Creditreform Bank Rating

Banco Santander S.A. (Group) as parent of
Banco Santander Totta S.A.

Creditreform Rating

Long-Term Issuer Rating: A
Outlook: stable

Short-Term Rating: L2

Preferred Sen. Unsec. Debt: A
Non-Preferred Sen. Unsec. Debt: A-
Tier 2 Capital: BBB-
AT1 Capital: BB+

22 November 2019

Rating Action:

Creditreform Rating affirms the long-term issuer rating of Banco Santander S.A. at 'A' (Outlook: stable) and affirms the credit ratings of its subsidiaries Banco Popular Español S.A. and Banco Santander Totta S.A.

Creditreform Rating (CRA) has affirmed Banco Santander S.A. (Group) – in the following Santander - long-term issuer rating at 'A' and the short-term rating at 'L2'. The rating outlook is stable. Concurrently we affirm the issuer rating of the Group's subsidiaries Banco Popular Español S.A. and Banco Santander Totta S.A., which reflect Santander's issuer rating, in line with our methodology.

Moreover, CRA affirms the rating of the Tier 2 Capital of Santander and its subsidiaries at 'BBB-' and the rating of AT1 Capital at 'BB+'. However, adjustments in our rating methodology for bank capital and debt instruments occurred because of legislative alterations in the European Union. As a result, CRA reclassifies its rating of senior unsecured debt of Santander and its subsidiaries to preferred senior unsecured debt and affirms it at 'A'. In addition, CRA assigns the non-preferred senior unsecured debt of Santander and its subsidiaries, which ranks junior to preferred senior unsecured debt, the following rating: 'A-'.

Please find a complete list of rating actions regarding the bank and its affected subsidiaries at the end of this rating update. In addition, we refer to the more detailed report of the Group from 15 August 2018 on our homepage.

Key Rating Drivers

CRA has affirmed the rating of Santander and its bank capital and debt instruments as a result of its periodic updating process for the following reasons:

- Internationally diversified business model with strong market position in key markets
- Ongoing cost reduction leads to a high level of profitability
- Continues reduction of its non-performing loan exposures
- Adequate capitalization but below peer group average

Rating Rationale

Santander's credit rating affirmation was primarily driven by its ability to generate consistent high net profits and the strong market positions in its ten core markets across Latin America, Europe and US.

Profitability

The Group's net profit increased by 13.5% to €9.3bn. Without exchange rate impacts net profit would increase by 25.8%. The net interest income remained stable at €34.3bn, but excluding the exchange rate impact, net interest income rose by 9%.

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The contribution of mature markets to the Group's profit was around 50% due to lower profitability levels as a result of low interest rates, high loan-loss provisions and restructuring costs.

Santander is outperforming the peer group clearly with its earnings figures. Decisive for the improvement are increased earnings in developing countries, particularly Brazil and Mexico, due to faster growth in volume. Following the acquisition of Banco Popular, net profit in the Spanish home market increased by 19.4% to €1.7bn.

Increased reserves were formed in 2019 for the ongoing staff reduction and investments in digitization, which will lead to a further decrease in operating costs in the coming years.

Asset Situation and Asset Quality

Santander reduced its high stock of non-performing exposure considerably year-over-year. In particular, the Group's NPL ratio decreased from 4.43% to 4.04%. Santander's risk-weighted asset ratios and net-write offs are higher compared to its European peer group due to significant emerging markets exposure.

The non-performing loan portfolio will be further reduced according to the 2019 half-year figures.

Refinancing and Capital Quality

Santander's capital ratios are slightly below average in peer group comparison. The Group reported a fully loaded CET1 ratio of 11.3%. Santander targets to improve its capital allocation and expects to maintain a fully loaded CET1 ratio of 12% in medium-term. In the 2018 ECB/EBA stress test exercise, Santander had one of the lowest capital levels in the adverse scenario.

