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13097
Banco Santander

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Long-term Rating	A+
Outlook*	Stable
Short-term Rating	-

*Long-term Rating refers to Foreign Currency Long-term Issuer Rating in principle.

1. Company Overview

Banco Santander, S.A. is Spain's largest commercial bank, and also operates in other European countries, Latin American countries and the United States through many subsidiaries. It is one of the largest leading global banking groups with consolidated assets of EUR 1.5 trillion, more than 140 million customers worldwide, and customer loans and deposits totaling EUR 916.2 billion and EUR 849.3 billion, respectively, at the end of 2020. Geographically, international operations outside of Spain account for more than 80% of its total income. By business segment, retail banking accounts for more than 80% of its total income.

While its subsidiaries are autonomous in terms of capital and liquidity with a view to containing possible risk contagion among the group's different units, corporate philosophy, strategy and risk management policy are shared across the group. Under the medium-term group strategy announced in April 2019, the bank plans to continue the initiatives to enhance customer loyalty and promote digitalization while also aiming to further enhance profitability through greater emphasis on the more profitable businesses and a cost reduction.

2. Business base

The bank holds a solid operating base in each of the markets where it operates, both in developed and emerging economies, thanks to its business strategy focused on critical mass and retail banking in selected markets. The core market segments defined by the bank (as of 2020) are nine countries consisting of Spain, the UK, the U.S., Brazil, Chile, Portugal, Mexico, Poland and Argentina, and consumer finance business undertaken in Europe by Santander Consumer Finance (SCF). In Spain, the bank has carved market shares of around 20% for both deposits and loans following the acquisition in 2017 of Banco Popular (Popular) (its integration was completed in July 2019). The acquisition has contributed to strengthening the bank's domestic business base as Popular, the leading lender to SMEs, had a complementary business profile. In the UK, the bulk of the bank's business is mortgages as it took over the franchise of building societies. In this particular field, the bank boasts a market share of around 10%. In the U.S., the bank's subsidiary Santander Bank, N.A. has a solid commercial banking franchise in the northeastern region and another subsidiary Santander Consumer USA (SCUSA) has a strong presence in the auto financing market. In Brazil (Banco Santander Brasil) and other Latin American countries and in Portugal (Santander Totta) and Poland (Santander Bank Polska, former Bank Zachodni WBK), it owns local commercial banks with deposit and loan market shares largely exceeding 10%. SCF primarily offers auto loans in 15 European countries, enjoying a leading position in many countries including Spain, Germany and the Nordic countries. Having a solid franchise in each market, the bank holds a competitive pricing power and sticky deposit base.

The bank's previous medium-term strategy covering the 2015-2018 period had focused on commercial transformation aimed to enhance customer loyalty and promote digitalization, with each unit working on various initiatives including reform of branch models, development of new products and optimization of transaction processes. The new strategy announced in April 2019 calls for continuing these initiatives while increasing the weight of the more profitable businesses such as the Latin American business and materializing EUR 1.2 billion cost reductions mainly in Europe. In 2020,

the bank added to that cost efficiency plan, a target to obtain another euro billion in cost savings for the medium term, to come mainly from Europe. It also announced its strategy to focus on payment services and digital consumer finance while promoting a creation of a group-wide common operating platform (One Santander). It also announced the creation of a new business "Digital Consumer Bank" by integrating SCF with Openbank, a largest digital bank in Europe, with the aim of building a global digital consumer finance business (segment information according to the new classification started to be disclosed from 2021).

3. Asset quality and risk management

Prior to the outbreak of the COVID-19 pandemic, the bank's asset quality continued to improve in most of its core markets, with its nonperforming loan (NPL) ratio declining to 3.32% at the end of 2019 from 5.6% at the end of 2013. The bank made steady progress in divesting its problem assets related to the real estate sector that it took over from Popular. As a result, the ratio of problem loans that also include foreclosed assets related to the real estate sector and the forbearance portfolio declined from 10% at the end of 2017 right after the acquisition of Popular to 5.7% at the end of 2019. The bank's credit cost ratio was contained at around 100 bps in 2018 and 2019, compared with more than 230 bps in 2012.

