Financial Institutions Ratings
Banco Santander S.A. – AT1 rating report

Security ratings

Outlook	Stable
6.375% USD 1.5bn perpetual AT1 notes (May 2014) equity conversion on 5.125% trigger	BBB-
6.25% EUR 1.5bn perpetual AT1 notes (March 2014) equity conversion on 5.125% trigger	BBB-
6.25% EUR 1.5bn perpetual AT1 notes (September 2014) equity conversion on 5.125% trigger	BBB-
6.75% EUR 750m perpetual AT1 notes (April (2017) equity conversion on 5.125% trigger	BBB-
5.25% EUR 1bn perpetual AT1 notes (September 2017) equity conversion on 5.125% trigger	BBB-
4.75% EUR 1.5bn perpetual AT1 notes (March 2018) equity conversion on 5.125% trigger	BBB-

The ratings were not solicited by the issuer; the analysis is based solely on public information.

Rating rationale

Scope rates the above securities issued by Santander at BBB-/Stable. The ratings are based on the following:

- Senior non preferred debt (eligible for MREL/TLAC): A+, Stable Outlook
- Minimum notches down from the senior non preferred debt rating: 4
- Additional notches: 1

In accordance with our rating methodology, the starting point for notching down when rating capital instruments is provided by the senior unsecured debt rating. The minimum four notches reflect the deeply subordinated status of AT1 capital instruments in the priority of claims, their going-concern loss-absorbing features and investors' exposure to coupon-cancellation risks. Please refer to Scope's Bank Capital Instruments Rating Methodology published in May 2018 for more details.

The additional notch for these securities reflects the double-trigger structure which limits the benefits of earnings diversification if the domestic profit outlook deteriorates, resulting in the bank no longer being able to upstream earnings from other parts of the group.

The release of this rating report does not constitute a rating action. The last rating action was assigned on 15 June 2017. For further information on the last rating action and regulatory information please click here.

Lead Analyst

Marco Troiano, CFA
m.troiano@scoperatings.com

Associate Analyst

Alvaro Dominguez Alcalde
a.dominguez@scoperatings.com

Team Leader

Sam Theodore
s.theodore@scoperatings.com

Scope Ratings GmbH

Suite 301
2 Angel Square
London EC1V 1NY

Phone +44 20 3457 0452

Headquarters

Lennéstraße 5
10785 Berlin

Phone +49 30 27891 0
Fax +49 30 27891 100

info@scoperatings.com
www.scoperatings.com

Bloomberg: SCOP

Issuer credit profile

Santander has an issuer rating of AA-, with a Stable Outlook.

The ratings are driven by the bank's strong, seasoned business model in retail and commercial banking, which produces a reliable and well-diversified earnings stream and generates capital at group level. We believe this business model has proven its resilience to shocks, having withstood the global financial crisis, the Spanish real estate market collapse, the euro area sovereign crisis and a recent recession in its key market of Brazil without damage to the bank's capital. Going forward, Santander faces a more challenging outlook in the UK as a result of Brexit-related macro uncertainty, but the outlook for Spain and Brazil is more positive.

Due to the group's presence in several developed and emerging markets, we believe that Santander's key ongoing challenges will be the different regulatory requirements and priorities among the various authorities and ensuring that prudential and supervisory requirements are met not only at group level but also locally.

Summary terms

Issuer	Banco Santander S.A.
Issue date	**March 2014**
Amount	EUR 1.5bn
Coupon	• 6.25% from 12 Mar. 2014 to 12 Mar. 2019 (excluded), then switches to 5y mid-swap rate + 5.41% • Paid quarterly
Format	• Non-step-up, non-cumulative contingent convertible perpetual preferred Tier 1 • Redeemable at the option of the bank, subject to regulatory consent (only after first reset date) • Redeemable at the option of the bank, subject to regulatory consent, in case of change in capital treatment or tax treatment (after closing date)
ISIN	XS1043535092
Capital treatment	Additional Tier 1

Issue date	May 2014
Amount	USD1.5bn
Coupon	• 6.375% from 19 May 2014 to 19 May 2019 (excluded), then switches to 5y mid-swap rate + 4.788% • Paid quarterly
Format	• Non-step-up, non-cumulative contingent convertible perpetual preferred Tier 1 • Redeemable at the option of the bank, subject to regulatory consent (only after first reset date) • Redeemable at the option of the bank, subject to regulatory consent, in case of change in capital treatment or tax treatment (after closing date)
ISIN	XS1066553329
Capital treatment	Additional Tier 1

