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Ratings

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Research Update:

Ratings On Banco Santander Affirmed Following Risk-Adjusted Capital Criteria Revision; UCO Removed; Outlook Stable

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Overview

- On July 20, 2017, we published an update to our risk-adjusted capital framework methodology.
- Under the new methodology, our calculation of Santander's 2016 risk-adjusted capital ratio (RAC) post the Popular acquisition is about 90 basis points lower than before, mostly because of our now more conservative treatment of deferred tax assets (DTAs).
- We believe, however, that the bank's wide geographic diversification and better-than-peers' asset quality track record in its main countries of operation are supportive factors that are not fully captured by our RAC measure.
- We continue to assess Santander's capitalization, compared to the risks it faces, as a ratings strength.
- We are affirming our 'A-/A-2' long-term ratings on the bank, and removing the under criteria observation (UCO) designation previously assigned to the long-term ratings.
- The stable outlook balances the likely more supportive economic and operating environment in Spain, with the managerial challenges posed by the recent acquisition of Banco Popular Español S.A., and potential risks arising in other countries (notably the U.K., Brazil, and the U.S.).

Rating Action

On July 27, 2017, S&P Global Ratings affirmed its 'A-/A-2' long- and short-term counterparty credit ratings on Spain-based Banco Santander S.A. and its 'BBB+/A-2' long- and short-term counterparty credit ratings on its highly strategic subsidiaries Banco Popular Español, S.A., Santander Consumer Finance S.A., Santander Holdings U.S.A. Inc and Santander Bank N.A. The outlook is stable for all but Banco Popular Español S.A., which has a positive outlook.

In a related action, we also affirmed our 'BBB+/A-2' long- and short-term counterparty credit ratings on Germany-based Santander Consumer Bank AG, core subsidiary of Santander Consumer Finance S.A.

We also affirmed our issue ratings on the senior, senior nonpreferred, subordinated and hybrid capital instruments issued or guaranteed by the banks listed above.

At the same time, we removed the UCO designation that we had assigned to the long-term issuer credit and issue ratings on the four entities, upon publication of the new risk-adjusted capital methodology on July 20, 2017.

Rationale

The affirmation of Banco Santander S.A. ratings follows our review of the impact on the bank of our revised risk-adjusted capital (RAC) framework, which we published on July 20, 2017.

While, under the new methodology, our calculation of the bank's capital ratios will fall below our previous measures, and indeed below a level that would be consistent with an adequate capital assessment, we believe that the bank's ability to absorb unexpected losses is higher than the RAC ratio suggests. This is because the bank's wide geographic diversification in economies that proved uncorrelated--as well as its sound, better-than-average asset quality track record--are not fully captured in our RAC measure. We therefore continue to view Santander's capitalization, compared to the risks it faces, as a rating strength: hence our affirmation. We revised downward our capital and earnings assessment to moderate from adequate, however, and upward our risk position assessment to very strong from strong.

We estimate that, following the application of our revised RAC methodology, the bank's pro forma RAC ratio at end-2016 (post-Popular acquisition) may have reduced to just below 6%. This reflects a combination of factors, the most relevant of which is our now more conservative treatment of DTAs. While we expect the bank's capital position to gradually strengthen via earnings retention (which we estimate at about €4 billion per year) and the issuance of AT1 instruments (estimated to total €4.5 billion in 2017-2018), we don't see the bank restoring it above 7% over the outlook horizon.

Conversely, we expect Santander's wide geographic diversification in economies that proved uncorrelated, as well as its business diversification, to continue supporting its capacity to accommodate potentially adverse scenarios. The diversification benefit that we calculate for Santander is still one of the highest in our sample of rated global banks, and is not reflected in the bank's pre-diversification RAC ratio. Additionally, we give credit to Santander's track record of better-than-average asset quality performance in its key markets, which suggests that it will likely face lower unexpected losses than the ones we incorporate in our RAC model.

While we acknowledge that the acquisition of Popular will weaken the group's asset quality metrics, we expect the bank to put in place the required measures to rapidly reduce the stock of problematic assets acquired and align Popular's credit risk practices with group standards.

