

07 JUN 2021

Fitch Revises Santander's Outlook to Stable; Affirms IDR at 'A-'

Fitch Ratings - Barcelona - 07 Jun 2021: Fitch Ratings has revised Banco Santander, S.A.'s Outlook to Stable from Negative, while affirming the bank's ratings, including the Long-Term Issuer Default Ratings (IDRs) at 'A-' and the Viability Rating (VR) at 'a-'. A full list of rating actions is below.

The Outlook revision reflects Fitch's view that Santander's ratings have sufficient headroom to withstand several downside scenarios to our baseline forecast. The operating environments in some of Santander's core markets, including the US, have stabilised, which together with the bank's business model and moderate risk appetite, mean that Santander should be able to return to pre-crisis operating profitability within the next two years. This would help support organic capital generation despite expected pressures on asset quality in 2021 and into 2022.

Key Rating Drivers

IDRs AND VR

Santander's ratings reflect our view that the bank's international footprint is a key franchise-and-business model strength, despite exposure to higher-risk emerging markets. The ratings also reflect our expectation that the group's rigorous approach to risk control and sound underwriting standards will mitigate asset-quality pressure from the pandemic, and that Santander will be able to maintain capital ratios that are at the lower end of peers' but commensurate with its ratings, helped by its resilient earnings generation capacity through economic cycles.

Santander benefits from broad and balanced geographic and business diversification, with solid retail-banking franchises in several European and Latin American countries. This results in good pricing power and access to large, stable deposit bases. Combined with Santander's experience over economic cycles in different markets, this has enabled the group to manage pandemic-related risks better than expected, although challenges remain. Wide margins in emerging-markets operations and a cost control-oriented culture (cost-to-income consistently below 50% since 2007) also provide an important first line of defence against periods of economic crises.

Santander, like its European peers, experienced material earnings challenges during 2020, driven by lower interest rates in mature markets, business disruption and large loan impairment charges (LICs) due to the economic impact of the pandemic across its markets. Operating profit/risk-weighted assets (RWAs) fell to 1.9% during in 2020 (from an average of 2.1% in the last 15 years) but recovered firmly in 1Q21, supported by a recovery in activity and materially lower LICs. To offset earnings pressures, the

group also implemented significant cost-cutting measures in 2020-1Q21 and is expanding into growing markets and segments, such as payment services and digital consumer lending. Fitch has revised the outlook on Santander's earnings and profitability score of 'a-' to stable from negative as we see sufficient headroom to accommodate pressures expected in 2021-2022.

Asset quality remains a weakness compared with some European peers, with existing downside risks reflected in a negative outlook on the 'bbb+' asset quality score. The group's exposure to emerging economies inherently results in an above-sector average impaired loan ratio and LICs, which are mitigated by higher net interest margins. Our assessment on the group's asset quality also considers sustainably high impaired loan coverage (above 60% at all times in the past 15 years; 74% at end-1Q21) given a significant share of secured lending, mainly in the form of retail mortgages.

Loan performance has been resilient to date (impaired loan ratio at 3.4% at end-March 2021), benefitting from government- and private-sector support measures in Santander's main markets. We expect that asset quality will deteriorate once these measures unwind in 2H21-2022, although the extent of deterioration should be contained by Santander's sound risk controls. At end-March 2021, 86% of loan moratoria had already expired, with only 5% of the total becoming non-performing.

Our assessment of the bank's capitalisation at 'a-' reflects our expectation that Santander will continue to operate with a common equity Tier 1 (CET1) ratio in the upper range of its 11%-12% target (12.3% CET 1 ratio at end-1Q21) while economic uncertainty persists. The CET1 ratio should trend down within the target range over time due to a resumption of dividend pay-outs and the group's growth strategy. Our assessment of capital also reflects our expectation that the group will keep its foreign subsidiaries well-capitalised.

Santander's funding and liquidity is stable, supported by large deposit franchises in the core markets. The group requires foreign subsidiaries to be locally funded. Santander also benefits from healthy liquidity and deep global capital-market access for wholesale funding, at the parent bank and subsidiaries level.

Santander's 'F2' Short-Term IDR is the lower of two options that map to an 'A-' Long-Term IDR on Fitch's rating scale, reflecting our 'a-' assessment of the bank's funding and liquidity profile.

DERIVATIVE COUNTERPARTY RATING (DCR), DEPOSIT RATINGS AND SENIOR DEBT

Santander's senior non-preferred notes (SNP) are rated at the same level as the bank's Long-Term IDR, reflecting Fitch's view that the default risk of the notes is equivalent to that of the IDR and on SNP's average recovery prospects.

The long-term senior preferred debt of Santander and that of its issuing vehicle (Santander International Products PLC), deposit ratings and the DCR are rated one notch above the group's Long-Term IDR to reflect the protection that accrues from buffers of junior and SNP debt, which exceed 10% of RWAs (after deconsolidating subsidiaries that are in different resolution groups, as Santander has a clear multiple-point-of-entry resolution strategy) on a sustained basis. We expect Santander to continue to issue a significant volume of SNP and junior debt to maintain its minimum requirement for

own funds and eligible liabilities (MREL) and subordination requirements.

