S&P Global
Ratings

RatingsDirect®

Banco Santander S.A.

Primary Credit Analyst:
Elena Iparraguirre, Madrid + 34 91 389 6963; elena.iparraguirre@spglobal.com

Secondary Contact:
Luigi Motti, Madrid + 34 91 788 7234; luigi.motti@spglobal.com

Table Of Contents

Table Of Contents (cont.)

Banco Santander S.A.

Rating Score Snapshot

Global Scale Ratings
Issuer Credit Rating
A+/Stable/A-1
Resolution Counterparty Rating
AA-/--/A-1+

SACP: a → **Support: +1** → **Additional factors: 0**

Anchor	bbb	
Business position	Very strong	+2
Capital and earnings	Adequate	0
Risk position	Strong	+1
Funding	Adequate	0
Liquidity	Adequate	
CRA adjustment		0

ALAC support	+1
GRE support	0
Group support	0
Sovereign support	0

Issuer credit rating
A+/Stable/A-1
Resolution counterparty rating
AA-/A-1+

ALAC--Additional loss-absorbing capacity. CRA--Comparable ratings analysis. ICR--Issuer credit rating. SACP--Stand-alone credit profile.

Credit Highlights

Overview

Key strengths	Key risks
Wide geographic diversification and solid retail banking franchises in the markets where it operates, which underpin solid and consistent earnings.	Exposure to higher-than-average economic risk in some countries of operation.
Successful strategy and implementation.	Weak macroeconomic growth outlook and high financing costs will pressure some borrowers.
Sound capitalization compared to the risks it faces.	

Profitability maintains its upward trend. Santander reported its highest ever profits in 2022 and results continued growing in the first half of 2023. This was on the back of ongoing margin expansion as assets were repriced to higher rates in several countries of operation--notably developed markets--whilst deposit costs remained contained. Strong earnings growth more than offset inflationary pressures on costs and a slightly higher cost of risk. We expect earnings momentum to continue, which will contribute to increasing the bank's distributions to shareholders, and still somewhat improve capitalization, with the risk-adjusted capital (RAC) ratio exceeding 8% by 2025.

Some signs of asset quality deterioration are emerging, but we expect this will be manageable. Although the group's nonperforming loan (NPL) ratio and credit losses have remained fairly stable over the past couple of years, we are beginning to see signs of asset quality deterioration in some markets--the Americas, Poland, and, to a much lower extent, the U.K. Naturally, the higher financing costs and softer economic activity are yet to take a toll on weaker borrowers, which would lead to additional problem loans. But overall, we expect asset quality deterioration to be fairly contained, with NPL and credit costs growing only marginally--peaking at 3.9% and 127 basis points (bps)--in 2024 and then moderately reducing in 2025.

The bank's new strategic plan maintains its previous priorities but commits to more ambitious targets. The plan was announced in February 2023, shortly after new CEO, Héctor Grisi, took office. The new plan maintains the previous priorities: growing the business, strengthening the group's profitability and efficiency, preserving solid capitalization and effective capital allocation, and making the business more digital and sustainable. But the targets have become more ambitious. The bank aims to increase its customer base by 40 million in three years, improve its return on tangible equity (ROTE) to 15%-17% by 2025 (from 13.4% in 2022), strengthen its efficiency ratio to about 42% (from 45.8%), and increase the pay-out to shareholders to 50% from 40%, while maintaining a common equity tier 1 (CET1) fully loaded ratio above 12%. A key strategic initiative is the "One Transformation" project, which aims to align all business units to a common, simpler operating model that would encompass a reduced product offering, more automated processes, and an improved, cloud-based IT architecture. Another of the plan's novelties is the emphasis the group wishes to put on growing the business and profit contribution of its global businesses (corporate and investment banking, wealth management and insurance, and payments and auto). The bank expects these business lines to contribute more than 40% of the group's revenues and more than 50% of the group's fees by 2025.

Santander's strong business model helps to offset the inherently higher risk of its footprint. Undoubtedly, Santander runs operations in countries that face higher-than-average economic risks, but its focus on retail banking activities, the powerful, efficient franchises it runs, and its wide geographic diversification have, over time, supported a track record of strong, consistent operating earnings.

Outlook

The stable outlook reflects our expectations that over the next couple of years Santander will be able to withstand the economic headwinds ahead and preserve its credit strengths, including its large and diversified footprint, strong earnings power, and sound risk-adjusted capitalization. We expect the group's operating performance to continue improving on the back of a generally favorable interest rate environment and the implementation of key strategic initiatives gives fruit, leading to return on equity (ROE) of about 11%-11.5% in 2023-2024 and slightly lower in 2025. We expect the bank's RAC ratio to improve moderately, exceeding 8% by 2025 thanks to higher profits and moderate growth, and despite higher distributions to shareholders. While asset quality will weaken, we anticipate deterioration to be contained, with the cost of credit standing at around 120 bps over 2023-2025.

Downside scenario

The ratings could come under pressure if the bank failed to maintain a buffer of bail-inable debt sustainably exceeding 500 bps of its S&P Global Ratings' risk-weighted assets. A negative rating action could also occur if the bank's wide geographical and business diversification stopped providing tangible benefits to its risk profile, or if unexpected events (such as material acquisitions) undermined its capital position. A lowering of our sovereign credit rating on Spain would also likely trigger a similar rating action on Santander because it is unlikely that we would rate Santander two notches above the rating on Spain.

Upside scenario

At the current rating level, we see limited upside to the ratings on Santander. We could take a positive rating action if the bank reached and maintained a higher level of risk-adjusted capital, provided that we also saw stronger resilience in a hypothetical sovereign default scenario, allowing a gap of two notches--the maximum under our methodology--above our sovereign credit rating on Spain.

Key Metrics

Banco Santander S.A.--Key ratios and forecasts

	--Fiscal year ended Dec. 31--				
(%)	**2021a**	**2022a**	**2023f**	**2024f**	**2025f**
Growth in operating revenue	4.8	12.4	7.0-8.5	3.0-3.5	0.4-0.4
Growth in customer loans	7.7	6.2	3.0-3.5	3.0-3.5	3.7-4.2
Growth in total assets	5.8	8.7	2.0-2.5	1.8-2.2	2.4-2.9
Net interest income/average earning assets (NIM)	2.7	3.0	3.0-3.3	3.0-3.3	2.9-3.2
Cost to income ratio	46.6	46.4	44-46	44-46	45-47
Return on average common equity	9.7	11.0	11.0-12.0	11-11.5	10.0-11.0
Return on assets	0.6	0.7	0.6-0.7	0.6-0.7	0.6-0.7
New loan loss provisions/average customer loans	0.8	1.1	1.2-1.3	1.2-1.3	1.1-1.2
Gross nonperforming assets/customer loans	3.5	3.5	3.5-3.9	3.8-4.2	3.5-3.9
Net charge-offs/average customer loans	0.9	1.1	1.1	1.1	1.0

Banco Santander S.A.--Key ratios and forecasts (cont.)					
	--Fiscal year ended Dec. 31--				
(%)	2021a	2022a	2023f	2024f	2025f
Risk-adjusted capital ratio	8.4	7.7	7.7-7.9	7.8-8.1	7.9-8.2