At the current level, the ratings also remain supported by the bank's powerful, geographically diversified, resilient and profitable retail banking franchise. Conversely, our ratings also acknowledge that the bank operates in jurisdictions that face higher-than-average economic risks. We view management as strong, though showing appetite to grow inorganically.

Our ratings do not benefit from additional loss-absorbing capacity (ALAC) support. This is because although we expect the bank to continue gradually building up its TLAC (total loss-absorbing capacity) cushion, primarily by issuing senior nonpreferred instruments, we do not expect that by the end of 2018 the buffer of instruments eligible to absorb losses in a resolution scenario will be sufficiently high to result in a one-notch ratings uplift.

Our ratings on the bank are one notch above our long-term sovereign credit rating on Spain, reflecting our view that there is an appreciable likelihood that Santander would not default in the stress scenario that would likely accompany a hypothetical default of the Spanish sovereign. In such a scenario we would expect Santander to face meaningful impairments, which would erode a significant portion of its capital base. However, the latter would remain positive and we would expect regulators to allow the bank to continue operating. The bank would also suffer sizeable outflows of liquidity, but we believe it would be able to overcome liquidity pressures by resorting to ECB funding.

The affirmations of Banco Popular Español S.A., Santander Consumer Finance S.A., Santander Holdings U.S.A. Inc (SHUSA) and Santander Bank NA ratings, highly strategic subsidiaries of Santander, and those of Germany-based Santander Consumer Bank AG, core subsidiary of Santander Consumer Finance S.A., follow the affirmation of ratings on their respective parents.

Outlook

SANTANDER: STABLE

The stable outlook balances, on the one hand, the potentially more supportive economic and operating environment in Spain, with the managerial challenges posed by the recent acquisition of Popular, a large bank with sizable asset-quality problems, which Santander plans to restructure and integrate into the group. We also factor in potentially more difficult economic conditions in the post-Brexit U.K., increased political uncertainty in Brazil, and emerging risks in the subprime auto lending business in the U.S. Additionally, the stable outlook takes into account that while the bank's capital compared to the risk it faces is likely to remain a ratings strength, it is unlikely that the bank will build up a large enough buffer of bail-in-able instruments to benefit from a rating uplift based on ALAC.

We could take a positive rating action if we see a more supportive economic and operating environment in Spain, along with signs that the potential external risks mentioned above are stabilizing, and evidence that the integration of Popular is proceeding smoothly and as planned. Likewise, we could raise the ratings if the bank exhibits a stronger build-up of loss-absorbing instruments than we currently expect.

Conversely, the ratings could come under pressure if the integration of Banco Popular encounters meaningful setbacks or unexpectedly undermines Santander's capital. The lowering of the sovereign rating on Spain could also put pressure on our rating on Santander.

POPULAR: POSITIVE

The positive outlook on Banco Popular reflects the possibility that we could raise our long-term rating on the bank in the next two years as the integration with Banco Santander advances, with us concluding that it is a core subsidiary to its parent.

We could revise the outlook to stable if the integration and restructuring process of Banco Popular take longer than expected, or if we see unanticipated risks starting to arise.

SCF: STABLE

The stable outlook on SCF reflects that on its parent. As long as we continue to assess SCF as highly strategic to Santander, our ratings on SCF will remain one notch below those on the parent and move in tandem with them.

An upgrade of SCF in the next two years would be triggered by a similar action on both the parent and the Spanish sovereign, or by our revision of SCF's status within group to core. Conversely, we could lower the ratings on SCF following a similar action on the parent, or if we believed that the parent's commitment to SCF had weakened, leading us to revise downward our view of the subsidiary's long-term strategic importance for the Santander group.

SANTANDER HOLDINGS U.S.A. INC AND SANTANDER BANK N.A.: STABLE

The stable rating outlooks on SHUSA and Santander Bank mirror the stable outlook on their parent, Banco Santander S.A. S&P Global Ratings expects that any changes in the ratings on SHUSA over the next two years will be tied to the group credit profile of its parent. We view SHUSA as a highly strategic subsidiary of Santander. This indicates that our ratings on SHUSA will be one notch below Santander's group credit profile, which is currently 'a-'.

