Action follows the merger by absorption of Banco Popular by Banco Santander

Madrid, October 01, 2018 -- Moody's Investors Service ("Moody's") has today taken the following rating actions on the ratings of the covered bonds transferred from Banco Popular Espanol, S.A. (Banco Popular) (deposits A2; adjusted baseline credit assessment baa1; counterparty risk (CR) assessment A3(cr)) to Banco Santander S.A. (Spain) (Banco Santander or the issuer) (deposits A2; adjusted baseline credit assessment baa1; counterparty risk (CR) assessment A3(cr)):

- Mortgage covered bonds (Cédulas Hipotecarias or CHs) issued by Banco Popular: withdrawn for reorganisation; previously Aa1.
- Public-sector covered bonds (Cédulas Territoriales or CTs) issued by Banco Popular: withdrawn for reorganisation; previously Aa1.
- CHs assumed by Banco Santander and transferred from the former Banco Popular: Aa1, new rating assigned.
- CTs assumed by Banco Santander and transferred from the former Banco Popular: Aa1, new rating assigned.

Today's rating action follows the merger by absorption of Banco Popular by Banco Santander.

Please refer to the Moody's Investors Service's Policy for Withdrawal of Credit Ratings, available on www.moodys.com

RATINGS RATIONALE

Today's rating actions follow the merger by absorption, effective as of 28 September 2018, of Banco Popular by its parent Banco Santander. Banco Santander will also absorb Banco Pastor S.A.U. (Banco Pastor) (not rated), which is a subsidiary of Banco Popular. Following the merger, Banco Santander will assume all the assets and liabilities of Banco Popular and Banco Pastor including the covered bonds. As a result, Moody's understands that the new cover pool backing Banco Santander's CHs represents the addition of Banco Popular's, Banco Pastor's and Banco Santander's former total mortgage pools. Moody's also understands that the new cover pool backing Banco Santander's CTs represents the addition of Banco Popular's, Banco Pastor's (if any) and Banco Santander's former total public-sector pools.

A covered bond benefits from (1) the issuer's promise to pay interest and principal on the bonds; and (2) if the issuer defaults, the economic benefit of a collateral pool (the cover pool). The ratings therefore take into account the following factors:

(1) The credit strength of Banco Santander (deposits A2; adjusted baseline credit assessment baa1; counterparty risk (CR) assessment A3(cr)) and a CB anchor of CR assessment plus 1 notch.

(2) Following a CB anchor event the value of the cover pool. The stressed level of losses on the cover pool assets following a CB anchor event (cover pool losses) for the CHs is 32.1%. The cover pool losses for CTs is 50%.

The analysis of the value of the cover pool considered:

a) The credit quality of the assets backing the covered bonds. The mortgage covered bonds are backed by Spanish commercial and residential mortgage loans. The collateral score for the mortgage cover pool is 16.4%. The public-sector covered bonds are backed by claims against Spanish public-sector entities or claims guaranteed by such entities. The collateral score for the public-sector cover pool is 21.2%. These figures are
based on the amalgamated cover pool of the Banco Santander and Banco Popular and excludes Banco Pastor's cover pool assets.

b) The robust Spanish legal framework for CHs. CHs are issued by Spanish financial institutions, secured by the issuer's entire mortgage book and regulated mainly by the Spanish Mortgage Market Law and the Insolvency Law. The Spanish legal framework for CHs is characterised by (1) the fact that CH holders have a priority security claim over the bank's whole mortgage pool (the total cover pool); (2) the restriction on issuing CHs to a maximum of 80% of the portion of loans regarded as eligible mortgages (the eligible cover pool), which provides for a minimum 25% over-collateralisation (OC) for the purposes of issuance; and (3) the fact that CHs do not have to be accelerated because of insolvency proceedings.

c) The robust Spanish legal framework for CTs. CTs are governed mainly by the Law 44/2002, of 23 November, on the reform of the Financial System and the Insolvency Law, and are full-recourse direct corporate obligations of the issuing entity. Legal framework strengths include (1) that CT holders have a priority security claim over all the issuer's public-sector loans made in the European Economic Area (the cover pool); (2) the restriction on issuing CTs to a maximum of 70% of the cover pool, which provides for a minimum 43% OC; and (3) if the issuer becomes insolvent, the CTs do not have to be terminated or accelerated.

d) The exposure to market risk. The market risk for the mortgage cover pool is 21.1%. The market risk for the public-sector cover pool is 39.4%. These figures are based on the amalgamated cover pool of Banco Santander and Banco Popular.

e) As of 30 June 2018, the OC in the mortgage cover pool based on the three merged entities is 135.3%, of which Banco Santander provides 25% on a "committed" basis (see Key Rating Assumptions/Factors, below). The OC in the public-sector cover pool based on Banco Santander and Banco Popular is 70.8% of which Banco Santander provides 42.9% on a "committed" basis (see Key Rating Assumptions/Factors, below).