The short-term senior preferred debt and deposit ratings of 'F1' benefit from equivalent long-term senior debt and deposit ratings being notched up to reflect lower credit risks.

SUBORDINATED DEBT

Subordinated debt issued by Santander is notched down from its VR in accordance with our assessment of each instrument's non-performance and relative loss-severity risk profiles. We rate the instruments two notches below the group's VR for loss severity as we expect recoveries to be poor for this type of debt in case of default/non-performance of the bank.

We rate additional Basel III Tier 1 (AT1) debt with fully discretionary coupon payment four notches below the group's VR. This comprises two notches each for loss-severity and for non-performance risk. Our assessment is based on the bank operating with a CET1 ratio that is above maximum distributable amount thresholds and our expectation that this will continue. Our assessment is also underpinned by the group's record of strong pre-provision earnings generation throughout the cycle and sound leverage ratio.

Legacy preferred shares are rated five notches below the bank's VR to reflect higher-than-average loss severity risk of these securities (two notches from the VR), as well as high risk of non-performance (an additional three notches) due to a profit test.

SUPPORT RATING AND SUPPORT RATING FLOOR

Santander's Support Ratings (SR) of '5' and Support Rating Floors (SRF) of 'No Floor' reflect Fitch's belief that senior creditors of the bank can no longer rely on receiving full extraordinary support from the sovereign in the event that the bank becomes non-viable. The EU's Bank Recovery and Resolution Directive (BRRD) and the Single Resolution Mechanism (SRM) for eurozone banks provide a framework for resolving banks that is likely to require senior creditors participating in losses, instead of, or ahead of, a bank receiving sovereign support.

RATING SENSITIVITIES

IDRs AND VR

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

An upgrade would be contingent on an upgrade of Spain's sovereign rating (A-/Stable). This would have to be accompanied by stronger capital ratios and improved asset quality. Equally important would be the ability to preserve the group's earnings resilience, which means maintaining the sound earnings performance at main international subsidiaries.

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

Santander's ratings would come under pressure if its CET1 ratio declines below 11% without a credible plan to rebuild it rapidly. Also, a meaningful erosion of earnings resilience over time (i.e. operating profit/RWAs below 2% on a sustained basis) would also likely result in a negative rating action. Santander's ratings remain sensitive to a downgrade of Spain or a significant weakening of the operating environment in its core markets.

DCR, DEPOSIT RATINGS AND SENIOR DEBT

Santander's DCR, senior debt and deposit ratings are primarily sensitive to changes in Santander's IDRs. We would also downgrade the DCR, long-term senior preferred and SNP debt and deposit ratings by one notch if the size of the combined buffer of junior and SNP debt at resolution perimeter sustainably falls below 10% of RWAs (adjusted by deconsolidating subsidiaries that are in different resolution groups) given the group partly meets its MREL with senior preferred debt.

SUBORDINATED DEBT

Subordinated debt is primarily sensitive to a change in Santander's VR. In addition, AT1 and legacy preferred shares ratings could be downgraded if non-performance risk increases relative to the risk captured in the bank's VR, for example, if capital buffers over regulatory requirements are eroded.

SUPPORT RATING AND SUPPORT RATING FLOOR

An upward revision of the Support Rating Floor and upgrade of the Support Rating are unlikely given current EU legislation and regulation on recovery and resolution.

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.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This

means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

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Rating Actions

ENTITY/DEBT	RATING	RECOVERY	PRIOR
Santander International Products PLC			

ENTITY/DEBT	RATING		RECOVERY	PRIOR
• Senior preferred	LT	A	Affirmed	A
Banco Santander, S.A.	LT IDR	A- ●	Affirmed	A- ●
	ST IDR	F2	Affirmed	F2
	Viability	a-	Affirmed	a-
	Support	5	Affirmed	5
	Support Floor	NF	Affirmed	NF
	DCR	A(dcr)	Affirmed	A(dcr)
• preferred	LT	BB	Affirmed	BB
• Senior non-preferred	LT	A-	Affirmed	A-
• long-term deposits	LT	A	Affirmed	A
• Senior preferred	LT	A	Affirmed	A

ENTITY/DEBT	RATING	RECOVERY	PRIOR
• subordinated	BBB	Affirmed	BBB
• preferred	BB+	Affirmed	BB+
• short-term deposits	F1	Affirmed	F1
• Senior preferred	F1	Affirmed	F1

RATINGS KEY OUTLOOK WATCH

POSITIVE	⊕	◇
NEGATIVE	⊖	◇
EVOLVING	◊	◆
STABLE	○	

Applicable Criteria

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

Additional Disclosures

[Solicitation Status](#)

Endorsement Status

Santander International Products PLC EU Issued, UK Endorsed

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