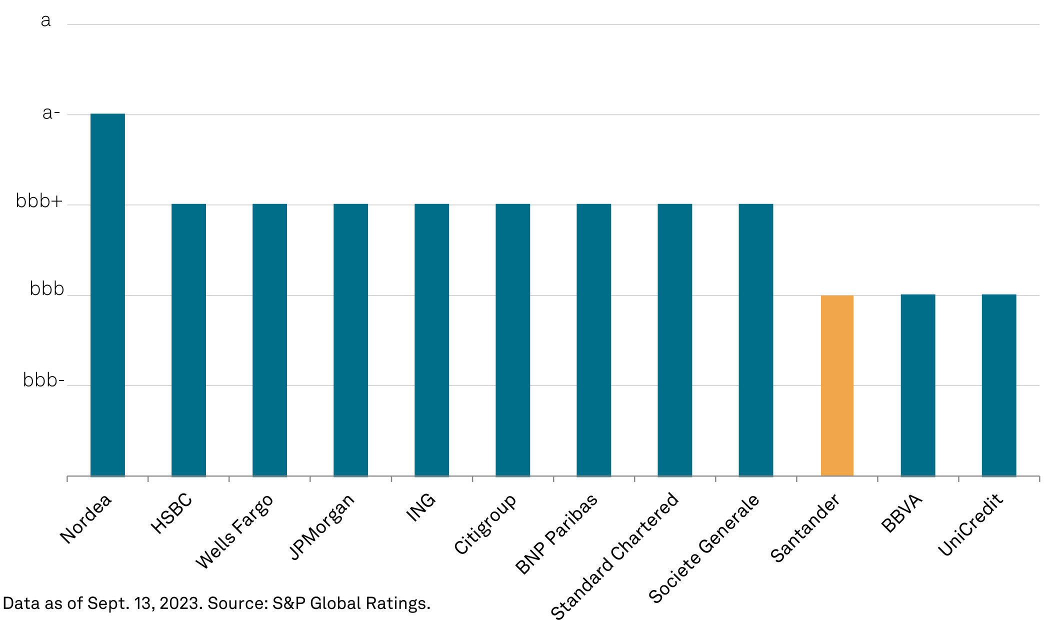
All figures are S&P Global Ratings-adjusted. a--Actual. f--Forecast. NIM--Net interest margin.

Anchor: 'bbb' Reflecting The Higher-Than-Average Economic Risk Of The Markets Where The Bank Operates

Our anchor for Santander is currently 'bbb', weaker than that of most of its global peers (see chart 1). We generally compare Santander with the following peers: HSBC, BNP, JP Morgan, Citigroup, Standard Chartered, ING, Societe Generale, Wells Fargo, BBVA, Nordea, and Unicredit.

Chart 1

Santander's anchor is lower than peers' and reflects higher economic risks of its footprint



Data as of Sept. 13, 2023. Source: S&P Global Ratings.

The weighted-average economic risk to which Santander is exposed is not only higher than that of global peers, but also marginally higher than that faced by institutions operating primarily in Spain. The U.K. and Spain account for the group's largest credit exposures--about one-quarter each in June 2023. Both have an economic risk score of 4. Brazil (economic risk of 7) and the U.S. (economic risk of 3) each account for about 10%. The remaining exposures are split roughly evenly at about 5% each between Mexico (economic risk of 6), Portugal (economic risk of 6), Germany (economic risk of 2), and other Latin American countries (economic risk of 7). The rest of Europe (economic risk 4), including Poland, accounts for the remaining 10%. Weightings are rounded to the nearest 5% before averaging.

With regard to industry risk, our assessment of '4' is supported by Spanish banks' solid funding profiles. Customer deposits, largely from households and therefore cheap and sticky, more than fully fund banks' loan books and banks have become net external creditors. Additionally, Spanish banks' profitability, which has been under substantial pressure in recent years, is set to benefit from the rapid increase in interest rates. That said, it will take some time for returns to comfortably exceed banks' cost of capital, particularly for mid-size banks. Spanish banks are well positioned to deal with inflationary pressure on costs because they have significantly downsized their operating structures over the past decade. But the banks face other headwinds such as the new temporary banking tax, which will eat into about 12% of banks' 2023 and 2024 profits on average. Furthermore, the public's opinion of banks has somewhat deteriorated. Banks gained recognition for their role during the pandemic, when they ensured credit continued to flow into the economy, but public sentiment has recently become more negative as customers feel the effects of higher financing costs. Largely supervised by the European Central Bank, Spain's institutional framework is aligned with international standards.

Business Position: A Powerful, Geographically Diversified, And Profitable Retail Banking Franchise

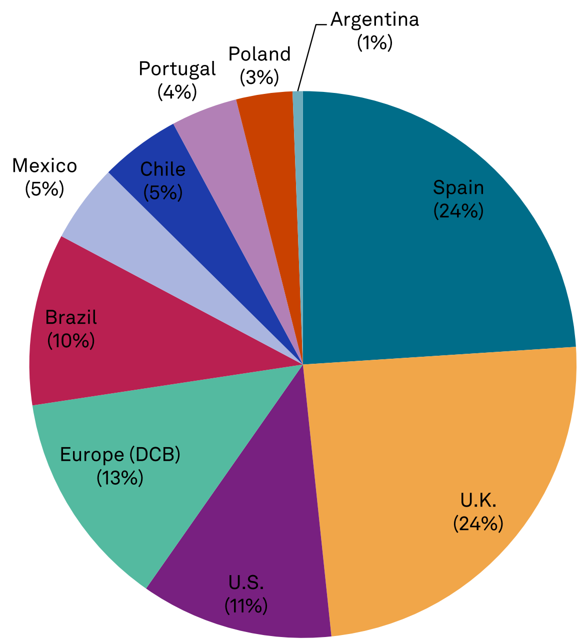
Santander benefits from a robust business model based on a geographically diversified franchise, with leading market positions in the countries where it operates and a focus on stable retail banking business, all of which contribute to strong, consistent earnings. Of the bank's global peers, only the ratings on French bank BNP Paribas and U.S. bank JP Morgan Chase benefit from these business model strengths to the same extent as Santander.

Santander is currently one of the most geographically diversified banks in the world (see chart 2). Generally, no single country concentrates more than 25% of the group's net profits and credit. Its presence in developed economies outweighs its presence in emerging markets (accounting for 79% and 21% of loans in June 2023, respectively), but it is more balanced when measured in terms of profit contribution (about 63% and 36% during the first half of 2023; see chart 3). The limited economic correlation of the countries in which it operates allowed Santander to accommodate the ups and downs of the different economic cycles and achieve consistent, resilient results over time. Geographic diversification even proved valuable during the pandemic, since the magnitude and timing of the economic effect in each country varied, and the bank used different levers in each of them to mitigate the impact.

Chart 2

Santander benefits from wide geographic diversification, weighted toward matured economies

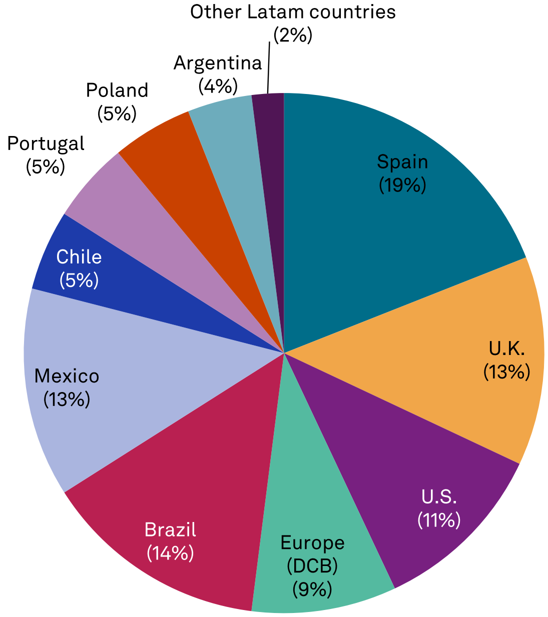
Geographical distribution of the group's customer loans as of June 2023



Source: Banks' financial report.