The impact of the pandemic on the bank's asset quality has been limited so far. As of the end of September 2021, the ratio of Stage 2 loans (based on IFRS 9) to the total loans rose slightly from 5.4% at the end of 2019 to 6.6%, but the NPL ratio continued to decline to reach 3.18%. The credit cost ratio rose to the 120bp range in 2020 due mainly to an increase of Stage 2 loans and a precautionary overlay of provisions aimed to provide against a weaker economic outlook but was contained to 83bp (on an annualized basis) in the first nine months of 2021.

After reaching 12% of total loans at the end of June 2020, the outstanding balance of loans under moratorium decreased to less than 1% of the bank's total loans. Most of these loans subject to moratorium resumed payment on the expiry of the moratorium period. Also, collateral coverage of the remaining loans under moratorium is high as they are mainly mortgage loans. Meanwhile, the outstanding balance of loans provided under the government guarantee programs accounted for around 4% of the total loans, with more than 80% of them covered by guarantees. Based on these, JCR holds that any additional credit costs that could arise after the end of the support measures can be fully absorbed by earnings.

The bank's securities portfolio accounts for less than 20% of its total assets. It is mainly composed of government bonds issued in the countries where it operates which each of its subsidiaries holds for the purpose of risk management. Judging from the past records of unrealized gains/losses or the duration of the bonds, credit risks and interest rate risks pertaining to the securities portfolio look to be limited.

The bank's risk management is centralized at the group level and each subsidiary strictly and proactively monitors and controls its own risks in accordance with the group's risk management policy. Most of the bank's risk exposure stems from credit risks associated with customer loans. By market, the UK accounts for the largest proportion of the bank's total credit exposure (comprising loans, guarantees and letters of credit) with a share of around 27%, followed by Spain with around 22%, the U.S. and SCF with approximately 10% each, Brazil with around 8% and others with less than 5% each (at the end of 2020). The bank's credit portfolio has a relatively higher risk profile among the major global financial institutions due partly to its wider exposure to emerging countries. Its credit cost ratio is high, averaging at around 110bp in the five years to 2020. Credit costs are particularly high for the loans made in Latin American countries especially in Brazil and SCUSA's auto loans that are focused on subprime borrowers. It should be noted, however, that the bank ensures ample spreads to absorb credit cost on loans with higher credit risks. In addition, JCR views that risks associated with credit concentration on large borrowers are low given that approximately 90% of the bank's loan portfolio consists of retail business well diversified among smaller borrowers and most of its big borrowers are companies with high internal ratings.

4. Earnings

While markets with relatively high risks constitute an important part of its business base, the bank makes stable earnings with tight risk controls. This is mainly because its earnings sources center on retail banking which is geographically diversified among countries whose economic growth is not correlated to each other. A country-by-country breakdown of its 2020 total income showcases geographical diversification, with Brazil accounting for 24% of the total, followed by the U.S. with 17%, Spain with 15%, and the UK, SCF and Mexico with 10% each, Chile with 5% and Portugal,

Poland and Argentina with 3% each. By business segment, more than 80% of the total income comes from retail banking, with invest banking and market-related business, which tend to be susceptible to market conditions, generating only limited income (both for geographical and business segments, percentages are calculated by excluding corporate center and Santander Global Platform). In addition to such earnings structure, it can absorb relatively high credit costs as its core earning power in terms of pre-provisioning operating income is high thanks to its solid margins ensured by appropriate pricing and restrained operating costs brought by strict cost control.

In recent years, the bank has been facing prolonged low interest rate environment in the EU. Even in this situation, the group-wide initiatives to enhance customer loyalty and promote digitalization have been bearing fruit in capturing more interest and fee incomes and in containing costs.

