

02 Oct 2020 | Downgrade

Fitch Downgrades Santander's Legacy Hybrid Preferred Securities to 'CCC'

Fitch Ratings-Barcelona-02 October 2020:

Fitch Ratings has downgraded three of Banco Santander, S.A.'s (A-/Negative) legacy hybrid preferred securities to 'CCC' from 'BB'. The downgrades reflect the heightened non-performing risks of these securities due to their profit test trigger and our expectation that the bank will report a net loss in the unconsolidated accounts of the parent bank in 2020. The three notes have the following ISINs: US05971K4067, XS0307728146 and XS0202197694.

Santander's Issuer Default Ratings, Viability Rating and other debt ratings are unaffected by this rating action.

Key Rating Drivers

The notes' ratings reflect Fitch's view that there is a heightened risk that these hybrid securities will become non-performing in 2021 as reported distributable profit, which excludes reserves under the original terms of the notes, is a distribution trigger. Therefore, a net loss reported in the unconsolidated accounts of the parent bank would prevent Santander from paying coupons on these securities under the terms and conditions of the notes.

We expect that Santander will report a net loss in unconsolidated accounts of the parent bank for 2020 as the result of a sizeable one-off negative impact from impairments on investments in some of its foreign subsidiaries recorded in 1H20. In our view, Santander will not generate sufficient profit in 2H20 to offset these one-offs and will not be able to make coupon payments on these legacy hybrid preferred securities.

The ratings on the securities reflect our expectation that the economic losses to investors in these securities in case of non-performance will be very low (below 10%) as the coupon payments should resume in 2022, if the bank returns to profitability in 2021 as we expect. In our view, Santander remains structurally profitable, as reflected in its VR and earnings and profitability score of 'a-', which is one of Santander's rating strengths.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrades:

The securities' ratings are primarily sensitive to Santander returning to profitability in 2021, which would allow the hybrid securities to return to performing status. At that point, we will use the bank's VR as the anchor rating and we expect that these legacy hybrid preferred securities will likely be rated five notches below Santander's VR to reflect higher loss severity risk of these securities when compared with average recoveries (two notches from the VR), as well as high risk of non-performance (an additional three notches) due to a profit test.

Factors that could, individually or collectively, lead to negative rating action/downgrades:

The securities could be downgraded if we expect that Santander will continue to report losses on an unconsolidated basis at the parent bank level in 2021 and beyond, resulting in a higher loss severity for investors than we currently expect.

ESG Considerations

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

Best/Worst Case Rating Scenario

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [<https://www.fitchratings.com/site/re/10111579>]

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

Banco Santander, S.A.

---preferred; Long Term Rating; Downgrade; CCC

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Additional information is available on www.fitchratings.com

Applicable Criteria

[Bank Rating Criteria \(pub. 28 Feb 2020\) \(including rating assumption sensitivity\)](#)

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