The timely payment indicator (TPI) assigned to these transactions is "Probable". This TPI constrains the rating of the covered bonds at its current level.

KEY RATING ASSUMPTIONS/FACTORS

Covered bond ratings are determined after applying a two-step process: an expected loss analysis and a TPI framework analysis.

EXPECTED LOSS: Moody's uses its Covered Bond Model (COBOL) to determine a rating based on the expected loss on the bond. COBOL determines expected loss as (1) a function of the probability that the issuer will cease making payments under the covered bonds (a CB anchor event); and (2) the stressed losses on the cover pool assets following a CB anchor event.

The CB anchor for these programmes is the CR assessment plus 1 notch. The CR assessment reflects an issuer's ability to avoid defaulting on certain senior bank operating obligations and contractual commitments, including covered bonds. Moody's may use a CB anchor of CR assessment plus one notch in the European Union or elsewhere, where an operational resolution regime is particularly likely to ensure continuity of covered bond payments.

-Banco Santander CHs:

The cover pool losses of Banco Santander CHs are 32.1% with market risk of 21.1% and collateral risk of 11%. Collateral risk is derived from the collateral score, which for this programme is currently 16.4%. These figures are Moody's estimates based on weighted cover pool data from Banco Santander and Banco Popular. As of June 2018, the OC in this cover pool is 135.3%, of which Banco Santander provides 25% on a "committed" basis. Under Moody's COBOL model, the minimum OC level that is consistent with the Aa1 rating target is 21.5%. These numbers show that Moody's is not relying on "uncommitted" OC in its expected loss analysis.

-Banco Santander CTs:

The cover pool losses of Banco Santander CTs are 50%, with market risk of 39.4% and collateral risk of 10.6%. Collateral risk is derived from the collateral score, which for this programme is currently 21.2%. These figures are Moody's estimates based on weighted cover pool data from Banco Santander and Banco Popular. As of June 2018, the OC in this cover pool is 70.8%, of which Banco Santander provides 42.9% on a "committed" basis. Under Moody's COBOL model, the minimum OC level that is consistent with the Aa1 rating target is 57%. These numbers show that Moody's is relying on "uncommitted" OC in its expected loss analysis.
For further details on cover pool losses, collateral risk, market risk, collateral score and TPI Leeway across covered bond programmes rated by Moody's please refer to "Moody's Global Covered Bonds Monitoring Overview", published quarterly. All numbers unless otherwise stated are based on the most recent modelling (based on data, as of end March 2018 for Banco Popular CHs and Banco Santander CTs and as of June 2018 for Banco Santander CHs and Banco Popular CTs).

TPI FRAMEWORK: Moody's assigns a "timely payment indicator" (TPI), which measures the likelihood of timely payments to covered bondholders following a CB anchor event. The TPI framework limits the covered bond rating to a certain number of notches above the CB anchor.

Factors that would lead to an upgrade or downgrade of the ratings:

The CB anchor is the main determinant of a covered bond programme's rating robustness. A change in the level of the CB anchor could lead to an upgrade or downgrade of the covered bonds. The TPI Leeway measures the number of notches by which Moody's might lower the CB anchor before the rating agency downgrades the covered bonds because of TPI framework constraints.

Based on the current TPI of "Probable", the TPI Leeway for these programmes is two notches. This implies that Moody's might downgrade the covered bonds because of a TPI cap if it lowers the CB anchor by three notches, all other variables being equal.

A multiple-notch downgrade of the covered bonds might occur in certain circumstances, such as (1) a country ceiling or sovereign downgrade capping a covered bond rating or negatively affecting the CB Anchor and the TPI; (2) a multiple-notch downgrade of the CB Anchor; or (3) a material reduction of the value of the cover pool.