Issue date	**September 2014**
Amount	EUR 1.5bn
Coupon	• 6.25% from 11 Sep. 2014 to 11 Sep. 2021 (excluded), then switches to 5y mid-swap rate + 5.64% • Paid quarterly
Format	• Non-step-up, non-cumulative contingent convertible perpetual preferred Tier 1 • Redeemable at the option of the bank, subject to regulatory consent (only after first reset date) • Redeemable at the option of the bank, subject to regulatory consent, in case of change in capital treatment or tax treatment (after closing date)
ISIN	XS1107291541
Capital treatment	Additional Tier 1

Issue date	**April 2017**
Amount	EUR 750m
Coupon	• 6.75% from 25 April 2017 to 25 April 2022 (excluded), then switches to 5y mid-swap rate + 6.803% • Paid quarterly
Format	• Non-step-up, non-cumulative contingent convertible perpetual preferred Tier 1 • Redeemable at the option of the bank, subject to regulatory consent (only after first reset date) • Redeemable at the option of the bank, subject to regulatory consent, in case of change in capital treatment or tax treatment (after closing date)
ISIN	XS1602466424
Capital treatment	Additional Tier 1

Issue date	**September 2017**
Amount	EUR 1bn
Coupon	• 5.25% from 29 September 2017 to 29 September 2023 (excluded), then switches to 5y mid-swap rate + 4.999% • Paid quarterly
Format	• Non-step-up, non-cumulative contingent convertible perpetual preferred Tier 1 • Redeemable at the option of the bank, subject to regulatory consent (only after first reset date) • Redeemable at the option of the bank, subject to regulatory consent, in case of change in capital treatment or tax treatment (after closing date)
ISIN	X51692931121
Capital treatment	Additional Tier 1

Issue date	March 2018
Amount	EUR 1.5bn
Coupon	• 4.75% from 19 March 2018 to 19 March 2025 (excluded), then switches to 5y mid-swap rate + 4.097% • Paid quarterly
Format	• Non-step-up, non-cumulative contingent convertible perpetual preferred Tier 1 • Redeemable at the option of the bank, subject to regulatory consent (only after first reset date) • Redeemable at the option of the bank, subject to regulatory consent, in case of change in capital treatment or tax treatment (after closing date)
ISIN	XS1793250041
Capital treatment	Additional Tier 1

Main risks	
Coupon cancellation	• Fully discretionary if the bank deems it necessary or desirable • Mandatory in case of i) insufficient Available Distributable Items; ii) request from the regulator • Mandatory if distributions exceed the Minimum Distributable Amount
Principal loss absorption	• Upon trigger event conversion into equity • Conversion to equity at the point of non-viability
Triggers for principal loss absorption*	• CRD4 transitional CET1 ratio (group) < 5.125% • CRD4 transitional CET1 ratio (Santander SA) < 5.125%

Source: Prospectuses, Scope Ratings.

Key risks

A. Coupon cancellation

Key risk: coupon cancellation

Coupon payments on the security are fully discretionary and subject to distribution restrictions.

Available Distributable Items (ADIs)

The concept of ADI is defined in the Capital Requirements Regulation (CRR; art. 4.1-128) as “the amount of the profits at the end of the last financial year plus any profits brought forward and reserves available for that purpose before distributions to holders of own funds instruments less any losses brought forward, profits which are non-distributable pursuant to provisions in legislation or the institution’s by-laws and sums placed to non-distributable reserves in accordance with applicable national law or the statuses of the institution, those losses and reserves being determined on the basis of the individual accounts of the institution and not on the basis of the consolidated accounts”.

Santander reported ADIs of EUR 56.7bn at the parent company level as of December 2017

Combined Buffer Requirement (CBR)

The CRD4-CRR restrictions on discretionary distributions are based on transitional CET1 requirements.

Santander’s total CET1 requirement for 2018, including both Pillar 2 and buffers, is 8.66%. This includes a CET 1 minimum requirement of 4.5%, a Pillar 2 requirement of 1.5% and a CBR of 2.66% (including a capital conservation buffer of 1.875%, a GSIB buffer of 0.75%, and a countercyclical buffer of 0.03%). This calculation does not include the Pillar 2 guidance, which is not binding.

