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
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/#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:

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
© 2021 Scope SE & Co. KGaA and all its subsidiaries including Scope Ratings GmbH, Scope Ratings UK Limited, Scope Analysis GmbH, Scope Investor Services GmbH, and Scope ESG Analysis GmbH (collectively, Scope). All rights reserved. The information and data supporting Scope’s ratings, rating reports, rating opinions and related research and credit opinions originate from sources Scope considers to be reliable and accurate. Scope does not, however, independently verify the reliability and accuracy of the information and data. Scope’s ratings, rating reports, rating opinions, or related research and credit opinions are provided ‘as is’ without any representation or warranty of any kind. In no circumstance shall Scope or its directors, officers, employees and other representatives be liable to any party for any direct,
indirect, incidental or other damages, expenses of any kind, or losses arising from any use of Scope’s ratings, rating reports, rating opinions, related research or credit opinions. Ratings and other related credit opinions issued by Scope are, and have to be viewed by any party as, opinions on relative credit risk and not a statement of fact or recommendation to purchase, hold or sell securities. Past performance does not necessarily predict future results. Any report issued by Scope is not a prospectus or similar document related to a debt security or issuing entity. Scope issues credit ratings and related research and opinions with the understanding and expectation that parties using them will assess independently the suitability of each security for investment or transaction purposes. Scope’s credit ratings address relative credit risk, they do not address other risks such as market, liquidity, legal, or volatility. The information and data included herein is protected by copyright and other laws. To reproduce, transmit, transfer, disseminate, translate, resell, or store for subsequent use for any such purpose the information and data contained herein, contact Scope Ratings GmbH at Lennéstraße 5 D-10785 Berlin.

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.

Contact

<table>
<thead>
<tr>
<th>Analyst</th>
<th>Mathias Pleissner</th>
<th><a href="mailto:m.pleissner@scoperatings.com">m.pleissner@scoperatings.com</a></th>
</tr>
</thead>
<tbody>
<tr>
<td>Team leader</td>
<td>Karlo Fuchs</td>
<td><a href="mailto:k.fuchs@scoperatings.com">k.fuchs@scoperatings.com</a></td>
</tr>
</tbody>
</table>

Scope Ratings GmbH • Lennéstraße 5 • D-10785 Berlin • Phone: +49 30 27891-0 • Fax: +49 30 27891-0
www.scoperatings.com

Executive Board: Guillaume Jolivet • District Court: Berlin: HRB 192993 B • VAT identification number: DE226486027

Save paper! Please consider the environment before printing this email. This email may contain confidential and/or privileged information. If you are not the intended recipient (or have received this email by mistake) please notify the sender immediately and destroy this email. Any unauthorised copying, disclosure or distribution of the material in this email is strictly forbidden.