The ratings of Santander's bank capital and debt instruments are affected due to our rating mechanism and the recent change in our methodology.

Liquidity

The liquidity situation is satisfactory.

Outlook

We consider the outlook of Santander's long-term issuer rating and its bank capital and debt instruments as stable. This reflects our view that Santander is likely to keep being very profitable in the upcoming years while still managing its stock of non-performing exposures. In April 2019, Santander presented its new strategic plan for the medium term. According to this plan, Santander will invest more than 20bn Euros in digitization and technology in the next four years. The Group aims to increase profitability and improve operational performance. We will observe whether Santander is able to meet its target.

In addition, we assume and pay special attention to the political and economic environment in Santander's markets of operations.

Scenario Analysis

In a scenario analysis, Santander's rating developed significantly better in the “best case” scenario and significantly worse in the "worst case" scenario. The ratings of bank capital and senior unsecured debt would behave similarly based on our rating mechanism. These ratings are especially sensitive to changes in total equity and to the bank capital and debt structure in general.

We could upgrade Santander's long-term issuer credit rating and its bank capital and debt instruments if we see a significant improvement of Santander's capital ratios. In addition, a continuous improvement of the Group's asset quality with a reduction of its non-performing loan exposures might lead to an upgrade as well.

By contrast, a downgrade of Santander's long-term issuer credit rating and its bank capital and debt instruments is likely if we see that Santander has declining capital ratios. In addition, a deteriorating profitability, as well as a rising non-performing loan exposure might lead to a downgrade of Santander's long-term issuer rating and its bank capital and debt instruments.

CRA's rating actions at a glance

Banco Santander S.A. (Group):

Long-Term Issuer Rating affirmed 'A', stable outlook

- Short-term rating affirmed at 'L2'
- Senior unsecured debt reclassified to preferred senior unsecured debt and affirmed at 'A'
- Non-preferred senior unsecured debt rated at 'A-'
- Tier 2 capital affirmed at 'BBB-'
- AT1 capital affirmed at 'BB+'

Banco Popular Español S.A.:

Long-Term Issuer Rating affirmed 'A', stable outlook

- Short-term rating affirmed at 'L2'
- Senior unsecured debt reclassified to preferred senior unsecured debt and affirmed at 'A'
- Non-preferred senior unsecured debt rated at 'A-'
- Tier 2 capital affirmed at 'BBB-'
- AT1 capital affirmed at 'BB+'

Banco Santander Totta S.A.:

Long-Term Issuer Rating affirmed 'A', stable outlook

- Short-term rating affirmed at 'L2'
- Senior unsecured debt reclassified to preferred senior unsecured debt and affirmed at 'A'
- Non-preferred senior unsecured debt rated at 'A-'
- Tier 2 capital affirmed at 'BBB-'
- AT1 capital affirmed at 'BB+'

Ratings Detail

Bank ratings

The bank ratings are dependent on a host of quantitative and qualitative factors. An improvement in either sub-category may result in a higher rating score.

LT Issuer / Outlook / Short-Term **A / stable / L2**

Bank Capital and Debt Instruments Ratings

The ratings for bank capital and debt instruments are inter alia dependent on subordination and relative size of the instrument class, based on the long-term issuer rating of the bank.

Preferred senior unsecured debt (PSU):	**A**
Non-preferred senior unsecured debt (NPS):	**A-**
Tier 2 (T2):	**BBB-**
Additional Tier 1 (AT1):	**BB+**

Ratings Detail and History

Please consult our website www.creditreform-rating.de for additional information regarding the dates of publication.

