GBB-Rating Gesellschaft für Bonitätsbeurteilung mbH

AA-

stable

Rating-Committee: 16.05.2018

Banco Santander, S.A.

Rating result

Strengths/Opportunities:

- Sound and sustainable strategy
- Strong market position in its core markets
- High profitability, low cost-income-ratio in a peer group comparison
- Broad geographical diversification and resilient model of financially autonomous subsidiaries
- Substantial investments in digitalization strategy
- Balanced funding profile and comfortable liquidity position

Weaknesses/Threats:

- NPL ratio still on an elevated level in some regions (e. g. Brazil, Spain, Portugal)
- CET1 ratio at a low level compared to peers
- Risks arising from (geo-)political tensions (trade disputes, political crises Brazil and Mexico; uncertain impacts of Brexit)
- Ongoing low interest rate environment in Europe

Financial data:

Figures (EUR million)	2017	2016
Adjusted gross profit	44,325	41,426
Operating result	12,091	10,768
Net income	8,207	7,486
Total assets	1,444,305	1,339,125
CET1 capital ratio	12.3%	12.5%
Total capital ratio	15.0%	14.7%

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Based on the information available at the date of the rating, the financial standing of Banco Santander, S.A. (hereinafter also referred to as "Santander" or "group"), is evaluated as very high. On the date of the rating-committee, GBB-Rating assigns a rating of AA-, with a stable outlook. The rating reflects the group's high level of profitability as well as the successful strategy implementation and its unremarkable risk profile.

The financial profile, based on the analysis of the consolidated financial statement, is assessed as strong. In 2017, the group's operating result after impairments rose by 12 % compared to 2016. This was primarily due to the surge in net interest income (+10 %) and net commission income (+14 %), which significantly offset higher administration costs (+9 %) and almost halved earnings on financial assets and liabilities held for trading.

As a result of the increase in revenues and net income, Santander's earnings indicators remain at a high level despite the rise in the average business volume and total risk exposure amount. The return on equity of 11.5 % and the cost income ratio of 51.9 % – both indicators based on GBB-Rating's calculation method – illustrate the high profitability of Santander.

In the first quarter of 2018, the groups underlying profit before tax climbed by 11 % compared to the same previous-year period. This improvement in results stemmed from a slight gain in gross income (+1 %), a decrease in loan-loss provisions (-5 %) and reduced expenses from other charges, which overcompensated for the rise in operating expenses (+4 %).

The reported CET1 ratio of 12.3 % (phased in) at year-end is considered as adequate with regard to the low-risk business model and the modest earnings volatility. However, in a peer-group comparison, Santander's capital ratios have to be considered as below average.

Nevertheless, Santander's capitalization potential is assessed as strong, in particular due to its high internal financing strength. Moreover, the capital increase of EUR 7 billion carried out in July 2017 following the acquisition of Banco Popular as well as the issuance of hybrid capital instruments (in order to fulfill the TLAC requirements) illustrate the groups capacities to procure capital.

Summary:

	Rating
Financial profile	strong
- Long-term earnings position	strong
- Sustained capital position	adequate
Business profile	strong
- Strategy and market	strong
- Risk profile	adequate
- Capitalization potential	strong

(strong > adequate > acceptable > deficient > problematic > insufficient)

Rating history:

Rating	Outlook	Date
AA-	**stable**	**16.05.2018**

Rating scale

Rating	Rating categories
AAA	highest financial standing
AA+ / AA / AA-	very high financial standing
A+ / A / A-	high financial standing
BBB+ / BBB / BBB-	good financial standing
BB+ / BB / BB-	satisfactory financial standing
B+ / B / B-	financial standing scarcely adequate
CCC+ / CCC / CCC-	financial standing no longer adequate
CC / C	inadequate financial standing
D	moratorium / insolvency proceedings

Santander has a sound and sustainable strategy with a focus on retail banking. An important element of the group's strategic organization is the model of financially autonomous subsidiaries and the broad geographical diversification (Continental Europe, UK, Latin America and USA). The group has a strong market position in most of its core markets. The substantial hike in client numbers in recent times is also based on the group's measures to extend its range of digital services. The successful implementation of its strategy is also reflected in the growth of income and profits as well as the achieved level of profitability.

The non-performing loan (NPL) portfolio and the NPL ratio basically show a positive development in recent years which can be seen as an indicator for an effective risk management. Although the NPL ratio in Spain and Portugal increased as a result of the acquisition and integration of Banco Popular, the sale of 51 % of Popular's real estate business to Blackstone illustrates that Santander is able to efficiently manage the associated risks. In conjunction with modest market and operational risks and with regard to the group's comfortable liquidity position, Santander's risk profile is assessed as adequate.