The bank's earnings performance in 2020 was adversely affected by the pandemic, as it ended up with a loss of EUR15.8 billion on consolidated profit. This was due mainly to the 30% increase in credit costs to EUR12.4 billion and a recording of impairment losses totaling EUR12.6 billion including goodwill impairment and valuation adjustment of deferred tax assets. On an underlying basis excluding the impact of non-recurring factors such as impairments, however, it made a consolidated profit absorbing the increased credit costs. In the first nine months of 2021, the bank's earnings performance recovered from the same period of the previous year, supported by significantly lower credit costs and higher pre-provisioning income on increased total income and cost containment.

5. Financial structure

The bank's consolidated common equity Tier 1 (CET1) ratio stood at 11.85% on a fully-loaded basis at the end of September 2021, sound enough to support its current rating. The impairment losses in 2020 did not impact the CET1 ratio, while the easing of the EU's Capital Requirements Regulation (CRR) following the pandemic had a positive impact of around 20bp. Going forward, some regulatory changes may lower the bank's capital ratios. Those include the "Targeted Review of Internal Models" being conducted by the ECB and the introduction of an output floor following the finalization of the Basel III reforms. Any negative impact from these changes will be moderated by the regulatory amendment made by the EU in 2020, which allows banks to exempt from the deduction of intangible assets from CET1 capital for certain software assets. JCR holds that the bank will retain its sound capital levels by absorbing impacts from the prospective regulatory changes, given the pace of its accumulation of retained earnings in the past years.

As regards the TLAC regulations, the bank has opted for the multiple-point-of-entry (MPE) approach under which multiple entities subject to resolution have been defined in the group. In recent years the group's funding has been focused on the issuance of TLAC/MREL-compliant securities including senior non-preferred (SNP) debts. The TLAC ratio of the resolution group headed by Banco Santander, S.A. was 25.5% based on risk-weighted assets at the end of September 2021. This is higher than the requirement of 21.5% as of January 2022. MREL applies to the European resolution group that includes Banco Santander, S.A. and Santander Consumer Finance S.A. The bank estimates that this resolution group complies with the MREL requirements.

The bank continues to retain a comfortable liquidity position. Its policy requires each subsidiary to hold a sufficient funding base and liquidity, and no intragroup funding and liquidity support is basically carried out except for SCF. The loan-to-deposit ratio exceeds 100% on a group basis, but the balances of loans and deposits are largely matched except for its consumer finance subsidiaries. In addition, the bank's refinancing risks are mitigated by the fact that its wholesale funding is mostly covered with medium- to long-term debts with diversified maturities. Both liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) stay at sound levels, respectively standing at 164% at the end of September 2021 and 124% at the end of June 2021.

6. ESG Factors in Credit Rating

As ESG factors in the rating of a bank, JCR primarily focuses on governance of business promotion as to whether it has established an organizational structure to give consideration to the interest of customers and its own asset quality. Putting too much importance on a short-term profitability and making loans which are incompatible with risk and return could impair asset quality and lead to a significant increase in credit costs. Also, an absence of customer-oriented attitude could lead to scandals such as inappropriate solicitation, which in turn may put the bank at reputation risk or litigation risk. In order to factor in ratings impact of a bank's governance status over business promotion on its asset quality, JCR assesses its management policy for lending

and credit cost performance. In the case of reputation risk and litigation risk, JCR conducts interviews with regard to business promotion policies. At present, the bank's rating is not affected by those governance factors.

Meanwhile, if sectors that are heavily dependent on fossil fuels miss out on the wave of the economic and social trend of decarbonization, a bank's quality of loans to these sectors could be negatively affected. JCR therefore pays attention to a possibility that risks related to climate change may affect a bank's earnings and financial ground. In this regard, the bank's loan portfolio is mostly composed of retail loans, and the bank has been making efforts to reduce exposure to thermal coal related sectors in its corporate and investment banking business while supporting clients' transition to green economy. Taking into these consideration, JCR holds that such climate change related risks are not affecting the bank's business base, earnings or financial ground at present and therefore do not reflect them in the bank's rating and rating outlook.

