FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Santander at 'A-'; Outlook Stable

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Fitch Ratings - Milan - 22 Sep 2023: Fitch Ratings has affirmed Banco Santander, S.A.'s (Santander) Long -Term Issuer Default Rating (IDR) at 'A-', the Short-Term IDR at 'F2' and the Viability Rating (VR) at 'a-'. The Outlook is Stable.

A full list of rating actions is below.

KEY RATING DRIVERS

Geographic Diversification A Key Strength: Santander's ratings reflect Fitch's view that the bank's international footprint is a key strength, featuring material exposures in stronger economies than its home Spanish market, such as the UK and the US, as well as towards emerging markets. Risks are well managed and the resolution approach, based on a multiple-point-of-entry principle, supports an adequate and independent management of the subsidiaries' capitalisation and funding.

The ratings also reflect our expectation that the group's rigorous risk-control approach will mitigate asset-quality pressures at times of uncertainty for its operating environments, and that Santander will maintain its capital ratios stable. The capital ratios are at the lower end of European peers', but are commensurate with the group's risk profile, helped by resilient earnings generation capacity through economic cycles.

Strong Retail Franchises: Santander's broad and balanced geographic and business diversification is underpinned by solid retail-banking franchises in several European and Latin American countries and, to a lesser extent, in the consumer finance sector in the US. This results in good pricing power and access to large, stable deposit bases. Combined with Santander's experience over several economic and interest-rate cycles in its various markets, this has enabled it to manage periods of stress relatively well.

Resilient Asset Quality: The good loan performance in most of Santander's geographies, underlying loan growth and the sales of impaired loans underpin the stability of the bank's impaired loans ratio over the past 18 months. We expect a mild deterioration in asset quality in 2H23 and 2024, with the gross impaired loans ratio remaining below 4% (end-June 2023: 3.3%).

The economic slowdown, higher inflation and interest rates weigh on borrowers, although better-quality portfolios, especially in certain riskier markets, such as Brazil and US consumer finance, and proactive impaired loans management should mitigate the risk of large inflows of impaired loans. Exposure to emerging markets results in above-European average impaired loan ratios and loan impairment charges, albeit these are mitigated by the higher net interest margins earned in these markets.

Sound Structural Profitability: Santander's balanced exposure to developed and emerging markets and dominant retail business underpin the stability of its revenue generation throughout economic and interest-rate cycles. Profitability improved on higher interest rates in 2023 and should continue to benefit from asset repricing throughout 2H23 and 2024. However, subdued loan growth and rising funding costs will constraint further improvements in operating profitability, which we expect to stabilise at about 3% of risk-weighted assets (RWAs; 1H23: 3%).

Inflation pressures make cost management challenging, but Santander's cost control-oriented culture (with a cost/income ratio consistently below 50% since 2007) provides an important first line of defence. The group's progress in simplifying and digitalising the bank should help to meet its medium-term cost/income ratio target of about 42% by 2025 (about 2% below the figure calculated by the bank for 1H23).

Adequate Capitalisation: Santander's capitalisation benefits from established internal capital generation and proven access to equity markets. Regulatory ratios remain low compared with other large European banks, but have a record of stability throughout the cycle and are maintained with solid buffers over regulatory minimums both at consolidated level and at individual subsidiaries. Capital is managed by the group on a "need-cost optimisation" basis, which reduces capital volatility.

We expect Santander will continue to operate with a common equity Tier 1 (CET1) ratio above 12% over 2023-2024, despite expected higher capital distribution, and in line with the group's medium-term guidance.

Stable and Diversified Funding: Santander's global retail deposit franchise has been resilient throughout the interest rate hiking with modest pass-through of higher rates, especially in continental Europe. We expect the group to face higher costs of customer funding in the coming quarters, reflecting both upward repricing and migration from current to term deposits, but for these higher costs to be manageable. Established access to wholesale funding in its core markets, adequate liquidity buffers and reduced utilisation of central bank funding also underpin the bank's strong funding and liquidity profile.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

Santander's ratings would come under pressure if its CET1 ratio declined sustainably below 12% without a credible plan to rebuild it in the short term. A meaningful erosion of the bank's profitability with an operating profit/RWAs below 2% on a sustained basis would also put pressure on the ratings.