Chart 3

Emerging markets are key contributors to the group's profitability
Geographical contribution to net attributable profits as of June 2023



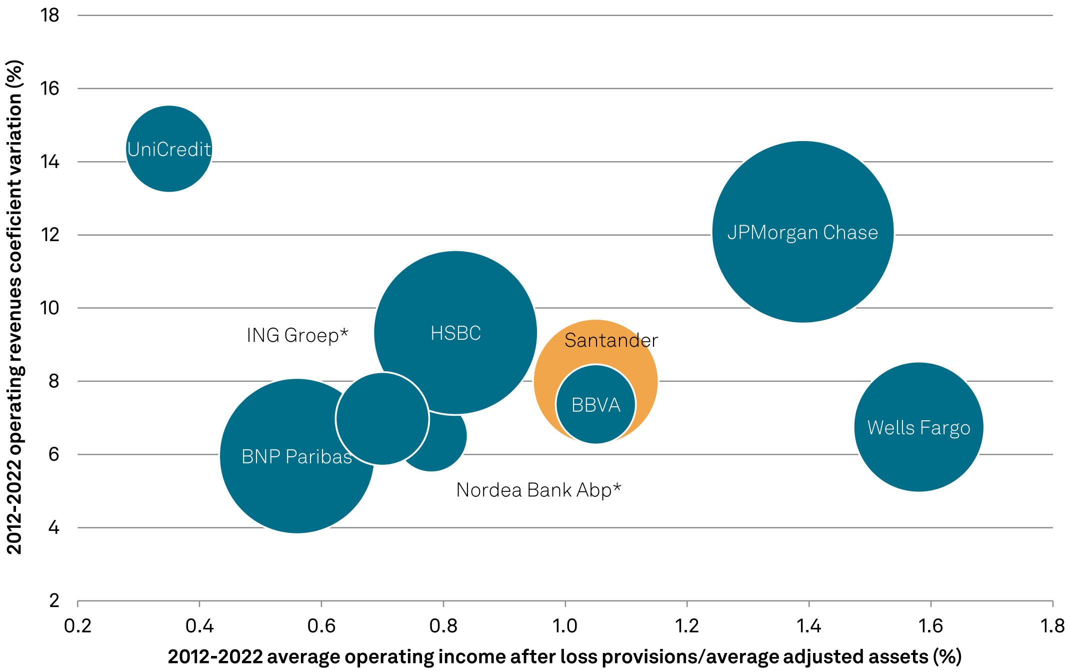
Excludes the corporate center. Latam--Latin America. Source: Banks' financial report.

Santander also enjoys strong positions and franchises in most of its markets of operation, which provide it with pricing power and a loyal retail customer funding base. In addition to the 18% market share in loans that the bank holds in Spain, Santander is the third-largest mortgage lender in the U.K. (holding about 11% of the market). It owns the second-largest banks in Portugal, Poland, and Chile and the third-largest banks in Mexico and Brazil (excluding public banks). It has also built one of the largest pan-European consumer finance business. Santander is present in the U.S., where it benefits from decent, though regional, and still underperforming, market positions in several strong northeastern markets, and a now fully owned consumer arm specialized in nonprime auto loans (SCUSA).

The group primarily focuses on retail banking activities, which support the bank's business and earnings stability. Compared with peers, Santander exhibits a track record of stronger, more-resilient earnings, and outstanding efficiency (see charts 4 and 5).

Chart 4

Santander has a record of strong profits and recurrent earnings

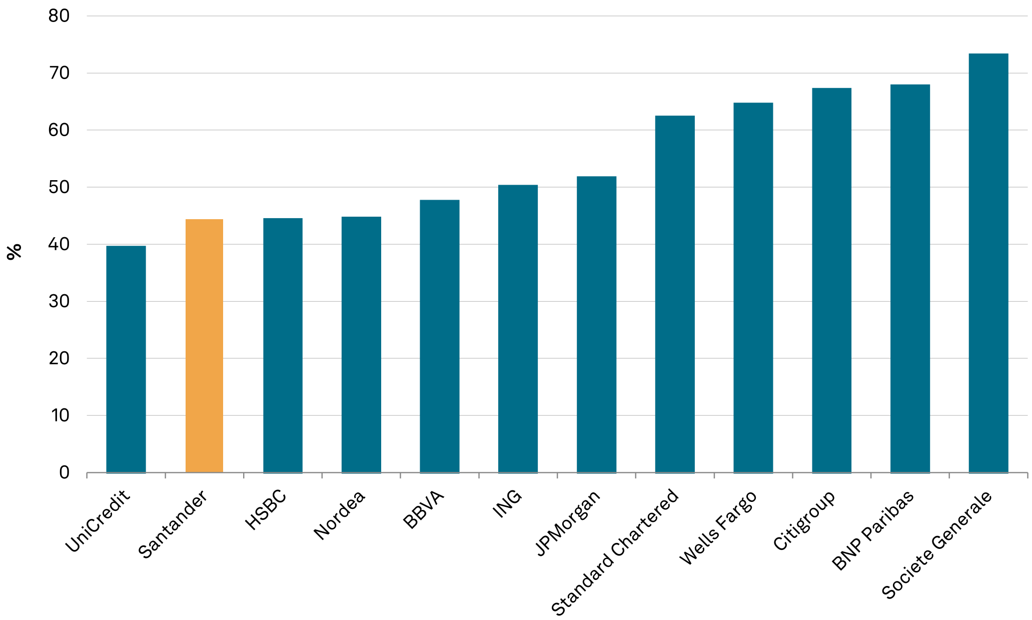


*Data as of 2014-2022. Bubble size represents total assets as of December 2022. Coefficient variation measures the standard deviation or operating revenues to the mean. Source: S&P Global Ratings.

Chart 5

High efficiency is one of Santander's key attributes

Cost-to-income ratio as of June 2023



Source: S&P Global Ratings.

Santander benefits from a clear, well-executed strategy, which led to the transformation of what was once a domestic institution into a strong and well-diversified global banking group. Inorganic growth has been a key enabler of the bank's build-up of a global franchise over the years, but merger and acquisition (M&A) activity has been more limited lately. The bank has instead engaged in buying minorities on some of its existing operations (Mexico and the U.S. consumer business, for example) in an effort to deploy capital toward higher-growth, more profitable countries and businesses. Although, if M&A opportunities were to arise, we do not disregard the possibility of the bank considering them, most likely in businesses or markets where it already operates.

After successfully delivering on the targets set for 2022, in early 2023 Santander announced a new strategic plan. The plan will be led by newly appointed CEO Héctor Grisi who was previously the head of Santander's Mexican unit and regional head of North America. The strategic priorities of previous plans still remain and include:

- Strengthening profits and increasing shareholder remuneration;
- Maintaining a solid capital base and a strict discipline in capital allocation, prioritizing the more profitable businesses;
- Growing the business, attracting new clients, and engaging further existing clients; and
- Progressing in digital and environmental social and governance (ESG) agendas.

But the new plan has more ambitious targets. For example, the bank aims to increase its customer base by 40 million in three years, improve its ROTE to 15%-17% by 2025 (from 13.4% in 2022), strengthen its efficiency ratio to about 42% (from 45.8%), and increase the pay-out to shareholders (in the form of dividends and share buy-backs) to 50% from 40%, while maintaining a CET1 fully loaded ratio above 12%.

A key way to achieve the targets is by aligning all business units to a common, simpler operating model. The project, named "One Transformation", aims to simplify the product offering, automate processes, and reduce the operational burden at branches (which will in turn lead to better customer experience). The plan will be supported by an improved IT architecture that contemplates the full migration of the current core banking systems to a cloud-based platform.