Figure 1: Ratings Detail and History

Bank Issuer Rating	**Rating Date**	**Result**
LT / Outlook / Short-Term (Initial)	15.08.2018	A / stable / L2
Rating Update	22.11.2019	A / stable / L2
Bank Capital and Debt Instruments	**Rating Date**	**Result**
Senior Unsecured / T2 / AT1 (Initial)	15.08.2018	A / BBB- / BB+
PSU / NPS / T2 / AT1	22.11.2019	A / A- / BBB- / BB+
Subsidiaries of the Bank	**Rating Date**	**Result**
Banco Popular Español S.A.		
LT / Outlook / Short-Term (Initial)	25.09.2018	A / stable / L2
Rating Update	22.11.2019	A / stable / L2
Bank Capital and Debt Instruments of Banco Popular Español S.A.		
Senior Unsecured / T2 / AT1 (Initial)	25.09.2018	A / BBB- / BB+
PSU / NPS / T2 / AT1	22.11.2019	A / A- / BBB- / BB+
Banco Santander Totta S.A.		
LT / Outlook / Short-Term (Initial)	25.09.2018	A / stable / L2
Rating Update	22.11.2019	A / stable / L2
Bank Capital and Debt Instruments of Banco Santander Totta S.A.		
Senior Unsecured / T2 / AT1 (Initial)	25.09.2018	A / BBB- / BB+
PSU / NPS / T2 / AT1	22.11.2019	A / A- / BBB- / BB+

Appendix

Figure 2: Group income statement | Source: eValueRate / CRA

Income Statement	2015	2016	2017	%	2018
Income (€000)					
Net Interest Income	32.812.000	31.089.000	34.296.000	+0,1	34.341.000
Net Fee & Commission Income	10.033.000	10.180.000	11.597.000	-1,0	11.485.000
Net Insurance Income	98.000	63.000	580.000	-91,2	51.000
Net Trading Income	2.386.000	2.101.000	1.665.000	+7,9	1.797.000
Equity Accounted Results	375.000	444.000	704.000	+4,7	737.000
Dividends from Equity Instruments	455.000	413.000	384.000	-3,6	370.000
Other Income	2.179.000	2.080.000	2.195.000	-23,9	1.671.000
Operating Income	**48.338.000**	**46.370.000**	**51.421.000**	**-1,9**	**50.452.000**
Expenses (€000)					
Depreciation and Amortisation	3.509.000	2.487.000	3.853.000	-32,1	2.615.000
Personnel Expense	11.107.000	11.004.000	12.047.000	-1,5	11.865.000
Tech & Communications Expense	-	-	-	-	-
Marketing and Promotion Expense	-	-	-	-	-
Other Provisions	3.106.000	2.508.000	3.058.000	-27,3	2.223.000
Other Expense	10.526.000	9.841.000	10.897.000	-3,7	10.489.000
Operating Expense	**28.248.000**	**25.840.000**	**29.855.000**	**-8,9**	**27.192.000**
Operating Profit & Impairment (€000)					
Pre-impairment Operating Profit	**20.090.000**	**20.530.000**	**21.566.000**	**+7,9**	**23.260.000**
Asset Writedowns	10.370.000	9.621.000	9.272.000	-3,6	8.936.000
Net Income (€000)					
Non-Recurring Income	-173.000	-141.000	-203.000	-39,4	-123.000
Non-Recurring Expense	-	-	-	-	-
Pre-tax Profit	**9.547.000**	**10.768.000**	**12.091.000**	**+17,5**	**14.201.000**
Income Tax Expense	2.213.000	3.282.000	3.884.000	+25,8	4.886.000
Discontinued Operations	-	-	-	-	-
Net Profit (€000)	**7.334.000**	**7.486.000**	**8.207.000**	**+13,5**	**9.315.000**
Attributable to minority interest (non-controlling interest)	1.368.000	1.282.000	1.588.000	-5,2	1.505.000
Attributable to owners of the parent	5.966.000	6.204.000	6.619.000	+18,0	7.810.000

