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Banco Santander S.A.

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Banco Santander S.A.

SACP	a-	+	Support	0	+	Additional Factors	0

Anchor	bbb-	
Business Position	Very Strong	+2
Capital and Earnings	Moderate	-1
Risk Position	Very Strong	+2
Funding	Above Average	0
Liquidity	Adequate	

ALAC Support	0
GRE Support	0
Group Support	0
Sovereign Support	0

Issuer Credit Rating
A-/Stable/A-2

Major Rating Factors

Strengths	Weaknesses
• Wide geographic diversification and solid market positions in the markets where it operates. • Focus on stable retail banking business, underpinning the bank's sound and resilient earnings. • Successful strategy and implementation. • Proven ability to access the capital markets for funding in difficult times.	• Exposure to higher-than-average economic risk in some of the countries where it operates. • Proven appetite for acquisitions.

Outlook: Stable

The stable outlook on Banco Santander S.A. balances the potentially more supportive economic and operating environment in Spain with the managerial challenges posed by the recent acquisition of Popular. This is a large bank with sizable asset-quality problems, which Santander plans to restructure and integrate into the group.

We also factor in that Santander may face more difficult economic conditions in the U.K. following the Brexit vote, increased political uncertainty in Brazil, and emerging risks in the subprime auto lending business in the U.S. Additionally, the stable outlook takes into account that while the bank's capital compared with the risk it faces is likely to remain a ratings strength, it is unlikely that the bank will build up a large enough buffer of bail-in-able instruments to benefit from a rating uplift based on additional loss-absorbing capacity (ALAC).

We could take a positive rating action if we see a more supportive economic and operating environment in Spain alongside signs that the potential external risks mentioned above are stabilizing. It would also depend on the integration of Popular proceeding smoothly and as planned. We could raise the ratings if the bank exhibits a stronger build-up of loss-absorbing instruments than we currently expect.

Conversely, the ratings could come under pressure if the integration of Banco Popular encounters meaningful setbacks or unexpectedly undermines Santander's capital. The lowering of the sovereign rating on Spain could also put pressure on our rating on Santander.

Rationale

The ratings on Santander reflect its wide geographic and business diversification, strong franchises in most of the markets where it operates, its focus on stable retail banking activities, and strong management. Over the years, these factors have resulted in a solid and resilient profitability track record. Our ratings also reflect the bank's sound capitalization compared with the risks it undertakes, although we acknowledge that the bank operates in jurisdictions with higher-than-average economic risks. The bank's appetite for acquisitions also weighs on our assessment.

Santander is one of the most geographically diversified global banks, with no single country concentrating more than 30% of the group's total credit. It operates in a number of economies that face higher-than-average economic risks, in particular the Iberian Peninsula and Latin America. However, its footprints in economies that proved to be uncorrelated have allowed the bank to accommodate the ups and downs of the different economic cycles and achieve consistent, resilient profitability over time. We expect this to continue as the bank deals with still-high political uncertainty in Brazil and a weak economic outlook in the U.K. amid ongoing Brexit negotiations.

In addition to its wide geographic presence, we believe the bank's strong franchises in most of the countries where it is present also supports the profitability of its business model as it provides the bank with pricing power and a loyal clientele, while its focus on retail banking supports business and earnings stability.

While the bank's capital measures are below those of many of its global peers, we consider that Santander's capital position is solid relative to the risks the bank undertakes and it has the capacity to accommodate potentially adverse scenarios. In particular, Santander benefits from a wide geographic diversification and better-than-average asset quality track record in its main countries of operation. Furthermore, we expect the bank to gradually strengthen its capitalization in the years ahead, with its risk-adjusted capital (RAC) ratio approaching 7% in 2019, from 5.9% at end-2016 (pro forma Popular's acquisition). Internal capital generation, as profitability recovers on the back of higher volumes and cost control, and the issuance of additional Tier I instruments should contribute to the buildup of capital.

The acquisition of Popular led to a significant increase in the group's stock of problematic assets, but the subsequent agreement to sell a 51% interest on the bulk of them to Blackstone was a quick, wise response to reduce the burden that having to manage the workout would represent. Supported by ongoing positive developments in Spain, we expect the group's stock of problematic assets to continue gradually declining. However, the political environment in Brazil and weaker economic growth in the U.K. and signs of emerging risks in subprime auto financing in the U.S., could still put pressure on asset quality in these three markets.

We believe the group has a fairly balanced funding profile, primarily based on retail funding. Reliance on wholesale funding is manageable, and well diversified by instrument, location, and maturity. The group has also demonstrated its ability to access the markets for funding in turbulent times.