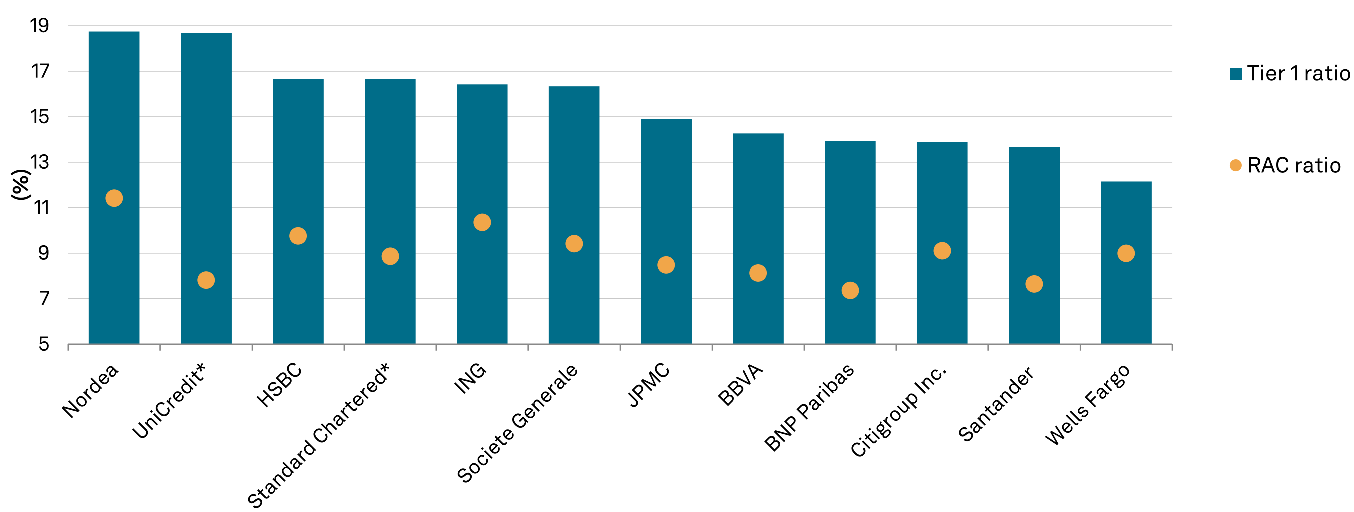
Another novelty of the plan is the emphasis the group wants to put on growing the business and profit contribution of its global businesses, namely corporate and investment banking, wealth management and insurance, payments and auto. The ambition is for these four businesses to contribute more than 40% of the group's revenues and more than 50% of the group's fees by 2025.

Capital And Earnings: Strong Profitability Prospects Will Support Some Capital Build Up

Although the gap has reduced in recent years, Santander's capitalization, measured by regulatory ratios and our RAC measure, still stands below that of most international peers (see chart 6). But the group benefits from a track record of stronger, more predictable earnings, which support the build up of capital and also make it regularly perform well in regulatory stress tests, consistently showing more manageable capital depletion than peers under adverse scenarios.

Chart 6

Santander's regulatory capital and RAC ratio are below that of most peers
Ratios as of December 2022



*RAC ratio corresponds to the forecasts, rather than the actual. Source: S&P Global Ratings.

Despite declining somewhat, Santander's RAC ratio of 7.7% at end-2022 remained comfortably in the 7%%-10% adequate bucket. Profitability tailwinds and moderate risk-asset expansion (3% annually in 2023-2024 and 4% in 2025 according to our estimates) will support some strengthening, although the bank also aims to increasing the payout to shareholders to 50%. We thus forecast our RAC ratio will be at just over 8% by 2025. On a regulatory basis, the bank's capital ratios will likely remain more stable, as capital generation will largely absorb the regulatory impacts to come. The bank is committed to maintain its fully loaded CET1 ratio at over 12%--at roughly the same level as of today. Quality of capital should also remain sound, with hybrid instruments (mainly additional Tier 1 [AT1] issued by the parent and the U.K. subsidiary) accounting for about 9%-10% of total-adjusted capital (TAC) over 2023-2025.

The far more favorable interest rate environment provides a significant impetus to the bank's returns, particularly in Europe, despite flattening economic activity. In 2022 Santander reported its highest profits ever (€9.6 billion), a mark that we expect will very likely be exceeded in 2023. Net attributable profits as of June 2023 already amounted to €5.2 billion, equivalent to a ROE of 11.6% and a ROTE of 14.6%. Stronger earnings, particularly wider net interest margins as assets are fully repriced to higher rates and deposit costs remain contained, will be the main contributor to profit expansion in 2023. From 2024, benefits of the "One Transformation" plan on costs will play more of a role in supporting growing profits. Over 2023-2025, we expect credit impairments to remain manageable, on average 122 bps of average loans. By region, the contribution of developed markets to the group's profits should increase.

All in all, we expect Santander's ROE to hover at 11.0%-11.5% this year and next, and that it will slightly decline in 2025. We anticipate its earnings buffer (which measures the capacity of the bank's earnings to cover normalized losses) to stand at a solid 199 bps of S&P Global Ratings' RWAs over 2023-2025.

The group's capital is fairly distributed across subsidiaries. From time to time, regulatory restrictions on dividend distributions may temporarily leave subsidiaries with excess capital, but these situations tend to be addressed and corrected over time. For example, in 2022 Portugal and the U.S. paid extraordinary dividends to the parent to reduce their excesses, and others could follow suit in 2023.

With phased-in and fully loaded common equity Tier 1 ratios of 12.3% and 12.24%, respectively, as of June 2023, and phased-in and fully loaded total capital ratios of 16.03% and 15.93%, Santander's capital ratios stood comfortably above its regulatory requirements (9.14% and 13.33% respectively). The bank's AT1 and Tier 2 buckets were not fully filled as of June 2023, but its maximum distributable amount buffer of 270 bps still looked comfortable, even if below that of peers.

Our capital measure is weaker than the regulatory calculation, reflecting the higher risks we see in the economies where Santander operates and the still-large balance of deferred tax assets resulting from timing differences outstanding on the bank's balance sheet. Therefore, our calculation of Santander's RWAs is 80% higher than the regulatory one.

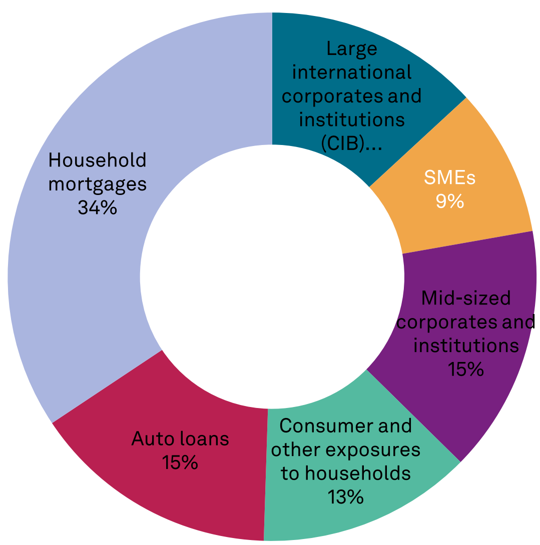
Risk Position: Benefits From Wide Geographic And Risk Diversification And Better Asset Quality Across Its Markets Of Operation

Despite Santander's capital ratios being lower than peers' (both by regulatory and S&P Global Ratings' measures), we consider its capitalization solid for the risks it faces. This is mainly due to the benefits it derives from its wide geographic diversification in economies that have historically proved to be uncorrelated, an aspect that our RAC calculation does not fully capture. the diversification benefit that we calculate for Santander (24% at end 2022) is one of the highest in our sample of rated global banks.