Figure 3: Group key earnings figures | Source: eValueRate / CRA

Income Ratios (%)	2015	2016	2017	%	2018
Cost Income Ratio (CIR)	58,44	55,73	58,06	-4,16	53,90
Cost Income Ratio ex. Trading (CIRex)	61,47	58,37	60,00	-4,12	55,89
Return on Assets (ROA)	0,55	0,56	0,57	+0,07	0,64
Return on Equity (ROE)	7,43	7,29	7,68	+0,99	8,68
Return on Assets before Taxes (ROAbT)	0,71	0,80	0,84	+0,14	0,97
Return on Equity before Taxes (ROEbT)	9,67	10,49	11,32	+1,91	13,23
Return on Risk-Weighted Assets (RORWA)	1,25	1,27	1,36	+0,22	1,57
Return on Risk-Weighted Assets before Taxes (RORWAbT)	1,63	1,83	2,00	+0,40	2,40
Net Interest Margin (NIM)	2,84	2,68	2,70	-0,03	2,67
Pre-Impairment Operating Profit / Assets	1,50	1,53	1,49	+0,10	1,59
Cost of Funds (COF)	2,02	2,00	1,67	-0,15	1,52

Change in %Points

Figure 4: Development of assets | Source: eValueRate / CRA

Assets (€000)	2015	2016	2017	%	2018
Cash and Balances with Central Banks	95.088.000	104.427.000	137.273.000	+0,9	138.490.000
Net Loans to Banks	27.755.000	13.290.000	51.152.000	+14,5	58.579.000
Net Loans to Customers	828.286.000	825.894.000	848.915.000	+4,0	882.921.000
Total Securities	203.834.000	211.842.000	226.427.000	-9,0	205.993.000
Total Derivative Assets	85.830.000	83.901.000	67.067.000	-2,1	65.634.000
Other Financial Assets	-	-	-	-	-
Financial Assets	**1.240.793.000**	**1.239.354.000**	**1.330.834.000**	**+1,6**	**1.351.617.000**
Equity Accounted Investments	3.251.000	4.836.000	6.184.000	+22,7	7.588.000
Other Investments	5.985.000	2.516.000	2.324.000	-32,7	1.563.000
Insurance Assets	331.000	331.000	341.000	-5,0	324.000
Non-current Assets & Discontinued Ops	5.646.000	5.772.000	15.280.000	-64,5	5.426.000
Tangible and Intangible Assets	48.765.000	50.191.000	49.333.000	+7,7	53.154.000
Tax Assets	27.814.000	27.678.000	30.243.000	+0,0	30.251.000
Total Other Assets	7.675.000	8.447.000	9.766.000	-4,3	9.348.000
Total Assets	**1.340.260.000**	**1.339.125.000**	**1.444.305.000**	**+1,0**	**1.459.271.000**

Figure 5: Development of asset quality | Source: eValueRate / CRA

Asset Ratios (%)	2015	2016	2017	%	2018
Net Loans/ Assets	61,80	61,67	58,78	+1,73	60,50
Risk-weighted Assets/ Assets	43,70	43,92	41,89	-1,30	40,59
NPLs*/ Net Loans to Customers	4,48	4,07	4,43	-0,39	4,04
NPLs*/ Risk-weighted Assets	6,33	5,72	6,21	-0,19	6,03
Potential Problem Loans**/ NPLs*	32,16	33,12	31,18	+118,11	149,29
Reserves/ NPLs*	71,49	72,51	63,66	+1,64	65,30
Reserves/ Net Loans	3,20	2,95	2,82	-0,18	2,64
Net Write-offs/ Net Loans	1,25	1,16	1,09	-0,08	1,01
Net Write-offs/ risk-weighted Assets	1,77	1,64	1,53	-0,02	1,51
Level 3 Assets / Total Assets	0,18	0,10	0,09	+0,08	0,17

Change in %Points

* NPLs are represented from 2017 onwards by Stage 3 Loans.

