Banco Santander S.A.'s Additional Tier 1 Instruments Rated 'BBB-'

April 30, 2024

PRIMARY CREDIT ANALYST

Elena Iparraguirre
Madrid
+ 34 91 389 6963
elena.iparraguirre
@spglobal.com

SECONDARY CONTACT

Luigi Motti
Madrid
+ 34 91 788 7234
luigi.motti
@spglobal.com

MADRID (S&P Global Ratings) April 30, 2024--S&P Global Ratings today rated the following outstanding Banco Santander S.A. non-step-up noncumulative contingent convertible perpetual preferred Tier 1 securities (the additional tier 1 or AT1 instruments) 'BBB-':

- $1.15 billion 9.625% securities issued Nov. 21, 2023;
- $1.35 billion 9.625% securities issued Nov. 21, 2023;
- €1 billion 3.625% securities issued Sept. 21, 2021;
- $1 billion 4.750% securities issued May 12, 2021;
- €750 million 4.125% securities issued May 12, 2021;
- €1.5 billion 4.375% securities issued Jan. 14, 2020; and
- €1.5 billion 4.75% securities issued March 19, 2018.

We also raised our issue rating on the series 2 €300 million CMS-linked noncumulative perpetual guaranteed preferred securities (the legacy preferred shares) originally issued by Santander Finance Preferred S.A. Unipersonal on Sept. 30, 2004, to 'BBB-' from 'BB+'. The outstanding amount of the securities is €144 million.

We rate these AT1 instruments four notches below our assessment of the bank's 'a' stand-alone credit profile. This reflects:

- One notch for contractual subordination;
- Two notches for the risk of discretionary coupon nonpayment, given that the instruments qualify as Tier 1 capital; and
- One notch for the risk of principal conversion into equity if the bank were in distress. The instrument will convert into capital when the bank's consolidated or individual common equity Tier 1 ratio reaches 5.125%, a level we do not see as a going concern trigger.

Santander's satisfactory capital and leverage maximum distributable amount (MDA) buffers do not call for additional notching. In December 2023, Santander reported an MDA buffer of 269 basis points (bps): its Tier 1 ratio stood at 13.74% versus a requirement of 11.06%. Meanwhile, its leverage ratio (4.71%) exceeded the 3.5% regulatory requirement by 121 bps.

We see the ability of EU banks to maintain comfortable headroom above capital and leverage regulatory requirements as a key mitigant of the risk that regulators impose restrictions on the payment of AT1 coupons. We assume the bank will maintain MDA buffers of well above 200 bps for capital and at least 100 bps for leverage.

The more restrictive definition of distributable items for the legacy preferred shares does not affect our rating on the AT1 instruments. The legacy preferred shares have a nondistribution clause conditional on the existence of enough distributable profits in the immediately preceding fiscal year. This implies a narrower definition of distributable items than the one applicable to the AT1 instruments.

We do not think the existence of this clause indirectly increases the probability of default of the AT1 instruments. We believe it is unlikely that Santander would decide to skip coupon payments on the AT1 instruments if it were to cancel coupon payments on the legacy preferred shares because of the narrower definition of distributable items.

Furthermore, when the bank reported a net loss in 2020, it did not interrupt payments on the legacy preferred shares then outstanding, treating them in line with the AT1 instruments. This was on the understanding that the preferred shares' stricter definitions within the terms and conditions were aligned with the requirements of Tier 1 eligibility in force at the time of issuance, and that the currently applicable EU Capital Requirements Regulation superseded such definitions.

We now see the legacy preferred shares as having a similar likelihood of default as the AT1 instruments. We thus raised our rating on the legacy preferred shares to 'BBB-' from 'BB+'. While we continue to reflect in our ratings the instruments' narrower definition of distributable items, the risk of coupon nonpayment is lower than that of Tier 1 instruments, because as of January 2022, the regulator considers the legacy preferred shares as Tier 2 capital.

The AT1 instruments have intermediate equity content, in our view. Therefore, we compute them in our measure of the bank's capital base in our risk-adjusted capital analysis. They have intermediate equity content because they are perpetual instruments that count as regulatory Tier 1 capital, do not contain step-up features, and can absorb losses through the discretionary nonpayment of coupons and equity conversion.

Conversely, the legacy preferred shares have no equity credit and are not counted in our measure of capital, mainly because they are now considered Tier 2 capital and their terms and conditions do not contemplate the possibility of equity conversion on a going-concern basis. That said, they form part of the bank's additional loss-absorbing capacity.

Ratings Score Snapshot

Issuer Credit Rating	A+/Stable/A-1
SACP	a
Anchor	bbb
Business position	Very strong (+2)
Capital and earnings	Adequate (0)
Risk position	Strong (+1)
Funding and liquidity	Adequate and adequate (0)
Comparable ratings analysis	0
Support	+1

Issuer Credit Rating	A+/Stable/A-1
ALAC support	+1
GRE support	0
Group support	0
Sovereign support	0
Additional factors	0

SACP--Stand-alone credit profile. ALAC--Additional loss-absorbing capacity. GRE--Government-related entity.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- 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
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.spglobal.com/ratings for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceId/504352. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings. Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.