Santander's ratings remain sensitive to a downgrade of Spain (A-/Stable) or to the group's current operating environment score (a-), the latter being particularly sensitive to the economic and banking prospects of Santander's core markets.

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, resulting in a better assessment of the group's operating environment.

An upgrade would also likely require an improvement in Santander's financial profile by means of a structurally stronger CET1 ratio and lower impaired loans ratio, while preserving the group's earnings resilience, which means maintaining the sound earnings performance at the main international subsidiaries.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

GOVERNMENT SUPPORT RATING (GSR)

Santander's GSR of 'ns' reflects our view that external extraordinary sovereign support, though possible, cannot be relied upon. This is because senior creditors can no longer expect to receive full extraordinary support from the sovereign in the event that the bank becomes non-viable.

SENIOR DEBT, DEPOSIT AND DERIVATIVE COUNTERPARTY (DCR) RATINGS

Santander's senior non-preferred notes 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 that senior non-preferred obligations are viewed as having average recovery prospects.

Santander's long-term senior preferred debt, deposit ratings and the DCR are rated one notch above Santander's Long-Term IDR to reflect the protection that accrues from buffers of junior and senior non-preferred 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 senior non-preferred and junior debt to maintain the group's 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 their equivalent long-term senior debt and deposit ratings being notched up from the Long-Term IDR to reflect lower credit risks.

SUBORDINATED AND JUNIOR 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 debt with fully discretionary coupon payment four notches below the group's VR. This corresponds to two notches for loss-severity and two notches 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 by a sound leverage ratio.

Legacy preferred shares are rated five notches below the bank's VR. This corresponds to two notches for loss-severity and three notches for non-performance risk given the presence of a profit test in the notes' terms and conditions.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

SENIOR DEBT, DEPOSIT RATINGS AND DCR

Santander's DCR, senior debt and deposit ratings are primarily sensitive to changes in Santander's IDRs, from which they are notched. We would downgrade the DCR, long-term senior preferred and non-preferred debt and deposit ratings by one notch to the same level as the IDRs if the size of the combined buffer of junior and senior non-preferred debt at resolution perimeter sustainably fall 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 AND JUNIOR SUBORDINATED DEBT

Santander's subordinated debt and hybrid securities' ratings are primarily sensitive to a change in Santander's VR, from which they are notched. The ratings are also sensitive to a change in the notes' notching, which could arise if Fitch changes its assessment of their non-performance relative to the risk captured in the VR or their expected loss severity. For additional Tier 1 issues, this could reflect a change in capital management or flexibility, or an unexpected shift in regulatory buffers and requirements, for example.

GSR

An upward revision of the GSR would be contingent on a positive change in the sovereign's propensity to support the bank. In Fitch's view, this is highly unlikely, although not impossible.

VR ADJUSTMENTS

The operating environment score of 'a-' is in line with the 'a' category implied score but above the 'bbb+' score typically assigned to domestic Spanish banks because of the following adjustment reason: international operations (positive).

The capitalisation & Leverage score of 'a-' has been assigned above the 'bbb' category implied score because of the following adjustment reasons: internal capital generation and growth (positive) and capital flexibility and ordinary support (positive).

The funding and liquidity score of 'a-' has been assigned above the 'bbb' category implied score because of the following adjustment reasons: deposit structure (positive) and non-deposit funding (positive).

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

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, either due to their nature or to 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.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
Banco Santander, S.A.	LT IDR	A- Rating Outlook Stable	Affirmed	A- Rating Outlook Stable
	ST IDR	F2	Affirmed	F2
	Viability	a-	Affirmed	a-
	DCR	A(dcr)	Affirmed	A(dcr)
	Government Support	ns	Affirmed	ns
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
subordinated	LT	BBB	Affirmed	BBB

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Bank Rating Criteria (pub. 01 Sep 2023) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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Banco Santander, S.A.	EU Issued, UK Endorsed

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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. Sector-specific best- and worst-case scenario credit ratings are listed in more detail at https://www.fitchratings.com/site/re/10238496

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