Our ratings on Banco Santander do not benefit from either government or additional loss-absorbing capacity (ALAC) support. However, we rate Santander one notch above the ratings on Spain, the bank's country of domicile. This reflects our view that there is an appreciable likelihood that Santander would not default in the hypothetical stress scenario of the Spanish sovereign defaulting. In such a scenario, Santander would likely face meaningful impairments that would erode a significant portion, but not all, of its capital base. The bank would also suffer sizable outflows of liquidity, but we believe it would be able to overcome liquidity pressures resorting to European Central Bank (ECB) funding.

Anchor: 'bbb-' reflecting the higher than average economic risk of the markets where the bank operates

Under our bank criteria we use our Banking Industry Country Risk Assessment (BICRA) economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning a long-term issuer credit rating. Our anchor for Santander is 'bbb-'. This results from our view of economic risk of the main countries where the bank has operations, and the industry risk in Spain, where the bank is legally incorporated and primarily regulated. The weighted-average economic risk to which Santander is exposed is somewhat lower than that faced by institutions operating primarily in Spain, but not enough to result in a different anchor. This is because outside its home market, the bank operates in countries that face both higher and lower economic risks than Spain. The U.K. and Spain account for the group's largest exposures, at almost 30% each as of end-2017, followed by Brazil and the U.S., each accounting for 10%. Exposure to Spain increased slightly as a result of the acquisition of Popular. Remaining exposures, accounting for about 5% each, include Portugal, Mexico, Germany, other Latin American countries and the rest of Europe.

With regard to industry risk, our score of '5' primarily reflects our expectation that banks are likely to remain structurally reliant on external funding--albeit less so than previously--and therefore vulnerable to shifts in investor confidence. Banks' meaningful deleveraging over the past five years has resulted in a rebalancing of their funding profiles, with customer deposits gaining significant weight in the funding mix. However, Spanish banks still owe about €170 billion to the ECB as of August 2017. We believe that this will be largely refinanced externally over time, given that banks have now restored their access to foreign capital markets. In our view, the operating environment will remain competitive because banks will find it challenging to achieve returns in line with their cost of capital. Although the deleveraging phase is nearing an end, we do not expect banks' business volumes to expand enough over the next few years to compensate for the negative effect of the prevailing low rates on earnings. Therefore, we see a risk that heightened competition to attract new business could threaten sensible pricing.

Table 1

Banco Santander S.A. -- Key Figures					
	--Year ended Dec. 31--				
	2017	**2016**	**2015**	**2014**	**2013**
Adjusted assets	1,413,632	1,308,249	1,309,483	1,234,696	1,087,614
Customer loans (gross)	824,695	771,212	785,022	746,043	662,262
Adjusted common equity	N/A	62,087	65,281	53,437	49,202
Operating revenues	49,849	45,511	47,419	44,248	40,943
Noninterest expenses	23,080	21,275	21,533	19,983	19,849
Core earnings	12,601	10,513	11,990	9,596	7,193

N/A--Not applicable.

Business Position: A powerful, geographically diversified retail banking franchise

In our view, Santander benefits from a very strong business position and is therefore very well placed to withstand the challenges posed by a potentially adverse operating environment, as demonstrated during the crisis years. The bank benefits from wide geographic diversification, strong market positions in most of the markets where it operates, significant business stability, and a track record of sound and resilient returns.

As a result of an intensive expansion strategy over the past two decades, Santander is currently one of the most geographically diversified banks in the world, with no single country concentrating more than 30% of the group's total credit and a fairly balance presence between developed and emerging economies. Significantly, the bank is present in countries that are economically not directly correlated with Spain, allowing it to accommodate the ups and downs of the different economic cycles and achieve consistent, resilient profitability over time. We expect this competitive advantage to continue to pay off, with the bank benefiting from the ongoing economic recovery in Spain as it deals with a still-challenging economic and political environment in Brazil and a weaker and uncertain economic outlook for the U.K. after the Brexit vote.

Santander also enjoys strong positions and franchises in most of its markets of operation, which provides it with pricing power and a loyal retail customer funding base. In addition to the now 18% market share that the bank holds in Spain, Santander is the second-largest mortgage lender in the U.K. (holding about 10% of the market) and gathers 9% of U.K. savings. It owns the second-largest bank in Chile and the fourth-largest bank in Mexico, Brazil, and Poland. It has also built up a consumer finance business, under Santander Consumer Finance S.A. (SCF), with widespread operations across Europe. Santander is also present in the U.S., where it benefits from good, albeit regional, market positions in several Northeastern states.

Santander is primarily focused on retail banking activities, which supports the bank's business and earnings stability.

Santander benefits from a clear strategy that has resulted in its successful transformation from a domestic institution into a strong and well-diversified global banking group. Management has, in our opinion, appropriately selected the countries for expansion. It has focused on large markets, with an adequate combination of matured and developing economies, and has intentionally pursued the buildup of strong banking franchises in each of its core markets. The bank has aimed to benefit from competitive advantages and economies of scale, and spread its commercial banking skills across the network. Santander has prioritized commercial banking activities as a recurrent profit source, while limiting investment and wholesale banking to service clients in its core markets. Finally, the bank has proved quite successful in integrating and turning around the institutions it has acquired.