Equally, the bank enjoys good diversification by risk and client type (see chart 7). Residential mortgages accounted for 34% of loans at June 2023 and have a low risk profile across geographies, and in particular in the U.K. where most of Santander's mortgages originate. The share of consumer lending (22% of the loan book) is higher than that of peers, due to its large auto-lending business in Europe and the U.S. But only the latter, which is about 60% subprime, has a higher-risk profile. Conversely, Santander Consumer Finance (SCF)'s consumer lending portfolio, mostly based in Germany, the Nordics and Spain, has a lower-than-average risk profile. Finally, corporate exposures, amounting to less than 40% of the total, are evenly split between small and midsize enterprise (SMEs; 9%), mid-sized corporates (15%), and large international corporates (13%), and are distributed across a number of sectors. Single name concentration is limited, with the 20 largest exposures representing 42% of the bank's 2022 TAC.

Chart 7

Santander's loan book is well diversified by asset class



Data as of June 2023. SMEs--Small and midsized enterprizes. Source: Bank's financial reports.

Compared to global peers, Santander generally reports higher problematic exposures and credit losses. But this is attributable to the riskier nature of the markets where it operates, rather than its credit underwriting, which we view as sound. Risks are also closely monitored and, as a result, Santander's asset quality track record is better-than-average in most markets of operation.

Since the end of 2021, the group's NPL ratio, according to our calculations, has been hovering around 3.5%, with coverage ranging from 65%-70% and credit losses averaging 110 bps of average loans. Asset quality performance proved quite resilient during the pandemic and the more recent energy crisis, but we are already seeing early signs of weakening in some markets--namely the Americas, Poland, and, to a much lower extent, in the U.K. Naturally, the higher financing costs will take a toll on weaker borrowers, which at the same time will face the slowdown of economic activity. Consequently, additional problem loans will emerge. But overall, we expect deterioration to be fairly contained, with NPL and credit costs growing only marginally, peaking at 3.9% and 127 bps in 2024, moderately reducing in 2025. As of June 2023, Stage 2 credits amounted to 6.7% of the total, somewhat below the average level reported by European banks.

Given the nature of its business, the bank's main risk exposure is to credit risk. That said, Santander is also structurally exposed to foreign currency risks which arise from its local currency investments in subsidiaries abroad. The bank's policy is to largely hedge the risk of adverse foreign currency movements affecting the group's regulatory capital ratio. Historically, this hedging has proved effective when foreign currencies suffered large devaluations. The hedging of subsidiaries' profit contribution to the group, though, is more opportunistic and may not cover 100% of expected profits. It depends on the bank's expectations of foreign exchange moves and pricing of the hedges.

The group also actively manages its structural exposures to interest rate risk, through asset-liability committee portfolios or swaps across geographies. At present, most operations (other than Brazil, Chile, and SCF), are asset sensitive, thus benefiting from interest rate increases. At June 2023 the asset-liability committee portfolio amounted to €87 billion, having grown in the past few months to prepare the group's balance sheet for when interest rates start to decline.

Running a business of such large size with operations in multiple jurisdictions entails some complexity. But we think risks are well under control. We believe Santander's retail business model, which is consistently replicated across its network, and its organizational structure, facilitate the bank's management. Additionally, the subsidiaries' self-financing profiles and the parent's less supportive stance than other peers toward subsidiaries in adverse scenarios help limit contagion risks across the group entities and set a threshold on risk taking by the parent.

Funding And Liquidity: A Structurally Balanced And Resilient Funding Profile

Santander enjoys a fairly balanced funding profile, weighted toward sticky retail deposits, largely provided by households and SMEs, and that are, to a large degree, insured. The group's loan-to-deposit ratio stood at 103% at June 2023. It also holds a manageable amount of wholesale funding, diversified by instrument, market, and investors; is exposed to limited refinancing risk as debt maturities are spread over several years and reliance on short-term wholesale debt is limited; and has good access to market funding even in times of market turbulence.

The bank's stable funding ratio, according to our calculations, stood at a solid 115% at June 2023, having improved from 101% at end-2019, with the regulatory net stable funding ratio standing at 121%.

The bank operates through subsidiaries independent from the parent for funding purposes. With the exception of UCI (a small joint venture with BNP engaged in providing mortgages in Spain, which receives some funding from Santander), funding resources channeled to others are immaterial. Even Santander Consumer Finance, which at some point made use of its parent's excess liquidity, currently receives no funding from its parent.

There are no significant differences in the funding profiles of subsidiaries within the group. The group entities with more excess customer deposits are Spain, Poland, Mexico, and Argentina, while the subsidiaries proportionally more dependent on wholesale financing are SCF, Chile, and SCUSA.

The group's wholesale debt outstanding in the market totaled €195.4 billion as of June 2023, across a wide array of instruments: senior (34%), covered bonds (25%), senior nonpreferred (26%), subordinated debt (10%), and preferred securities (5%). If securitizations are added, the group's total wholesale debt would be around €250 billion. Banco Santander S.A. and Santander U.K. are the most active issuers, accounting for about 85% of the group's wholesale debt outstanding. The calendar of debt maturities is well spread and manageable. Furthermore, Santander has easy access to the markets. In the first half of 2023, for example, it had completed most of its funding plans for the whole year.

Santander also benefits from sound liquidity, which the repayment of central bank borrowings has not eroded. Through 2022 and 2023, Santander materially reduced its borrowings from the European Central Bank (ECB)'s targeted longer-term refinancing operations, and by 2024 the minor ECB borrowings remaining, largely at Santander's parent and SCF, will be fully reimbursed, with only the U.K. maintaining some central bank funding. Our measure of the group's broad liquid assets to short-term wholesale funding stood at 2.4x at June 2023, with broad liquid assets also accounting for a solid 54% of customer deposits as of the same date. The group's regulatory liquidity ratio stood at 158% as of June 2023. Liquidity is held in cash (€204 billion) and liquid securities portfolios (€116 billion). The later are primarily invested in government securities, which are fairly split across countries. About half of the securities portfolio is accounted as held-to-collect, with unrealized losses representing a manageable 2% of the bank's fully loaded CET1.

Support: One Notch Of ALAC Uplift

Since the end of 2021, the issuer credit rating on Santander includes one notch of additional loss-absorbing capacity (ALAC) uplift (see "Six European Banks Upgraded On ALAC Or Group Support Uplift; Off UCO On Implementation of Revised FI Criteria," published Dec. 16, 2021), as is the case for most of its global peers. That is because we expect the bank will maintain a buffer of subordinated bail-inable debt wide enough to provide protection for senior creditors in a resolution scenario. Over the outlook horizon, we expect Santander's ALAC to remain comfortably above the 500 bp threshold we require for the bank to benefit from one notch of ratings uplift.

Given Santander comfortably complies with both its minimum requirement for own funds and eligible liabilities (MREL) and total loss-absorbing capacity (TLAC) requirements, we do not expect much additional net issuance of bail-inable debt in the future, and that it will rather focus on replacing instruments that lose eligibility. As of June 2023, Santander reported an MREL of 36.3% versus a requirement of 33.6% (both including the 3.8% combined capital buffer), while its TLAC was 24.6% of RWAs, compared with the required 21.8% (both also including the combined buffer requirement). The bank's MREL includes some €20 billion of senior preferred debt, but modest subordination requirements suggest the bank will not replace this debt with more subordinated instruments either.

