

FITCH AFFIRMS SANTANDER'S MORTGAGE COVERED BONDS AT 'AA'

Fitch Ratings-Madrid-28 September 2018: Fitch Ratings has affirmed Banco Santander S.A.'s (Santander, A-/Stable/F2) mortgage covered bonds (Cedulas Hipotecarias or CH) at 'AA' with Stable Outlook upon the completion of the merger through absorption of Banco Popular Espanol, S.A.U. and Banco Pastor, S.A.U. (together Grupo Popular) on 28 September 2018. The 'AA' rating of Santander's CH has been assigned to the CH being transferred from Grupo Popular.

The Stable Outlook on Santander's CH reflects that on the bank's Long-Term Issuer Default Rating (IDR).

KEY RATING DRIVERS

Merger by Absorption

As a consequence of the merger all assets and liabilities of Grupo Popular have been absorbed by Santander. The merger leads to a consolidated mortgage cover pool of approximately EUR84.9 billion providing security to outstanding CHs of EUR35.8 billion as of 28 September 2018. These post-merger figures are supported by separate cover pool data files for Banco Santander and Grupo Popular and express a total over-collateralisation (OC) ratio of 135.3% as of end-June 2018.

The merged cover pool comprises approximately 65.3% residential mortgages, 26.4% commercial mortgages to SME borrowers and 8.3% to real estate developers. The weighted average seasoning of the cover pool is 7.3 years and its remaining term to maturity 15.5 years. The post-merger official cover pool data tape will be delivered by Santander during the next few months, and therefore the above cover pool statistics are preliminary and subject to change.

IDR and Recovery Uplift

The 'AA' rating of Santander's CH inclusive of those transferred from Grupo Popular is based on Santander's 'A-' Long-Term IDR, an IDR uplift of two notches and a recovery uplift of two notches. Spanish covered bonds are eligible for a maximum IDR uplift of two notches given their bail-in exemption in a resolution scenario, Fitch's assessment that resolution of the issuer will not result in the direct enforcement of recourse against the cover pool and a low risk of under-collateralisation at the point of resolution.

The level of OC of 122% relied upon by Fitch, provides more protection than the agency's unchanged 'AA' breakeven OC of 36%. The agency will review Santander's CH's breakeven OC once official post-merger cover pool tape is available. Fitch expects this ratio to remain broadly stable, given the cover pool composition and granularity.

Relied-Upon OC

Given the merger, and in accordance with Fitch Covered Bonds Rating Criteria, the 12-month look-back period to establish the level of OC that can be relied upon starts in June 2018. The relied-upon OC is derived after applying a 10% OC haircut to the total OC ratio as per the agency's criteria for Spanish issuers with a 'F2' Short-Term IDR.

Payment Continuity Uplift (PCU)

The unchanged PCU of zero notches reflects the lack of liquidity protection mechanisms to bridge payments to CHs in the event of recourse to the cover pool. This is common for all CHs rated by Fitch as they have hard bullet maturities while the cover assets gradually amortise.

RATING SENSITIVITIES

The 'AA' rating of Santander's CH is vulnerable to a downgrade if the bank's Long-Term IDR is downgraded by one or more notches, or if the OC that Fitch considers in its analysis decreases below Fitch's 'AA' breakeven level of 36%. If the OC declines to the 25% legal minimum, the CH rating would be downgraded by one notch to 'AA-'.

Contact:

Primary Analyst

Beatriz Gomez

Associate Director

+34 91 702 57 75

Fitch Ratings Espana S.A.U.

Plaza de Colon 2, Torre II, planta 5

Madrid, 28046

Secondary Analyst

Ricardo Garcia

Associate Director

+34 91 702 57 72

Committee Chairperson

Juan David Garcia

Senior Director

+34 91 702 57 74

Media Relations: Athos Larkou, London, Tel: +44 20 3530 1549, Email:
athos.larkou@fitchratings.com.

Additional information is available on www.fitchratings.com

Applicable Criteria

CLOs and Corporate CDOs Rating Criteria (pub. 19 Jul 2018)

<https://www.fitchratings.com/site/re/10038306>

Covered Bonds Rating Criteria - Effective from 13 August 2018 to 8 October 2018 (pub. 13 Aug 2018)

<https://www.fitchratings.com/site/re/10040601>

European RMBS Rating Criteria - Effective from 11 May 2018 to 5 October 2018 (pub. 11 May 2018)

<https://www.fitchratings.com/site/re/10030134>

Multi-Issuer Cedulas Hipotecarias Rating Criteria (pub. 13 Mar 2018)

<https://www.fitchratings.com/site/re/10022868>

SME Balance Sheet Securitisation Rating Criteria (pub. 23 Feb 2018)

<https://www.fitchratings.com/site/re/10020825>

Structured Finance and Covered Bonds Counterparty Rating Criteria (pub. 01 Aug 2018)

<https://www.fitchratings.com/site/re/10039504>

Structured Finance and Covered Bonds Country Risk Rating Criteria (pub. 18 Sep 2017)

<https://www.fitchratings.com/site/re/903496>

Structured Finance and Covered Bonds Interest Rate Stresses Rating Criteria (pub. 02 Feb 2018)

<https://www.fitchratings.com/site/re/10018549>

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTPS://WWW.FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](https://www.fitchratings.com/understandingcreditratings). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEB SITE AT WWW.FITCHRATINGS.COM. PUBLISHED RATINGS, CRITERIA, AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE, AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE CODE OF CONDUCT SECTION OF THIS SITE. DIRECTORS AND SHAREHOLDERS RELEVANT INTERESTS ARE AVAILABLE AT [HTTPS://WWW.FITCHRATINGS.COM/SITE/REGULATORY](https://www.fitchratings.com/site/regulatory). FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD

PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.

Copyright © 2018 by Fitch Ratings, Inc., Fitch Ratings Ltd. and its subsidiaries. 33 Whitehall Street, NY, NY 10004. Telephone: 1-800-753-4824, (212) 908-0500. Fax: (212) 480-4435. Reproduction or retransmission in whole or in part is prohibited except by permission. All rights reserved. In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third-party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided "as is" without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US\$1,000 to US\$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US\$10,000 to US\$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001

Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the "NRSRO"). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see <https://www.fitchratings.com/site/regulatory>), other credit rating subsidiaries are not listed on Form NRSRO (the "non-NRSROs") and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.