** Potential Problem Loans are represented from 2018 onwards by Stage 2 Loans.

Figure 6: Development of refinancing and capital adequacy | Source: eValueRate / CRA

Liabilities (€000)	2015	2016	2017	%	2018
Total Deposits from Banks	175.373.000	149.398.000	190.314.000	-1,3	187.909.000
Total Deposits from Customers	683.142.000	691.111.000	777.730.000	+0,4	780.496.000
Total Debt	243.522.000	251.874.000	238.945.000	+9,5	261.621.000
Derivative Liabilities	85.525.000	82.973.000	66.266.000	-6,4	62.007.000
Securities Sold, not yet Purchased	-	-	-	-	-
Other Financial Liabilities	20.878.000	26.516.000	28.428.000	-13,2	24.664.000
Total Financial Liabilities	**1.208.440.000**	**1.201.872.000**	**1.301.683.000**	**+1,2**	**1.316.697.000**
Insurance Liabilities	627.000	652.000	1.117.000	-31,5	765.000
Non-current Liabilities & Discontinued Ops	-	-	-	-	-
Tax Liabilities	7.725.000	8.373.000	7.592.000	+7,2	8.135.000
Provisions	14.494.000	14.459.000	14.489.000	-8,7	13.225.000
Total Other Liabilities	10.221.000	11.070.000	12.591.000	+3,9	13.088.000
Total Liabilities	**1.241.507.000**	**1.236.426.000**	**1.337.472.000**	**+1,1**	**1.351.910.000**
Total Equity	**98.753.000**	**102.699.000**	**106.833.000**	**+0,5**	**107.361.000**
Total Liabilities and Equity	**1.340.260.000**	**1.339.125.000**	**1.444.305.000**	**+1,0**	**1.459.271.000**

Figure 7: Development of capital ratios | Source: eValueRate / CRA

Capital Ratios (€000)	2015	2016	2017	%	2018
Total Equity/ Total Assets	7,37	7,67	7,40	-0,04	7,36
Leverage Ratio	4,73	5,40	5,28	-0,06	5,22
Phased-in: Common Equity Tier 1 Ratio (CET1)	12,55	12,53	12,26	-0,79	11,47
Phased-in: Tier 1 Ratio (CET1 + AT1)	12,55	12,53	12,77	+0,35	13,12
Phased-in: Total Capital Ratio (CET1 + AT1 + T2)	14,40	14,68	14,99	-0,01	14,98
Fully Loaded: Common Equity Tier 1 Ratio (CET1)	10,05	10,55	10,84	+0,46	11,30
Fully Loaded: Tier 1 Ratio (CET1 + AT1)	11,00	11,53	12,11	+0,69	12,80
Fully Loaded: Total Capital Ratio (CET1 + AT1 + T2)	13,05	13,87	14,48	+0,29	14,77
Change in %Points					

Figure 8: Development of liquidity | Source: eValueRate / CRA

Liquidity (%)	2015	2016	2017	%	2018
Net Loans/ Deposits (LTD)	121,25	119,50	109,15	+3,97	113,12
Interbank Ratio	15,83	8,90	26,88	+4,30	31,17
Liquidity Coverage Ratio	146,00	146,00	133,00	+25,00	158,00
Customer Deposits / Total Funding (excl. Derivates)	59,10	59,92	61,18	-0,67	60,51
Net Stable Funding Ratio (NSFR)	-	-	-	-	114,00
Change in %Points					

Regulatory

Creditreform Rating AG was neither commissioned by the rating object nor by any other third party for the rating. The analysis took place on a voluntary basis by Creditreform Rating AG and is to be described in the regulatory sense as an unsolicited rating.

The rating is based on publicly available information and internal evaluation methods for the rated bank. The quantitative analysis is based mainly on the latest annual accounts, interim reports, other investor relations information of the bank, and calculated key figures by eValueRate / CRA. Subject to a peer group analysis were 24 competing institutes.