RATING METHODOLOGY

The principal methodology used in these ratings was "Moody's Approach to Rating Covered Bonds" published in December 2016. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions of the disclosure form.

Moody's did not use any stress scenario simulations in its analysis.

For ratings issued on a program, series or category/class of debt, this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series or category/class of debt or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

For any affected securities or rated entities receiving direct credit support from the primary entity(ies) of this credit rating action, and whose ratings may change as a result of this credit rating action, the associated regulatory disclosures will be those of the guarantor entity. Exceptions to this approach exist for the following disclosures, if applicable to jurisdiction: Ancillary Services, Disclosure to rated entity, Disclosure from rated entity.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

The below contact information is provided for information purposes only. Please see the ratings tab of the issuer page at www.moodys.com, for each of the ratings covered, Moody's disclosures on the lead rating
analyst and the Moody's legal entity that has issued the ratings.

Please see www.moodys.com for any updates on changes to the lead rating analyst and to the Moody's legal entity that has issued the rating.

Please see the ratings tab on the issuer/entity page on www.moodys.com for additional regulatory disclosures for each credit rating.

Miguel Lopez Patron
Analyst
Structured Finance Group
Moody's Investors Service Espana, S.A.
Calle Principe de Vergara, 131, 6 Planta
Madrid 28002
Spain
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Nicholas Lindstrom
Associate Managing Director
Structured Finance Group
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

Releasing Office:
Moody's Investors Service Espana, S.A.
Calle Principe de Vergara, 131, 6 Planta
Madrid 28002
Spain
JOURNALISTS: 44 20 7772 5456
Client Service: 44 20 7772 5454

© 2018 Moody's Corporation, Moody's Investors Service, Inc., Moody's Analytics, Inc. and/or their licensors and affiliates (collectively, "MOODY’S"). All rights reserved.

CREDIT RATINGS ISSUED BY MOODY'S INVESTORS SERVICE, INC. AND ITS RATINGS AFFILIATES (“MIS”) ARE MOODY’S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND MOODY’S PUBLICATIONS MAY INCLUDE MOODY’S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MOODY’S DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS AND MOODY’S OPINIONS INCLUDED IN MOODY’S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. MOODY’S PUBLICATIONS MAY ALSO INCLUDE QUANTITATIVE MODEL-BASED ESTIMATES OF CREDIT RISK AND RELATED OPINIONS OR COMMENTARY PUBLISHED BY MOODY’S ANALYTICS, INC. CREDIT RATINGS AND MOODY’S PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS AND MOODY’S PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. NEITHER CREDIT RATINGS NOR MOODY’S PUBLICATIONS COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MOODY’S ISSUES ITS CREDIT RATINGS AND PUBLISHES MOODY’S PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL, WITH DUE CARE, MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.
applicable). This document is intended to be provided only to “wholesale clients” within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY’S that you are, or are accessing the document as a representative of, a “wholesale client” and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to “retail clients” within the meaning of section 761G of the Corporations Act 2001. MOODY’S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail investors. It would be reckless and inappropriate for retail investors to use MOODY’S credit ratings or publications when making an investment decision. If in doubt you should contact your financial or other professional adviser.

Additional terms for Japan only: Moody's Japan K.K. ("MJKK") is a wholly-owned credit rating agency subsidiary of Moody's Group Japan G.K., which is wholly-owned by Moody’s Overseas Holdings Inc., a wholly-owned subsidiary of MCO. Moody’s SF Japan K.K. ("MSFJ") is a wholly-owned credit rating agency subsidiary of MJKK. MSFJ is not a Nationally Recognized Statistical Rating Organization ("NRSRO"). Therefore, credit ratings assigned by MSFJ are Non-NRSRO Credit Ratings. Non-NRSRO Credit Ratings are assigned by an entity that is not a NRSRO and, consequently, the rated obligation will not qualify for certain types of treatment under U.S. laws. MJKK and MSFJ are credit rating agencies registered with the Japan Financial Services Agency and their registration numbers are FSA Commissioner (Ratings) No. 2 and 3 respectively.

MJKK or MSFJ (as applicable) hereby disclose that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MJKK or MSFJ (as applicable) have, prior to assignment of any rating, agreed to pay to MJKK or MSFJ (as applicable) for appraisal and rating services rendered by it fees ranging from JPY200,000 to approximately JPY350,000,000.

MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.