Our ALAC analysis focuses on banks' recapitalization capacity in a resolution scenario once losses have been absorbed by Tier 1 capital. The ALAC buffer thus comprises senior nonpreferred and subordinated debt instruments. Given the bank's multiple-point-of-entry resolution strategy, our analysis centers on the parent's resolution perimeter. We only compute bail-inable instruments issued (or to be issued) by Banco Santander S.A., excluding those issued by subsidiaries abroad identified as separate points of entry in resolution (most notably, all instruments issued out of the U.K. and the U.S.). Equally, our RWA calculation only corresponds to the businesses falling under the parent's resolution perimeter, as these would be the ones the parent would have to recapitalize in a resolution scenario. The parent's resolution perimeter mainly encompasses its Spanish operations, Santander Consumer Finance, and, since the second quarter of 2023, also its Portuguese operations. Conversely, the U.K., Poland, the U.S., Mexico, Brazil, Chile, Argentina, Uruguay, Peru, and Colombia have been identified as separate points of entry in resolution. The parent would not be required to recapitalize them in a resolution scenario and thus host authorities could require them to build their own cushions of bail-inable debt to face such an event.

We markedly increased the threshold for a one-notch uplift for Santander, to 500 bps from the standard 300 bps. This reflects that the parent bank operates with double leverage and, as a result, in a resolution scenario some of its Tier 2 and senior nonpreferred debt would likely need to absorb losses, including those arising from the value lost in its investments in subsidiaries outside the resolution perimeter, not solely to recapitalize the business.

With the incorporation of the ALAC notch into the ratings, the issuer credit rating (ICR) on Santander stands one notch above the sovereign credit rating on Spain, its country of domicile. This means we believe there is an appreciable likelihood that Santander would not default in the stress scenario that would likely accompany a hypothetical default of Spain. In such a scenario, our modeling anticipates Santander would face substantial impairments--which would erode a significant portion, but not all, of its capital base--and that it could suffer sizable liquidity outflows. This would very likely trigger the bank's resolution and thus the bail-in of junior instruments. Still, this action, and the funding support that would likely be provided by authorities during the resolution, would together help the bank avoid an immediate default on its senior obligations if the Spanish sovereign were to default.

Environmental, Social And Governance

ESG factors are not a material, direct influence on our credit ratings on Santander.

Santander's governance, control standards, and transparency are high, which is very much needed given its presence in several countries exposes the group to diverse risks. In recent years, it has been under the regulatory scrutiny of the U.S. authorities and was required to make meaningful adjustments to its risk management in the country. We understand that major issues have now been addressed. The bank also has large exposures to markets such as those in Latin America, where governance practices may be weaker than in Spain, Santander's domestic market, and therefore require constant monitoring. So far, the bank has managed those risks well. Santander's board of directors is diverse, fairly international, and includes several independent members. The representation of the Botín family, founder of the bank, looks high compared with the economic interest the family holds. Of the two seats the family holds, however, one belongs to Ana Botín in her role as executive chairman. In 2018, the decision-making process at the board level raised some questions, as a new CEO was announced and reconsidered only three months later, leading to a legal dispute that ended in a high economic compensation.

Social factors are increasingly relevant for a retail-focused bank like Santander. However, the bank has experienced fewer client claims or conduct issues than several other global banks in the past decade. It was not affected by Spanish customers' claims on mortgage interest rate floors and the bank managed to proactively reduce the risk of claims in other instances (arranging solutions to private banking clients affected by Bernie Madoff's case or to retail clients of Popular who lost their investments when the bank was resolved). In the U.K., misconduct charges largely originated from payment protection insurance cases at the bank that Santander acquired before the financial crisis, but it was also fined in 2018 for failing to effectively process the accounts and investments of deceased customers.

Environmental factors do not overly affect the bank's credit quality, and related risks are very much in line with those faced by peers. Of note, Santander is a large provider of auto loans (15% of the group's loan exposure), so the business and financial challenges that the auto industry faces could indirectly affect its business prospects. A substantial change in consumer preferences, such as favoring renting over ownership, could force the bank to adapt its product offer. The group has set a target to be carbon neutral by 2050 and it is committed to facilitate the green transition of its clients. By 2025 it aims to have raised and facilitated €120 billion of green financing.

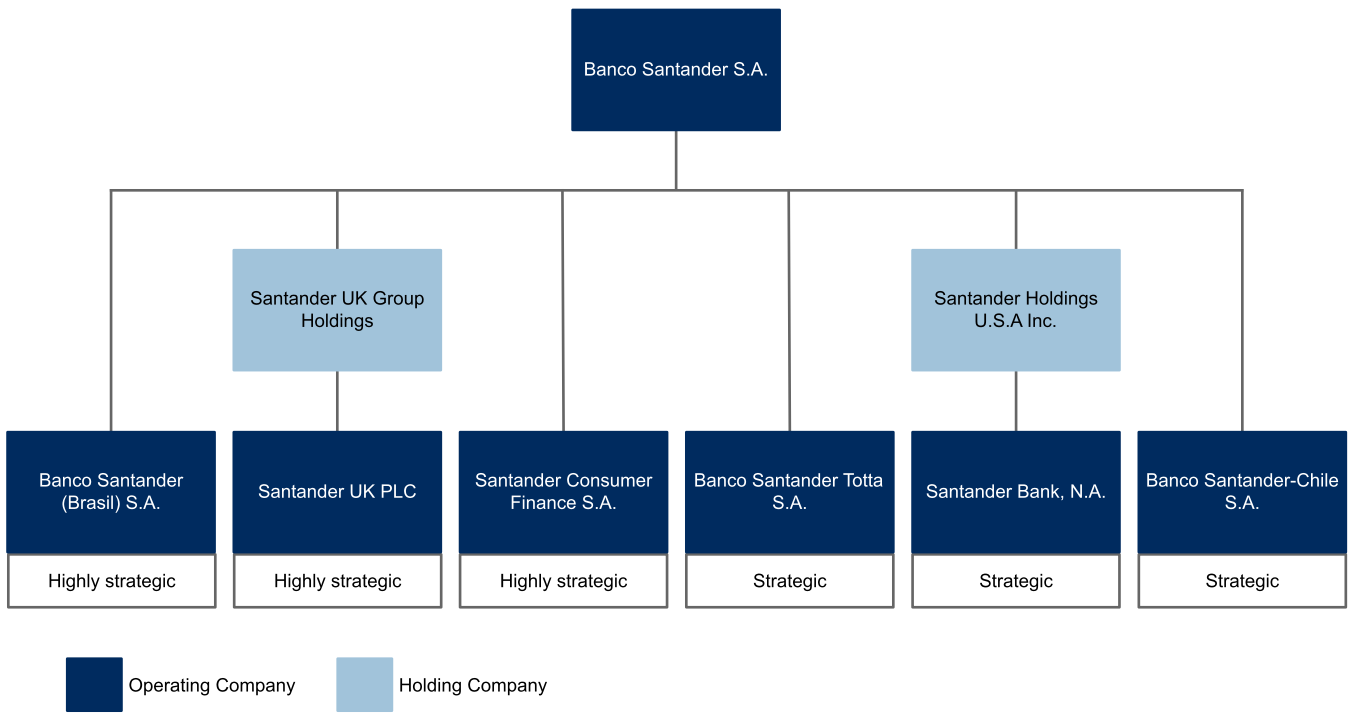
Group Structure And Rated Subsidiaries

We rate six of Santander's operating subsidiaries globally. In contrast to most other global banking groups, we do not consider any of Santander's subsidiaries as core (see "How We’re Refining Our View Of The Strategic Importance Of Certain Spanish Bank Subsidiaries," published Aug. 2, 2019).

At present, the ratings on only three of Santander's subsidiaries benefit from group support: Santander Consumer Finance S.A. (three notches of uplift), Banco Santander Totta, S.A. in Portugal (one notch), and Banco Santander N.A. in the U.S. (three notches).