SANTANDER CONSUMER BANK: STABLE

The stable outlook on SCB mirrors that on its parent SCF as we expect it to remain a core subsidiary and as such be directly affected by a strengthening or weakening credit profile of its parent.

We could raise the ratings on SCB if we were to upgrade SCF. Conversely, we could lower the ratings on SCB following a similar action on SCF, or if we were to revise downward SCB's core status. We see the latter scenario as remote over the outlook horizon.

Ratings Score Snapshot

	To	From
Counterparty credit rating	A-/Stable/A-2	A-/Stable/A-2
SACP:	a-	a-
Anchor:	bbb-	bbb-
Business Position	Very Strong (+2)	Very Strong (+2)
Capital and Earnings	Moderate (-1)	Adequate (0)
Risk Position	Very Strong (+2)	Strong (+1)
Funding	Above Average (0)	Above Average (0)
Liquidity	Adequate	Adequate
Support	0	0
ALAC Support	0	0
GRE Support	0	0
Group Support	0	0
Sovereign Support	0	0
Additional Factors	0	0

Related Criteria

- 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
- Criteria - Financial Institutions - Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Criteria - Financial Institutions - Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Financial Institutions - Banks: Commercial Paper I: Banks, March 23, 2004

Related Research

- Outlook On Spain-Based Banco Santander S.A. Revised to Stable From Positive On Acquisition Of Banco Popular Español, June 9, 2017
- Outlook on Banco Santander 'A-' Long-Term Rating Revised To Positive On Expected Sizable ALAC Buffer; Ratings Affirmed, Feb. 9, 2017
- Banco Santander's Inaugural Second Ranking Senior Notes Rated 'BBB+', Jan. 27, 2017

Ratings List

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Ratings Affirmed

Banco Popular Espanol S.A.	
Counterparty Credit Rating	BBB+/Positive/A-2
Banco Santander S.A.	
Counterparty Credit Rating	A-/Stable/A-2
Senior Unsecured	A-
Subordinated	BBB
Subordinated	BBB+
Preference Stock	BB
Certificate Of Deposit	A-/A-2
Commercial Paper	A-2
Santander Consumer Bank AG	
Santander Bank, N.A.	
Santander Holdings U.S.A Inc.	
Santander Consumer Finance S.A.	
Counterparty Credit Rating	BBB+/Stable/A-2
Santander Consumer Finance S.A.	
Senior Unsecured	BBB+
Commercial Paper	A-2
Santander Holdings U.S.A Inc.	
Senior Unsecured	BBB+
Preferred Stock	BB
BCH North American Capital Corp.	
Commercial Paper[1]	A-2
BPE Financiaciones S.A.	
Senior Unsecured[2]	BBB+

EMISORA SANTANDER ESPANA, S.A.U.	
Senior Unsecured[1]	A-
Santander Bank, N.A.	
Senior Unsecured	BBB+
Subordinated	BBB
Santander Central Hispano Finance (Delaware) Inc.	
Commercial Paper[1]	A-2
Santander Central Hispano International Ltd.	
Commercial Paper[1]	A-2
Santander Commercial Paper, S.A. Unipersonal	
Commercial Paper[1]	A-2
Santander Consumer Bank AS	
Senior Unsecured[3]	BBB+
Santander Finance Capital S.A. Unipersonal	
Preferred Stock[1]	BB
Preferred Stock[1]	BB+
Santander Finance Preferred S.A. Unipersonal	
Preferred Stock[1]	BB
Santander International Debt, S.A. Unipersonal	
Senior Unsecured[1]	A-
Santander International Preferred S.A. Unipersonal	
Preferred Stock[1]	BB+
Santander Issuances S.A. Unipersonal	
Subordinated[1]	BBB
Santander Perpetual, S.A. Unipersonal	
Junior Subordinated[1]	BB+
Sovereign Capital Trust VI	
Preferred Stock	BB
Sovereign Real Estate Investment Trust	
Preferred Stock	BB

[1]Guaranteed by Banco Santander S.A.
[2]Guaranteed by Banco Popular Espanol S.A.
[3]Guaranteed by Santander Consumer Finance S.A.

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.