Santander is delivering on its 2016-2018 strategic plan, which set up as priorities the improvement of the group's operating profitability by promoting revenue growth and efficiency; capital strengthening, prioritizing a less capital-intensive model; the engagement of clients; and the acceleration of the digitalization of the business. In our view, Santander is making good progress toward achieving its financial targets by end-2018. The latter include reaching return on tangible equity above 11.5% (it was 10.4% at end-2017) and increasing its earnings per share growth rate to double digits. To achieve these targets, the bank is focusing on revenue growth, improving client loyalty, gaining market share, generating more fee business, and focusing on more profitable segments (affluent and private banking clients, and small and midsize enterprises [SMEs] for example). In addition, Santander is undergoing an ambitious cost reduction plan that targets about €3 billion cost savings (compared with the 2013 cost base) by the end of 2018, with a view to improving the group's cost-to-income ratio to 45%-47%.

Targets have not changed despite the less favorable than initially considered economic environment in Brazil and the U.K. after the Brexit vote. In Brazil, while the economy seems to be getting out of recession, political stability remains uncertain amid corruption allegations against high-profile individuals and companies in both the private and public sectors and across political parties, which could challenge the implementation of policy measures needed to correct the economy's weaknesses. In the U.K., uncertainty surrounding the U.K.'s future relationship with the EU is likely to undermine its economic performance.

In addition to dealing with the above, and also with a more uncertain political environment in Mexico as the country goes through presidential elections, all eyes in 2018 will be, in our view, on the turnaround of Popular in Spain. We viewed the acquisition of Popular as positive from a business perspective: it strengthened the bank's market positioning in its home market, particularly in the SME segment; offered the possibility of gaining further efficiency; and the cost was affordable. But, Santander has to undertake a deep restructuring of Popular, which will still take some time to bear fruit. Among others, it will have to embark on a meaningful readjustment of Popular's branch network and staff to rationalize costs, to integrate its IT systems with those of the group and to align Popular's commercial and risk practices to group standards, while keeping business attrition under control. The launch of a commercial initiative to compensate clients from the losses they incurred at the time of the bank's resolution and marketing campaigns to improve the bank's image and link it to that of its parent should help in this last goal.

In our view, the recent acquisition of Popular shows that, as the economic environment becomes more favorable, Santander may be willing to embark in larger acquisitions than the ones we have seen in the previous few years, if the opportunities arose. We think the group could be strategically interested in investing in Mexico, the U.S., the U.K. and possibly Poland, to further strengthen its local presence. In the more medium term, we would also expect Santander to participate in future consolidation moves in Europe as the Banking Union project progresses.

Table 2

Banco Santander S.A. -- Business Position					
	--Year ended Dec. 31--				
(Mil. €)	**2017**	**2016**	**2015**	**2014**	**2013**
Loan market share in country of domicile	18.3	13.6	13.2	13.5	13.0
Deposit market share in country of domicile	18.9	13.4	14.2	14.8	15.6
Total revenues from business line (mil. €)	50,541.0	45,720.3	47,652.0	47,472.1	43,187.8
Commercial banking/total revenues from business line	11.0	12.7	11.1	10.5	11.9
Retail banking/total revenues from business line	87.1	85.4	84.7	77.2	80.6
Commercial & retail banking/total revenues from business line	98.1	98.2	95.8	87.7	92.5
Other revenues/total revenues from business line	1.9	1.8	4.2	9.1	5.8
Return on equity	7.2	6.9	7.1	7.7	6.1

Capital and Earnings: Capital should continue strengthening

Our calculation of RAC measures for Santander are weaker than those of peers and supportive of a moderate capital assessment, despite the expected improvement we see ahead. The higher risks we see in the economies where Santander operates and the bank's still large balance of deferred tax assets outstanding weigh in our calculation of the bank's RAC ratios. Our calculation of Santander's risk-weighted assets (RWAs) is about 1.8x higher than the regulatory one.

We estimate that Santander's pro forma 2016 RAC ratio after the acquisition of Popular (that is, including our best estimate of Popular's RWAs and the €7 billion capital increase that Santander completed to finance the acquisition) stood at just below 6%. Through retained earnings and issuance of Additional Tier 1 (AT1) instruments, we expect the bank's capital to strengthen further, but the RAC to remain just below 7% by the end of 2019. Management has also stated its intention to improve its fully loaded Common Equity Tier 1 ratio above 11% by end-2018, when the current strategic plan finishes. At end-2017, it stood at 10.8% comfortably above Supervisory review and evaluation requirements (8.66% for 2018).