Rating drivers

Santander's rating result could be stabilized by maintaining or increasing its already high level of profitability.

On the contrary, the group's rating could be adversely affected by a slowdown of the global economic growth, e. g. as a result of growing protectionism. Additionally, a weakening of the economic trend, especially in Latin America and Europe, could imply a deterioration of asset quality, increasing loan-loss provisions and, as a consequence, lower profitability.

Strategy and market

Strategy

Santander's sound and sustainable strategy, focused on retail and commercial banking, led to a successful business development, which is reflected in the increase in income, profits and profitability and the growth in its client base. Fundamental characteristics of its business approach are the broad geographical diversification and its model of subsidiaries which are autonomous in managing its liquidity and capital.

The group's retail banking, which accounts for 91 % of total gross income in 2017, comprises a comprehensive range of lending and deposit products, including residential mortgages, vehicle financing and SME finance. Standardized products such as current accounts and credit cards are usually combined with customer loyalty measures (e. g. cashback), in particular within the "1|2|3" branding. Retail banking is complemented by products and services in the areas of private banking, insurance and asset management. The wealth management and wholesale banking services, which include, amongst others, financing solutions for corporate clients, transaction and investment banking services, are of minor importance.

Santander's core markets, measured by attributable profits and the number of customers, are Brazil, Spain, the United Kingdom (UK), Mexico and Santander Consumer Finance, whereby the latter mainly operates in Central and Northern Europe. In 2017, approximately 52 % of the underlying attributable profit was earned in Europe, 44 % in Latin America (with Brazil as largest contributor with a 26 % share of profits) and 4 % in the USA. The broad geographical presence in developed markets (with generally low interest rates) as well as in emerging markets (whose interest rates are on a relatively high level) reduces Santander's sensitivity to economic downturns in individual regions.

In 2017, the number of customers (133 million compared with 125 million in 2016) grew in all target markets. The rise was particularly pronounced in Spain and – despite challenging economic and/or political conditions – in Brazil and Mexico. Furthermore, the number of clients that consider Santander their main bank ("loyal customers") increased by 13 %. The successful customer acquisition also stems from substantial investments in digitalization and the expansion of online services. Examples of digital services include "Openbank" (an online bank in Spain providing a comprehensive range of retail banking products), "Santander Cash Nexus" (a mobile application for treasury services, especially for multinationals) and the introduction of an app for global payments using blockchain technology.

Santander has a leading market position in retail lending in Spain, Portugal, Chile and Argentina, and ranks among the three largest lenders in Brazil, Mexico and Poland. In the British retail banking market (mortgages, loans), Santander is the fifth largest bank behind the leading domestic players. In Spain, Santander benefited from the takeover of Banco Popular Español S.A. (Banco Popular) and became market leader in lending with a share of about 20 %. Banco Popular was acquired in June 2017 for EUR 1 from Spain's bank restructuring authority FROB, after European and Spanish authorities decided that the institution is likely to fail due to a liquidity crisis and declared its resolution according to BRRD.

Due to the clear strategy, the group-wide consistent business model and its consequent strategy implementation, Santander's profitability (measured by RoTE, CIR) takes a leading position within its peer group. The defined targets regarding growth in customer numbers, boosting its profitability and an improvement of credit risk indicators appear to be achievable.

Market

In 2017, the macroeconomic environment developed favorably both in industrial nations and in emerging markets. Global growth is expected to reach 3.9 % in 2018 (2.5 % in advanced economies, 2.0 % in Latin America) according to IMF calculations. However, the global economy can be negatively affected by geopolitical tensions (e. g. military conflicts in the Middle East, political tensions between Russia and the Western World) and escalating trade disputes. Hereinafter, the market analysis focuses more closely on Santander's core markets Brazil, the United Kingdom (UK) and Spain.

Despite difficult political conditions, the **Brazilian** economy has overcome the recession with a GDP growth of about 1 % in 2017. GDP is expected to grow by approximately 3 % on a year-on-year basis in both 2018 and 2019. As a result of the economic crisis, the unemployment rate rose sharply from below 7 % in 2014 to above 13 % in 2017. Due to the current economic recovery, the unemployment rate fell to 12.6 % in February 2018. In conjunction with the lower inflation rate (3 % in 2017 compared to about 6 % in 2016) and recent cuts in key interest rate "Selic" (6.5 % as of March 2018), this development is likely to have a positive effect on private consumption. Risks arise from political instability, illustrated by the failed pension reform which aimed to reduce the high budget deficit. The profitability of the Brazilian banking sector is considerably higher than in Continental Europe, with a Return on Equity (RoE) of about 12 % in June 2017 (according to Brazil's central bank). The volume of nonperforming loans increased between 2014 and 2016, whereas indicators of the credit quality subsequently stabilized. In consequence of the still high unemployment rate and highly-leveraged companies, credit demand remains at a relatively low level. In view of the sustained positive economic development, a further improvement of credit quality can be expected.