We expect the CBR to increase over time as the capital conservation buffer and the systemic buffer are gradually further phased in (2.5% and 1% respectively in 2019).

As of Q1 2018, Santander’s CET1 transitional (phase-in) ratio stood at 11.2%, 2.5% above the requirement. However, this distance is likely to decline over the coming years through the gradual phasing-in of CRD4 buffers.

Santander’s fully loaded CET1 ratio at the end of March 2018 was 11%. Assuming Santander maintains a CET1 of over 11% (as targeted by management), the buffer to the MDA trigger should remain above 150bps (currently 250bps).

We also highlight that, while investors mostly focused on the distance to the CET1 requirement in the past, banks have to comply with all capital requirements at all times before CET1 capital can be allocated to meet CBR. In other words, if a bank does not have sufficient Additional Tier 1 or Tier 2 capital (or MREL), CET1 instruments can be used to fill the shortfall instead, provided the same capital cannot be used twice.

Hence monitoring of coupon-cancellation risk must take into account any weakness in the bank’s capital structure, as this could lead to the CBR not being met and the MDA calculation to be activated.

Table 1 shows the calculation of the distance to the CBR for Santander based on CET1, Tier 1 and total capital ratios.

Table 1: Distance to estimated capital requirements

	2017	Q1 2018	2019
Required CET1 associated with distribution restrictions	**7.8%**	**8.7%**	**9.5%**
Combined buffer (CBR)			
- Capital conservation	1.25%	1.88%	2.50%
- Systemic	0.50%	0.75%	1.00%
- Countercyclical	0.02%	0.03%	0.03%
Pillar 2 CET1 requirement	1.50%	1.50%	1.50%
Pillar 1 CET1 requirement	4.50%	4.50%	4.50%
Santander Group CET1, transitional (%)	12.3%	11.2%	
Distance to CET1 requirement incl. CBR (%)	**4.5%**	**2.5%**	
Distance to CET1 requirement incl. CBR (EUR bn)	**27.2**	**15.2**	
Santander Group Tier 1, transitional (%)	12.8%	12.9%	
Required Tier 1, incl. CBR (%)	9.3%	10.2%	
Distance to Tier 1 requirement incl. CBR (%)	**3.5%**	**2.7%**	
Santander Group total capital, transitional (%)	15.0%	14.7%	
Required total capital, incl. CBR (%)	11.3%	12.2%	
Distance to total capital requirement incl. CBR (%)	**3.7%**	**2.5%**	
RWAs (EUR bn)	605	600	

Source: Scope Ratings

B. Principal loss absorption

Key risk: principal loss absorption

The mechanism for loss absorption is equity conversion.

All securities have a 5.125% CET1 trigger, where CET1 capital is based on transitional rules. The triggers apply to the Santander group and Santander SA (parent company).

Distance to trigger

The current distance to the trigger is a comfortable 6.1% for the group as of March 2018.

Management has targeted a CET1 ratio of over 11% at the end of 2018. Based on this target, the distance to the trigger will remain around 6%. Banco Santander SA's CET1 ratio was 19.45% as of December 2017, well above the respective trigger.

Table 2: Distance to trigger

	2017	Q1 2018	2019
Trigger level	5.125%	5.125%	5.125%
Santander Group CET1, transitional (%)	12.3%	11.2%	
Distance to trigger (%)	**7.1%**	**6.1%**	
Distance to trigger (EUR bn)	**43.2**	**36.4**	

Source: Scope Ratings

Scope Ratings GmbH

Headquarters Berlin
Lennéstraße 5
D-10785 Berlin

Phone +49 30 27891 0

Frankfurt am Main
Neue Mainzer Straße 66-68
D-60311 Frankfurt am Main

Phone +49 69 66 77 389-0

Paris
33 rue La Fayette
F-75009 Paris

Phone +33 1 82885557

London
Suite 301
2 Angel Square
London EC1V 1NY

Phone +44 203-457 0 4444

Madrid
Paseo de la Castellana 95
Edificio Torre Europa
E-28046 Madrid

Phone +34 914 186 973

Milan
Via Paleocapa 7
IT-20121 Milan

Phone +39 02 30315 814

Oslo
Haakon VII's gate 6
N-0161 Oslo

Phone +47 21 62 31 42

info@scoperatings.com
www.scoperatings.com

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