In 2017, Santander raised €1.7 billion in AT1 instruments and it may raise a similar amount in 2018 in order to fully fill its regulatory AT1 bucket and prepare the bank to meet its total loss-absorbing capacity (TLAC) requirements on Jan. 1, 2019. We therefore expect the weight of hybrid instruments on Santander's capital structure to increase somewhat, but remain adequate at 12%-13% of total adjusted capital (TAC) at end-2018.

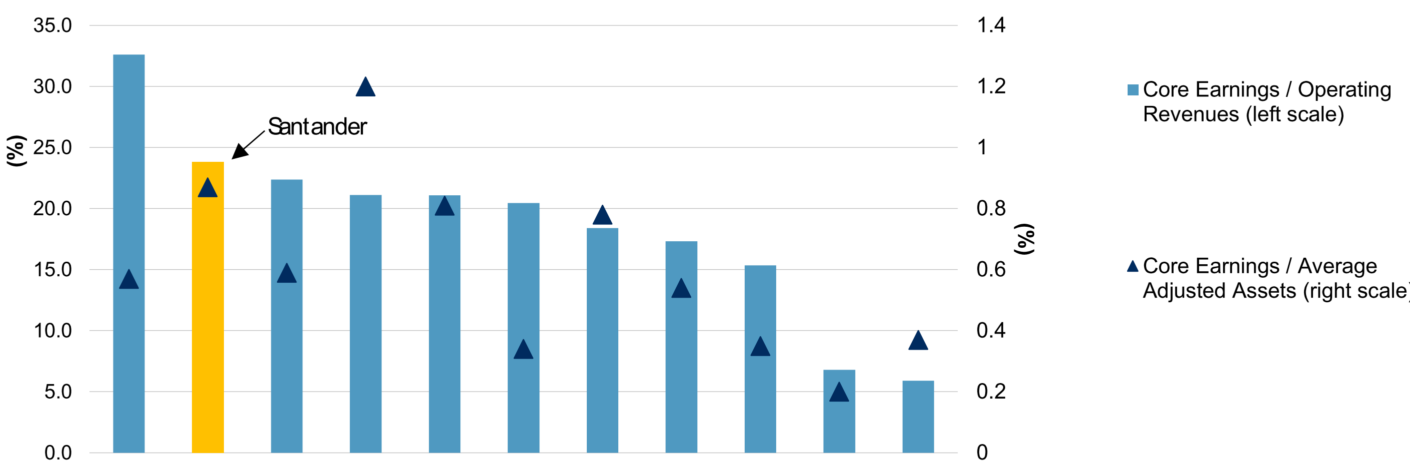
Capitalization of subsidiaries is generally aligned with the group's level and target, except in those geographies where host regulators require higher minimum capital requirements, as it is the case in Poland, or they have constrained dividend distribution (payout generally stands at 50%), as it has been the case in Argentina and the U.S. recently.

We project that Santander's bottom line will strengthen gradually in 2018 and 2019 on the back of stronger revenues and stable operating and credit costs. The latter also holds true at the subsidiaries level. We estimate that, on aggregate, the group's operating revenues could increase by 2.5% per year, fairly in line with the pace of volume growth. Both the net interest income and the fee line should support revenue growth. Operations in emerging economies and the U.S. will benefit, in our view, from better revenue prospects (in the first case related primarily to higher volume growth, in the second to higher interest rates). Matured economies, on the other hand, offer more potential for cost containment--particularly Spain, as cost synergies from the Popular acquisition materialize. Santander quantified in €500 million the potential cost synergies at the time of the acquisition (to be reached by 2020). Strong efficiency should continue been a key feature of the bank. At the group level, we see, however, limited room for credit provisions to decline meaningfully from current levels. Overall, we see the group return on equity improving, but hovering at around 7.5%-8.0% this year and next. We forecast the dividend payout at about 45%.

We expect Santander's earnings generation capacity to remain robust. We expect the bank's earnings buffer, which measures the capacity of the bank's earnings to cover normalized losses, to stand at around 135-140 basis points (bps) of S&P Global Ratings' RWA over 2018 and 2019.

Chart 1

Operating Profitability Comparison
Average of 10 years over 2008-2017



Peers include Wells Fargo & Co., Royal Bank of Canada, Santander S.A., Standard Chartered Bank, JPMorgan Chase & Co., HSBC Holdings PLC, Nordea Bank AB, Bank of America Corp., BNP Paribas, Credit Agricole S.A., Barclays Bank PLC, Rabobank Nederland, Citigroup Inc., Societe Generale, KBC Bank N.V. Source: S&P Global Ratings.

