The Credit Rating process was conducted:

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| With Rated Entity or Related Third Party participation | NO |
| With access to internal documents | NO |
| With access to management | NO |

The following substantially material sources of information were used to prepare the Credit Ratings: public domain and Scope Ratings' internal sources.
Scope Ratings considers the quality of information available to Scope Ratings on the Rated Entity or instrument to be satisfactory. The information and data supporting these Credit Ratings originate from sources Scope Ratings considers to be reliable and accurate. Scope Ratings does not, however, independently verify the reliability and accuracy of the information and data. Prior to the issuance of the Credit Rating action, the Rated Entity was given the opportunity to review the Credit Ratings and Outlooks and the principal grounds on which the Credit Ratings and Outlooks are based. Following that review, the Credit Ratings were not amended before being issued.

## Regulatory disclosures

These Credit Ratings and Outlooks are issued by Scope Ratings GmbH, Lennéstraße 5, D-10785 Berlin, Tel +49 30 27891-0. The Credit Ratings and Outlooks are UK-endorsed.
Lead analyst: Mathias Pleißner, Director
Person responsible for approval of the Credit Ratings: Olivier Toutain, Executive Director
The Credit Ratings/Outlooks were first released as a public Credit Rating by Scope Ratings on 22 September 2015. The Credit Ratings/Outlooks were last updated on 17 September 2020. The Credit Ratings and Outlooks were converted from public to subscription Credit Ratings on 29 August 2019.

## Potential conflicts

See www.scoperatings.com under Governance & Policies/EU Regulation/Disclosures for a list of potential conflicts of interest related to the issuance of Credit Ratings.

## Conditions of use / exclusion of liability

## About Scope Ratings GmbH

Scope Ratings GmbH is part of the Scope Group with headquarters in Berlin and offices in Frankfurt, London, Madrid, Milan, Oslo and Paris. As the leading European credit rating agency, the company specialises in the analysis and ratings of financial institutions, corporates, structured finance, project finance and public finance. Scope Ratings offers a credit risk analysis that is opinion-driven, forward-looking and non-mechanistic, an approach which adds to a greater diversity of opinions for institutional investors. Scope Ratings is a credit rating agency registered in accordance with the EU rating regulation and operating in the European Union with ECAI status.

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