The information and documents processed met the requirements of the rating system of Creditreform Rating AG as published on the website www.creditreform-rating.de. The rating was carried out on the basis of the rating methodology for bank ratings as well as the methodology for the rating of bank capital and unsecured debt instruments in conjunction with Creditreform`s basic document "Rating Criteria and Definitions".

The complete presentation of the rating methodologies used by Creditreform Rating AG and the basic document "Rating Criteria and Definitions" is published on the following homepage:

www.creditreform-rating.de/de/regulatory-requirements/.

On 22 November 2019, the rating was presented by the analysts to the rating committee and adopted in a resolution.

The rating result was communicated to Banco Santander S.A. (Group) and its subsidiaries, and the preliminary rating report was made available to the bank. There was no change in the rating score.

The rating is valid until withdrawal and is subject to monitoring from the rating date (see cover page). The rating will be comprehensively reviewed at least once every year. Within this period, the rating can be updated.

In 2011 Creditreform Rating AG was registered within the European Union according to EU Regulation 1060/2009 (CRA-Regulation). Based on the registration Creditreform Rating AG (CRA) is allowed to issue credit ratings within the EU and is bound to comply with the provisions of the CRA-Regulation.

Conflict of Interests

No conflicts of interest were identified during the rating process that might influence the analyses and judgements of the rating analysts involved or any other natural person whose services are placed at the disposal or under the control of Creditreform Rating AG and who are directly involved in credit rating activities or approving credit ratings and rating outlooks.

In case of providing ancillary services to the rated entity, CRA will disclose all ancillary services in the credit rating report.

Rules on the Presentation of Credit Ratings and Rating Outlooks

The approval of credit ratings and rating outlooks follows our internal policies and procedures. In line with our policy "Rating Committee," all credit ratings and rating outlooks are approved by a rating committee based on the principle of unanimity.

To prepare this credit rating, CRA has used following substantially material sources:

1. Aggregated data base by eValueRate
2. Annual Report and interim reports
3. Investors relations information and other publications
4. Website of the rated bank

There are no other attributes and limitations of the credit rating or rating outlook other than displayed on the CRA website. Furthermore CRA considers satisfactory the quality and extent of information available on the rated entity. In regard to the rated entity Creditreform Rating AG regarded available historical data as sufficient.

Between the disclosure of the credit rating to the rated entity and the public disclosure no amendments were made to the credit rating.

The "Basic data" information card indicates the principal methodology or version of methodology that was used in determining the rating, with a reference to its comprehensive description.

In case where the credit rating is based on more than one methodology or where reference only to the principal methodology might cause investors to overlook other important aspects of the credit rating, including any significant adjustments and deviations, Creditreform Rating AG explains this fact in the credit rating and indicates how the different methodologies or these other aspects are taken into account in the credit rating. This information is integrated in the credit rating report.

The meaning of each rating category, the definition of default or recovery and any appropriate risk warning, including a sensitivity analysis of the relevant key rating assumptions, such as mathematical or correlation assumptions, accompanied by worst-case scenario credit ratings as well as best-case scenario credit ratings are explained in mentioned methodologies and / or in the credit rating report.

The date at which the credit rating was released for distribution for the first time and when it was last updated including any rating outlooks is indicated clearly and prominently in the "Basic data" card as a "Rating action"; first release is indicated as "initial rating", other updates are indicated as an "update", "upgrade or downgrade", "not rated", "confirmed", "selective default" or "default".

In the case of a rating outlook, the time horizon is provided during which a change in the credit rating is expected. This information is available within „Basic data" information card.

In accordance to Article 11 (2) EU-Regulation (EC) No 1060/2009 registered or certified credit rating agency shall make available in a central repository established by ESMA information on its historical performance data, including the ratings transition frequency, and information about credit ratings issued in the past and on their changes. Requested data are available at the ESMA website: https://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml.

An explanatory statement of the meaning of Creditreform`s default rates are available in the credit rating methodologies disclosed on the website.

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