We do not incorporate group support into the ratings on the remaining three subsidiaries for various reasons: the sovereign creditworthiness of the host country limits any upside potential (Brazil); the ratings benefit already from ALAC uplift (Santander U.K. PLC); or the stand-alone credit profile (SACP) is already one notch lower than the parent's group credit profile of 'a' (Santander Chile).

Santander's simplified organization chart including rated subsidiaries only



Source: Banco Santander S.A., S&P Global Ratings.

Hybrid Ratings

We consider senior nonpreferred debt, nondeferrable subordinated debt, and preference shares as hybrid instruments and arrive at these ratings by notching down from the bank's 'a' SACP.

We therefore rate Banco Santander S.A.'s senior nonpreferred debt at 'A-', one notch below the bank's SACP to reflect subordination versus senior obligations.

We rate nondeferrable subordinated debt at 'BBB+', two notches below the bank's SACP. In addition to being subordinated, we believe these instruments (capital instruments for regulatory purposes) could be written down to absorb losses ahead of resolution, that is, before the institution reaches the point of nonviability.

We rate junior subordinated debt at 'BBB-', four notches below the bank's SACP. In addition to the above, the wider notching compared with nondeferrable subordinated instruments reflects the risk of coupon suspension and these instruments computing as a Tier 2 regulatory capital (one notch), as well as the existence of a mandatory trigger for coupon suspension linked to the availability of enough profits in the prior year's reporting--as opposed to enough distributable reserves (an additional notch).

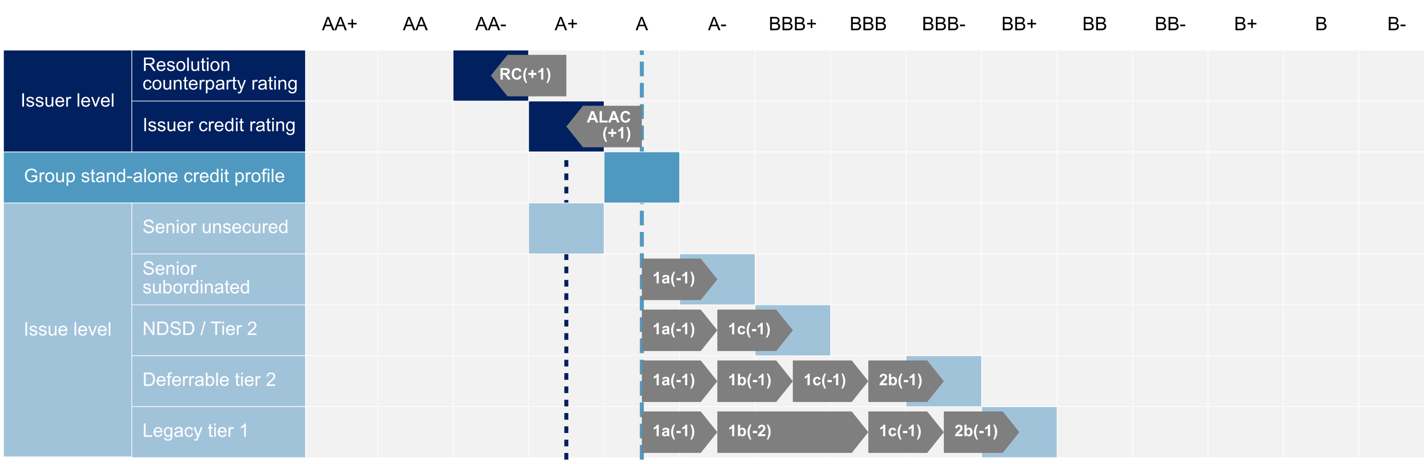
Finally, we rate the remaining two legacy preference shares, with a residual outstanding of €150 million, five notches below the bank's SACP, at 'BB+'. The additional notch difference relates to preference shares computing as Tier 1 rather than Tier 2 capital.

We do not rate the bank's AT1 instruments issued in the past few years.

Resolution Counterparty Ratings (RCRs)

We set the RCR of Banco Santander at 'AA-'. The RCR is a forward-looking opinion of the relative default risk of certain senior liabilities that may be protected from default through an effective bail-in resolution process for the issuing entity. We therefore rate them one notch above the long-term ICR on the bank to show their lower relative default risk. Santander's RCR also stands two notches above the long-term sovereign credit rating on Spain, indicating that we see a considerable likelihood that a sovereign default would not immediately trigger a default on the bank's RCR liabilities.

Banco Santander S.A. : Notching



Key to notching

- ----- Group stand-alone credit profile
- ------ Issuer credit rating
- RC Resolution counterparty liabilities (senior secured debt)
- ALAC Additional loss-absorbing capacity buffer
- 1a Contractual subordination
- 1b Discretionary or mandatory nonpayment clause and whether the regulator classifies it as regulatory capital
- 1c Mandatory contingent capital clause or equivalent
- 2b Other nonpayment or default risk not captured already

Note: The number-letter labels in the table above are in reference to the notching steps we apply to hybrid capital instruments, as detailed in table 2 of our "Hybrid Capital: Methodology And Assumptions" criteria, published on March 2, 2022.
NDSD--Non-deferrable subordinated debt.

Key Statistics

Table 1

Banco Santander S.A.--Key figures

	--Year ended Dec. 31--				
(Mil. €)	**2023**	**2022**	**2021**	**2020**	**2019**
Adjusted assets	1,759,457.4	1,714,506.8	1,577,530.2	1,490,478.7	1,492,966.1
Customer loans (gross)	995,643.8	994,781.5	937,063.7	869,856.1	882,815.2
Adjusted common equity	78,772.5	75,590.8	73,147.9	68,907.2	73,485.8
Operating revenues	29,514.1	54,920.0	48,845.9	46,621.2	51,367.0
Noninterest expenses	13,099.7	25,479.9	22,779.7	22,433.0	24,379.0
Core earnings	7,433.4	13,380.2	12,662.8	N/A	12,291.5

N/A--Not applicable.

Table 2

Banco Santander S.A.--Business position

	--Year ended Dec. 31--				
(%)	**2023**	**2022**	**2021**	**2020**	**2019**
Loan market share in country of domicile	18.0	17.5	17.4	17.5	17.6
Deposit market share in country of domicile	20.5	19.5	18.4	18.3	18.9
Total revenues from business line (currency in millions)	29,791.3	54,938.2	48,899.5	46,735.3	52,657.6
Commercial banking/total revenues from business line	14.6	13.5	11.6	11.5	10.0
Retail banking/total revenues from business line	73.8	77.7	81.1	79.6	82.7
Other revenues/total revenues from business line	11.6	8.8	7.3	8.8	7.3
Return on average common equity	11.6	11.0	9.7	(9.7)	6.7

Table 3

Banco Santander S.A.--Capital and earnings

	--Year ended Dec. 31--				
(%)	**2023**	**2022**	**2021**	**2020**	**2019**
Tier 1 capital ratio	13.7	13.6	14.2	14.0	13.1
S&P Global Ratings' RAC ratio before diversification	N/A	7.7	8.4	7.7	7.7
S&P Global Ratings' RAC ratio after diversification	N/A	10.0	11.0	9.8	9.5
Adjusted common equity/total adjusted capital	90.4	90.0	88.0	88.8	89.1
Net interest income/operating revenues	70.9	70.3	68.3	68.6	68.7
Fee income/operating revenues	20.7	21.5	21.5	21.5	22.9
Market-sensitive income/operating revenues	4.4	3.0	3.2	4.7	3.0
Cost to income ratio	44.4	46.4	46.6	48.1	47.5
Preprovision operating income/average assets	1.9	1.8	1.7	1.6	1.8
Core earnings/average managed assets	0.8	0.8	0.8	N/A	0.8

N/A--Not applicable. RAC--Risk-adjusted capital.