Table 3

Banco Santander S.A. -- Capital And Earnings

	--Year ended Dec. 31--				
(Mil. €)	**2017**	**2016**	**2015**	**2014**	**2013**
Tier 1 capital ratio	12.77	12.53	12.55	12.23	12.34
S&P RAC ratio before diversification	N/A	6.35	7.27	5.96	5.79
S&P RAC ratio after diversification	N/A	8.25	10.11	8.29	8.04
Adjusted common equity/total adjusted capital	N/A	90.69	91.05	90.85	92.31

Table 3

Banco Santander S.A. -- Capital And Earnings (cont.)

	--Year ended Dec. 31--				
(Mil. €)	**2017**	**2016**	**2015**	**2014**	**2013**
Net interest income/operating revenues	68.80	68.31	69.20	66.78	63.35
Fee income/operating revenues	23.26	22.37	21.16	21.91	23.84
Market-sensitive income/operating revenues	3.34	4.62	5.03	6.44	8.29
Noninterest expenses/operating revenues	46.30	46.75	45.41	45.16	48.48
Preprovision operating income/average assets	1.92	1.81	1.99	2.04	1.77
Core earnings/average managed assets	0.90	0.78	0.91	0.80	0.60

2016 RAC data reflects 2017 new risk-adjusted capital criteria. N/A--Not applicable.

Table 4

Banco Santander S.A. Risk-Adjusted Capital Framework Data

(Mil. €)	Exposure*	Basel III RWA	Average Basel III RW (%)	S&P Global Ratings RWA	Average S&P Global Ratings RW (%)
Credit risk					
Government and central banks	256,750	6,350	2	95,639	37
Institutions and CCPs	76,733	15,187	20	31,515	41
Corporate	277,173	184,440	67	307,824	111
Retail	539,302	201,490	37	391,459	73
Of which mortgage	318,782	82,161	26	144,992	45
Securitization§	12,462	2,234	18	4,332	35
Other assets†	60,863	65,093	107	98,287	161
Total credit risk	1,223,283	474,794	39	929,056	76
Credit valuation adjustment					
Total credit valuation adjustment	--	395	--	1,380	--
Market risk					
Equity in the banking book	3,471	21,571	622	16,163	466
Trading book market risk	--	26,080	--	38,822	--
Total market risk	--	47,651	--	54,985	--
Operational risk					
Total operational risk	--	61,084	--	92,867	--
(Mil. €)		**Basel III RWA**		**S&P Global Ratings RWA**	**% of S&P Global Ratings RWA**
Diversification adjustments					
RWA before diversification		588,088		1,078,287	100
Total Diversification/Concentration Adjustments		--		(248,639)	(23)
RWA after diversification		588,088		829,648	77

Table 4

Banco Santander S.A. Risk-Adjusted Capital Framework Data (cont.)

(Mil. €)	Tier 1 capital	Tier 1 ratio (%)	Total adjusted capital	S&P Global Ratings RAC ratio (%)
Capital ratio				
Capital ratio before adjustments	73,709	12.5	68,462	6.3
Capital ratio after adjustments‡	73,709	12.5	68,462	8.3

*Exposure at default. §Securitization exposure includes the securitization tranches deducted from capital in the regulatory framework. †Other assets includes deferred tax assets (DTAs) not deducted from ACE. ‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. Sources: Company data as of Dec. 31, 2016, S&P Global Ratings.

Risk Position: Better asset quality record than peers and wide risk diversification

Our assessment of Santander's risk position as very strong reflects our view of the benefits Santander derives from its wide geographic diversification in economies that proved uncorrelated, as well as good diversification by risk type, and its sound, better-than-average asset quality track record, something that our RAC calculation does not fully capture.

The diversification benefit that we calculate for Santander is one of the highest in our sample of rated global banks, with our calculation of its RWA after diversification effects standing 23% below that of RWA before diversification effects. In addition to enjoying wide geographic diversification, we consider that Santander's loan book has good diversification by clients (single-name concentration is manageable and reducing) and product, which contribute to a reduced risk profile. Residential mortgages accounted for 36% of total loans at end-2017, consumer lending for 18%, other loans to individuals 11%, large international corporates 11%, midsize companies 15%, and SMEs 9%. The portfolios that structurally have higher risks (consumer lending in Brazil, SME lending in Spain, Portugal, and Brazil, and U.S. consumer finance operations) do not weight meaningfully in the overall portfolio, while mortgages, on the other hand, have generally a low risk profile across geographies, and particularly in the U.K. where most of Santander's mortgages are originated. Additionally, the consumer lending portfolio of SCF, which is mostly based in Germany, the Nordics, and Spain, also has a lower-than-average risk profile.

Compared with other global peers, Santander generally reports higher problematic exposures and credit losses. But, we attribute the latter at the riskier nature of the markets where it operates, rather than its credit underwriting. Indeed our view is that Santander's asset quality track record has been better than banking industry averages in most of the main markets where it operates, thanks to the group's strong, centralized risk management, conservative underwriting standards, and close monitoring of risks.