7. Overall assessment and rating outlook

The rating is mainly supported by the bank's geographically diversified and retail-focused earning structure, solid operating base in each of the markets where it operates and stable earnings capacity. On the other hand, it is constrained by a relatively high risk profile of its credit portfolio. The outlook of the rating is Stable. In 2020 the bank incurred a loss on consolidated profit, but this was due mainly to increased credit costs and impairment losses brought by the pandemic. Excluding the impairment losses, however, it made a positive consolidated profit by absorbing credit costs with its resilient pre-provisioning income. The business environment has been improving with the recovery trend of the economy in the core regions where the bank operates. While future development of its asset quality after the end of the support measures implemented by the governments and the bank itself should be watched, JCR holds that the bank will be able to absorb any additional credit costs with its earnings and maintain its capital ratio largely at the current level through a steady profit generation in the medium term.

Any major damage to its capital base resulting from deterioration of the quality of credit portfolio or its earnings base due to factors such as a prolonged impact of the pandemic or weakening of economic and financial conditions in the countries where it operates could bring downward pressure on the rating. On the contrary, a further reduction of risks in the bank's credit portfolio or sounder capitalization could lead up to an improvement of its creditworthiness.

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Consolidated Financial Summary

(Million euros,%, bp)

	2016/12	2017/12	2018/12	2019/12	2020/12
Total assets (end-year balance)	1,339,125	1,444,305	1,459,271	1,522,695	1,508,250
Loans and advances to customers (end-year balance)	790,470	848,915	882,921	942,218	916,199
Customer deposits (end-year balance)	691,112	777,730	780,496	824,365	849,310
Total income	44,232	48,355	48,424	49,229	44,279
Pre-provisioning profit from operations	20,623	22,304	23,422	22,459	20,771
Profit from operations	10,997	13,045	14,436	12,927	8,389
Profit for the period	7,486	8,207	9,315	8,116	-7,708
ROA (based on pre-provisioning profit from operations)	1.54	1.58	1.62	1.49	1.35
Non-performing balances/Total loans and contingent liabilities	3.93	4.08	3.73	3.32	3.21
Cost of credit	118	107	100	100	128
Total regulatory capital ratio	14.68	14.99	14.98	15.05	16.18
Tier 1 capital ratio	12.53	12.77	13.12	13.14	13.95
Common equity Tier 1 capital ratio	12.53	12.26	11.47	11.65	12.34

* Figures for the most recent period could be indicators based on preliminary figures.
(Notes) Calculation of ROA is based on the average balance of total assets
(Source) Annual Reports, IR materials, etc.

Ratings

	Rating	Outlook*	Amount (millions)	Currency	Rate (%)	Issue Date	Maturity Date	Release
Foreign Currency Long-term Issuer Rating	A+	Stable	-	-	-	-	-	2021.10.27
Samurai Senior Non Preferred Bonds - First Series (2017)	A	-	83,700	JPY	0.568	2017.12.11	2023.01.11	2021.10.27
Samurai First Series (2019)	A+	-	50,000	JPY	0.463	2019.12.05	2024.12.05	2021.10.27
Samurai Senior Non Preferred Bonds - Third Series (2017)	A	-	12,200	JPY	1.015	2017.12.11	2027.12.10	2021.10.27

History of Long-term Issuer Rating

(Foreign Currency Long-term Issuer Rating or its equivalent)

Date	Rating	Outlook*	Issuer
2017.05.19	A+	Stable	Banco Santander

*Outlook for Foreign Currency long-term issuer rating, or direction in case of Credit Monitor.

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