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 & central banks	455,377	27,278	6.0	84,699	18.6
Of which regional governments and local authorities	1,617	330	20.4	514	31.8
Institutions and CCPs	89,584	13,481	15.0	33,255	37.1
Corporate	296,655	151,491	51.1	322,012	108.5
Retail	605,624	220,374	36.4	337,057	55.7
Of which mortgage	392,985	87,881	22.4	156,361	39.8
Securitization§	57,007	9,898	17.4	20,228	35.5
Other assets†	74,142	60,904	82.1	124,036	167.3
Total credit risk	1,578,389	483,426	30.6	921,287	58.4
Credit valuation adjustment					
Total credit valuation adjustment	--	1,100	--	4,296	--
Market Risk					
Equity in the banking book	6,056	18,548	306.3	50,486	833.6
Trading book market risk	--	15,800	--	22,764	--
Total market risk	--	34,348	--	73,249	--
Operational risk					
Total operational risk	--	62,700	--	98,331	--
	Exposure	**Basel III RWA**	**Average Basel II RW (%)**	**S&P Global Ratings RWA**	**% of S&P Global Ratings RWA**
Diversification adjustments					
RWA before diversification	--	607,437	--	1,097,164	100.0
Total diversification/ concentration adjustments	--	--	--	-260,398	(23.7)
RWA after diversification	--	607,437	--	836,766	76.3
		Tier 1 capital	**Tier 1 ratio (%)**	**Total adjusted capital**	**S&P Global Ratings RAC ratio (%)**
Capital ratio					
Capital ratio before adjustments		83,033	13.7	83,959	7.7
Capital ratio after adjustments‡		83,033	13.6	83,959	10.0

*Exposure at default. §Securitization exposure includes the securitization tranches deducted from capital in the regulatory framework. †Exposure and S&P Global Ratings' risk-weighted assets for equity in the banking book include minority equity holdings in financial institutions. ‡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. CCPs--Central counterparty clearing house. Sources: Company data as of Dec. 31, 2022. S&P Global Ratings.

Table 5

Banco Santander S.A.--Risk position

	--Year ended Dec. 31--				
(%)	**2023**	**2022**	**2021**	**2020**	**2019**
Growth in customer loans	0.2	6.2	7.7	(1.5)	4.1
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	(23.7)	(23.6)	(21.1)	(19.4)
Total managed assets/adjusted common equity (x)	22.7	23.2	22.1	22.1	21.0
New loan loss provisions/average customer loans	1.3	1.1	0.8	1.4	1.1
Net charge-offs/average customer loans	1.2	1.1	0.9	0.9	1.3
Gross nonperforming assets/customer loans + other real estate owned	3.5	3.5	3.5	3.7	3.8
Loan loss reserves/gross nonperforming assets	66.2	65.4	69.1	74.3	65.8

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

Table 6

Banco Santander S.A.--Funding and liquidity

	--Year ended Dec. 31--				
(%)	**2023**	**2022**	**2021**	**2020**	**2019**
Core deposits/funding base	62.6	64.8	64.4	63.8	62.0
Customer loans (net)/customer deposits	103.4	101.0	103.6	103.9	109.6
Long-term funding ratio	86.7	87.3	88.4	86.4	80.3
Stable funding ratio	114.7	115.6	116.6	112.4	101.6
Short-term wholesale funding/funding base	14.1	13.4	12.3	14.5	21.0
Broad liquid assets/short-term wholesale funding (x)	2.4	2.4	2.6	2.1	1.4
Broad liquid assets/total assets	28.5	27.6	27.1	25.5	24.0
Broad liquid assets/customer deposits	54.0	49.8	49.0	47.2	46.4
Net broad liquid assets/short-term customer deposits	32.6	30.1	30.9	26.1	13.1
Short-term wholesale funding/total wholesale funding	37.2	37.5	34.0	39.3	54.3
Narrow liquid assets/3-month wholesale funding (x)	3.3	3.3	3.7	2.9	2.2

Banco Santander S.A.--Rating component scores

Issuer Credit Rating	**A+/Stable/A-1**
SACP	a
Anchor	bbb
Economic risk	
Industry risk	
Business position	Very strong
Capital and earnings	Adequate
Risk position	Strong
Funding	Adequate
Liquidity	Adequate
Comparable ratings analysis	0
Support	+1
ALAC support	+1
GRE support	0

Banco Santander S.A.--Rating component scores (cont.)	
Issuer Credit Rating	**A+/Stable/A-1**
Group support	0
Sovereign support	0
Additional factors	0

ALAC--Additional loss-absorbing capacity. SACP--Stand-alone credit profile.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- 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
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings Detail (As Of October 10, 2023)*	
Banco Santander S.A.	
Issuer Credit Rating	A+/Stable/A-1
Resolution Counterparty Rating	AA-/--/A-1+
Commercial Paper	
Foreign Currency	A-1
Senior Subordinated	A-
Issuer Credit Ratings History	
22-Mar-2022	A+/Stable/A-1
16-Dec-2021	A+/Negative/A-1
24-Jun-2021	A/Stable/A-1
29-Apr-2020	A/Negative/A-1
Sovereign Rating	
Spain	A/Stable/A-1
Related Entities	
Banco Santander (Brasil) S.A.	
Issuer Credit Rating	BB-/Positive/B
Brazil National Scale	brAAA/Stable/brA-1+

Ratings Detail (As Of October 10, 2023)*(cont.)	
Banco Santander-Chile S.A.	
Issuer Credit Rating	A-/Stable/A-2
Commercial Paper	
Foreign Currency	A-2
Senior Unsecured	A-
Banco Santander SA (London Branch)	
Certificate Of Deposit	
Local Currency	A-1
Banco Santander S.A. (New York Branch)	
Commercial Paper	
Local Currency	A-1
Banco Santander Totta S.A.	
Issuer Credit Rating	BBB+/Positive/A-2
Resolution Counterparty Rating	BBB+/--/A-2
Senior Unsecured	BBB+
Banque Stellantis France	
Issuer Credit Rating	BBB+/Stable/A-2
Senior Unsecured	BBB+
Santander Bank, N.A.	
Issuer Credit Rating	A-/Stable/A-2
Senior Unsecured	A-
Short-Term Debt	A-2
Subordinated	BBB+
Santander Consumer Bank AG	
Issuer Credit Rating	A/Stable/A-1
Resolution Counterparty Rating	A+/--/A-1
Commercial Paper	A-1
Senior Unsecured	A
Santander Consumer Finance S.A.	
Issuer Credit Rating	A/Stable/A-1
Resolution Counterparty Rating	A+/--/A-1
Commercial Paper	
Local Currency	A-1
Senior Subordinated	BBB+
Senior Unsecured	A
Short-Term Debt	A-1
Subordinated	BBB
Santander Financial Services PLC	
Issuer Credit Rating	A-/Stable/A-2
Resolution Counterparty Rating	A/--/A-1
Santander Holdings U.S.A Inc.	
Issuer Credit Rating	BBB+/Stable/A-2
Senior Unsecured	BBB+

Ratings Detail (As Of October 10, 2023)*(cont.)	
Santander UK Group Holdings PLC	
Issuer Credit Rating	BBB/Stable/A-2
Junior Subordinated	BB-
Senior Unsecured	BBB
Short-Term Debt	A-2
Subordinated	BB+
Santander UK PLC	
Issuer Credit Rating	A/Stable/A-1
Resolution Counterparty Rating	A+/--/A-1
Junior Subordinated	BB
Junior Subordinated	BB+
Preference Stock	BB
Senior Secured	AAA/Stable
Senior Unsecured	A-1

*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.