Over recent years and up to the acquisition of Popular in Spain, the group's asset quality indicators have showed a continuous improvement. Total nonperforming loans (NPLs) were reduced to 4.2% of loans in December 2016, down from 6.1% at end 2013, as positive developments in Spain offset higher delinquencies in Brazil as the country entered a deep recession. The addition of Popular's problematic portfolio in June 2017 made the group's NPL ratio jump to almost 6%, reaching a level close to that of end 2013, with real estate assets adding another 3%, raising the total nonperforming asset ratio to 9%. However, the status quo was restored shortly after with the agreement to sell a 51% interest on Popular's €30 billion problematic portfolio to Blackstone. At end-2017, the group's NPLs returned to 4.5%. Although Santander did not sell 100% of its exposure, we view the divestment positively. It had no effect on profit and loss and addressed one of the challenges we identified at the time of the acquisition, that is the need to allocate significant resources to the workout of a large nonperforming portfolio the bank did not originate.

From here, we expect the group to continue managing down the stock of problematic assets, benefiting from a generally benign economic environment. Although the Brazilian portfolio proved fairly resilient and the economy is now returning to growth, we still see it as a potential focus of risk. In the U.K., weaker economic prospects post-Brexit could also lead to increased asset quality problems, albeit from a very low base. We also think that the very low risk profile of Santander's lending operations in the U.K. should help it preserve asset quality in the likely less benign cycle ahead. Finally, we also see risks of potential further asset quality deterioration in the U.S. subprime auto lending book.

Credit costs on aggregate have declined meaningfully from the peak in 2012, though in our view are probably already at the level they will remain over the next couple of years. We view the bank's coverage on aggregate (at 64% of NPLs at end-2017) and by geographies (including those that have lower coverage levels than those of the group, like U.K and Spain) as comfortable.

Given the nature of its business, the bank's main risk exposure is to credit risk. Still, Santander is also structurally exposed to foreign currency risks due to its local currency investments in subsidiaries abroad. The bank, however, actively hedges its exposure with a view to minimizing the impact of any adverse movement in the group's regulatory capital ratio and subsidiaries' profit contribution to the group. By holding asset-liability committee portfolios across geographies, Santander also hedges its structural interest rate risk. At present, all balance sheets, except Brazil, are positioned to benefit from interest rates increases.

The bank does not have the complexity of other large banking groups, despite its large size. We also believe that Santander's business model, which is consistent across its network, and its organizational structure facilitate the bank's management.

Table 5

Banco Santander S.A. -- Risk Position	--Year ended Dec. 31--				
	2017	**2016**	**2015**	**2014**	**2013**
Growth in customer loans	6.9	(1.8)	5.2	12.7	(5.8)
Total diversification adjustment / S&P RWA before diversification	N/A	(23.1)	(28.1)	(28.1)	(28.0)
Total managed assets/adjusted common equity (x)	21.5	21.8	20.8	23.9	22.8
New loan loss provisions/average customer loans	1.2	1.2	1.4	1.6	1.7
Net charge-offs/average customer loans	1.5	1.4	1.4	1.5	1.4
Gross nonperforming loans/customer loans	4.6	4.2	4.6	5.4	6.1
Loan loss reserves/gross nonperforming loans	63.7	74.9	73.4	67.4	61.8

RWA--Risk-weighted assets. N/A--Not applicable.

Funding and Liquidity: A structurally balanced and resilient funding profile

We assess Santander's funding profile as above average compared with its domestic peers and its liquidity as adequate.

Our funding assessment is supported by Santander's sound loan-to-deposit ratio (110% at end-2017 on a consolidated basis), limited refinancing risk (as debt maturities are spread over several years), and proven ability to access market funding even in times of market turbulence (either taking advantage of windows of opportunity or through private placements). We calculated the bank's stable funding ratio at a solid 103% as of December 2017, having improved from 94.5% at end-2011. The rebalancing of Santander's funding profile has been achieved through deleveraging and market-share gains in deposits in matured markets. In emerging countries, growth in deposits and loans has moved in tandem.

The bank operates abroad through subsidiaries that are managed independently from the parent for funding purposes. At present, only three subsidiaries still receive funding from the parent: SCF, SCUSA, and UCI (a joint-venture with BNP). The first two have plans underway to gradually reduce such reliance. There are no significant differences in the funding profiles of subsidiaries within the group. The group entities that proportionally depend more on wholesale financing are SCF, Chile, and the U.S. consumer finance operations (SCUSA).

The group's wholesale debt outstanding in the market totaled about €200 billion across a wide array of instruments (senior, securitizations and covered bonds, subordinated debt, and preferred securities). Banco Santander S.A. and Santander UK are the more active issuers in the group, accounting for about two thirds of the group's debt outstanding. The calendar of debt maturities is well spread.

Santander has opportunistically increased its reliance on ECB funding in recent years to take advantage of attractive conditions. We don't consider this funding to be structural, but rather opportunistic, taking into account the bank's large liquidity cushions and its proven capacity to access wholesale markets.

Santander benefits from sound, increasing liquidity. We estimate the group's liquidity ratio at 1.5x in December 2017, up from 1.0x at end-2011. Because of the accelerated issuance of TLAC-eligible instruments in 2017, the group is accumulating ample liquidity. That will also be the case in 2018, but we would expect the situation to normalize overtime as non TLAC or eligible debt matures.

Table 6

Banco Santander S.A. -- Funding And Liquidity					
	--Year ended Dec. 31--				
(Mil. €)	**2017**	**2016**	**2015**	**2014**	**2013**
Core deposits/funding base	60.5	59.7	58.9	58.9	61.5
Customer loans (net)/customer deposits	110.5	115.2	117.5	118.6	112.6
Long term funding ratio	81.4	81.0	79.8	77.2	79.6
Stable funding ratio	103.5	100.9	101.0	98.0	101.4
Short-term wholesale funding/funding base	19.9	20.4	21.6	24.2	21.6
Broad liquid assets/short-term wholesale funding (x)	1.5	1.4	1.3	1.2	1.3
Net broad liquid assets/short-term customer deposits	16.9	13.9	13.4	9.9	12.8
Short-term wholesale funding/total wholesale funding	49.3	49.8	51.8	58.1	55.5
Narrow liquid assets/3-month wholesale funding (x)	2.1	2.1	2.0	1.7	1.8

External Support: No notches of uplift for ALAC or government support

Although we consider Santander to have high systemic importance in the Spanish banking system, the bank is not eligible for ratings uplift based on external government support as, following the implementation of a resolution framework in Spain, we now consider the prospect of support for banks from the Spanish government as uncertain.

Unlike in the past, the long-term rating on the Spanish sovereign does not constrain the ratings on Santander at their current level. Indeed, we rate Santander at the level of its stand-alone credit profile (SACP), which is one notch above the long-term rating on Spain. This reflects our view that there is an appreciable likelihood that Santander would not default in the stress scenario that would likely accompany a hypothetical default of the Spanish sovereign. In such a scenario, we would expect Santander to face meaningful impairments, which would erode a significant portion, but not all, of its capital base. That remains the case despite the acquisition of Popular, which increased the group's exposure to Spain. Regulatory forbearance, however, would be likely as it would be challenging for the bank to comply with minimum regulatory capital requirements post-impairments. Similarly, we would expect Santander's Spanish operations to suffer sizable outflows of liquidity, but consider that the bank would be able to overcome liquidity pressures by resorting to ECB funding.

The ratings on Santander do not benefit from ALAC uplift either, as we believe that despite ongoing issuance of bail-in-able instruments, the bank's ALAC buffer will fall short of the minimum threshold to be eligible for a one-notch uplift, which we set up at 400 bps of our calculation of RWAs. We estimate that the bank's ALAC threshold could reach 381 bps by the end of 2019. We included in our calculation of the ALAC buffer the excess capital above the bank's 5% RAC, those Tier 1 and Tier 2 instruments not included in TAC but that we believe will have the capacity to absorb losses without triggering the default of senior obligations of the bank, and senior non-preferred debt instruments, which the bank successfully started issuing in 2017. We have only included bail-in-able instruments issued by Banco Santander S.A., excluding those issued by subsidiaries abroad identified as separate points of entry in resolution. In our forecasts we have taken into account Santander parent's additional issuance plans for 2018 (about €2 billion-€3 billion of AT1-Tier II instruments and €10 billion-€12 billion of senior non-preferred).

We lowered the threshold for the bank to benefit from one notch of ALAC uplift by 100 bps, the maximum possible, to 4.0% to reflect the multiple point of entry approach for the bank's resolution strategy. The Single Resolution Board identified nine different points of entry for the Santander group (Spain, Portugal, the U.K., Poland, the U.S., Mexico, Brazil, Chile, and Argentina). Conversely, we understand that SCF and its German subsidiary Santander Consumer Bank AG will form part of the resolution perimeter of Banco Santander S.A. Identifying different points of entry implies acknowledging that those operations will be subject to separate resolution processes from that of the parent. Therefore, we would expect them to build up their own cushions of bail-in-able instruments to face such scenario, provided that is required by host authorities, rather than expect a downstreaming from the parent. At present, we understand that the U.K., the U.S. and Portuguese operations have plans underway to build up their own TLAC minimum requirements for own funds and eligible liabilities (MREL) cushions.

Additional Rating Factors: Subsidiaries

We rate seven of Santander's operating subsidiaries globally, of which four currently benefit from parental support and, as a result, are rated higher than their SACPs. That is the case for Banco Popular Español S.A. (the only one for which we do not have an SACP assigned) and SCF in Spain, Banco Santander Totta S.A. in Portugal and Banco Santander NA in the U.S. We see all four as highly strategic for the parent.

Conversely, for various reasons we do not incorporate parent support into the ratings on the remaining three subsidiaries, despite two of them--Santander UK PLC and Banco Santander (Brazil) S.A.--being core for the group, in our view. We consider Chilean operations as just strategically important for the group. In the case of Santander's Brazilian subsidiary, the ratings are constrained by Brazil's sovereign creditworthiness, while the ratings on the other two rather benefit from ALAC uplift (Santander UK PLC) or government support uplift (Banco Santander Chile S.A.). The ratings on the U.K. and Chilean operations are higher than our assessment of Santander's group credit profile or (GCP; 'a-'). In the case of the U.K. subsidiary, this is because the U.K. operations have substantial ALAC cushions that can absorb losses in a resolution scenario. In the case of Chile, the ratings on the subsidiary benefit from the likelihood of receiving financial support from the Chilean government, given its high systemic importance and the supportive stance of Chilean authorities toward its banking system. The stand-alone creditworthiness of both, U.K. and Chilean, operations stand at or below the level of the parent's GCP ('bbb+' in the case of the U.K., 'a-' in the case of Chile).

Related Criteria

- 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
- Criteria - Financial Institutions - Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Criteria - Financial Institutions - Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Financial Institutions - Banks: Commercial Paper I: Banks, March 23, 2004

Anchor Matrix

Industry Risk	Economic Risk									
	1	2	3	4	**5**	6	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	**bbb-**	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

Ratings Detail (As Of March 16, 2018)

Banco Santander S.A.	
Issuer Credit Ratings	A-/Stable/A-2
Certificate Of Deposit	
Local Currency	A-2
Commercial Paper	
Local Currency	A-2
Preference Stock	BB
Preferred Stock	BB
Preferred Stock	BB+
Senior Subordinated	BBB+
Senior Unsecured	A-
Short-Term Debt	A-2
Subordinated	BBB
Issuer Credit Ratingss History	
09-Jun-2017	A-/Stable/A-2
09-Feb-2017	A-/Positive/A-2
06-Oct-2015	A-/Stable/A-2
04-Jun-2014	BBB+/Stable/A-2
20-Dec-2013	BBB/Stable/A-2
22-Nov-2013	BBB/Watch Pos/A-2
Sovereign Rating	
Spain	BBB+/Positive/A-2
Related Entities	
Abbey National Capital Trust I	
Preferred Stock	BB
Banco Popular Espanol S.A.	
Issuer Credit Rating	BBB+/Positive/A-2

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Ratings Detail (As Of March 16, 2018) (cont.)	
Senior Unsecured	BBB+
Banco Santander (Brasil) S.A.	
Issuer Credit Rating	BB-/Stable/B
Brazil National Scale	brAA-/Stable/brA-1+
Junior Subordinated	CCC
Subordinated	B-
Banco Santander-Chile S.A.	
Issuer Credit Rating	A/Negative/A-1
Commercial Paper	
Foreign Currency	A-1
Senior Unsecured	A
Subordinated	A-
Banco Santander Totta S.A.	
Issuer Credit Rating	BBB-/Stable/A-3
Senior Unsecured	BBB-
PSA Banque France	
Issuer Credit Rating	BBB/Stable/A-2
Commercial Paper	A-2
Senior Unsecured	BBB
Santander Bank, N.A.	
Issuer Credit Rating	BBB+/Stable/A-2
Senior Unsecured	BBB+
Short-Term Debt	A-2
Subordinated	BBB
Santander Consumer Bank AG	
Issuer Credit Rating	BBB+/Stable/A-2
Senior Subordinated	BBB
Santander Consumer Finance S.A.	
Issuer Credit Rating	BBB+/Stable/A-2
Commercial Paper	
Local Currency	A-2
Senior Unsecured	BBB+
Short-Term Debt	A-2
Subordinated	BBB-
Santander Holdings U.S.A Inc.	
Issuer Credit Rating	BBB/Stable/A-2
Preferred Stock	BB
Senior Unsecured	BBB
Santander UK Group Holdings PLC	
Issuer Credit Rating	BBB/Stable/A-2
Junior Subordinated	B+
Senior Unsecured	BBB
Short-Term Debt	A-2
Subordinated	BB+

Ratings Detail (As Of March 16, 2018) (cont.)	
Santander UK PLC	
Issuer Credit Rating	A/Stable/A-1
Junior Subordinated	BB
Junior Subordinated	BB+
Preference Stock	BB
Preferred Stock	BB
Senior Unsecured	A
Short-Term Debt	A-1
Subordinated	BBB-
Sovereign Real Estate Investment Trust	
Preferred Stock	BB

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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