The economic recovery in **Spain** from the aftermath of the financial crisis in 2008 continued with GDP growth of 3.1 % in 2017 according to IMF, thus far above the average of the Euro Area (2.3 %). In 2018, the growth rate is expected to slightly weaken to just under 3.0 %. Unemployment rate is still at a very high level (16.1 % in February 2018) but is expected to further decline over the next years. The previously dominant construction industry only accounts for a small portion of Spain's economic output, which returned to the pre-crisis level in 2017. Private consumption is likely to remain an essential pillar of the economic growth which is beneficial for the retail banking sector. The normalization of Spain's economic conditions is reflected by recent improvements in Spain's credit rating. Risks for the economy can originate from the crisis in Catalonia. Although the crisis does not show any notable effect on economic growth until now, a renewed escalation of the crisis might adversely affect growth. While Spain still has a very high branch density, its number decreased in recent years and the banking industry was characterized by a broad consolidation through mergers and acquisitions. The volume of loans to customers further declined in 2017. Credit standards in lending to households (consumer credit, house purchase) eased at the end of 2017 and credit demand slightly increased, in line with the development in the euro zone. A continuously low level of interest rates in combination with a high (although declining) NPL ratio above EU average negatively affects the profitability of Spanish banks whereas the cost-income-ratio of the Spanish banking sector is at a remarkably low level.

The economic development in the **UK** is challenged by the Brexit. The depreciation of the British Pound, mainly resulting from the uncertainties in connection with the prospective withdrawal of the UK from the European Union, has positive effects on exports, but pushed inflation up to 2.7 % in 2017 (2016: 0.7 %). Annual GDP growth is expected to remain below 2 % in the following years. The results of the Brexit negotiations and UK's future access to the European Economic Area will strongly influence its economic development. The highly competitive retail banking sector is dominated by four large domestic institutions – Lloyds, Barclays, RBS and HSBC – and Santander UK (in terms of gross loan volume and number of retail accounts). Consumer credit volume showed a dynamic growth in previous years (outpacing the rise in household income) whereas growth rates decelerated in recent months. The implications of the Brexit on consumer sentiment and credit demand cannot yet be reliably estimated. UK banks' RoE is negatively impacted by misconduct costs (e. g. regarding the mis-selling of payment protection insurances).

Strong long-term earnings position

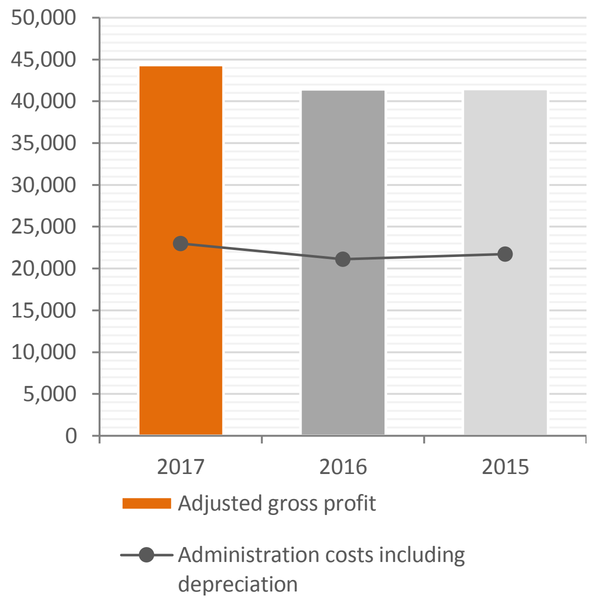
In 2017, Santander group reported a positive development in earnings, with an increase in gross result of 12 %. Owing to Santander's focus on retail banking, the adjusted gross profit – which consists of the long-term operating income components – is dominated by the net interest income. Its sharp increase (+10 %) is mainly the result of the marked decline in interest expenses. Net fee and commission income is mainly generated from payment-, insurance- and security services and surged by 14 % in 2017. The strong rise of both income components overcompensated for the reduced result from categories of financial instruments, in particular regarding gains on financial assets and liabilities held for trading. Altogether, adjusted gross profit exceeded the previous year's figure by 7 %. This increase is largely attributable to the operation units in continental Europe (most notably Spain and Santander Consumer Finance) and in Brazil.

Administration expenses including depreciation and amortization costs noticeably exceeded previous year's level by 9 %, mainly due to higher personnel costs (which contribute 59 % to administration costs) and a rise in IT expenditures. In accordance with the improvement in credit quality and in line with the trend in previous years, impairment losses slightly decreased by 3 %.

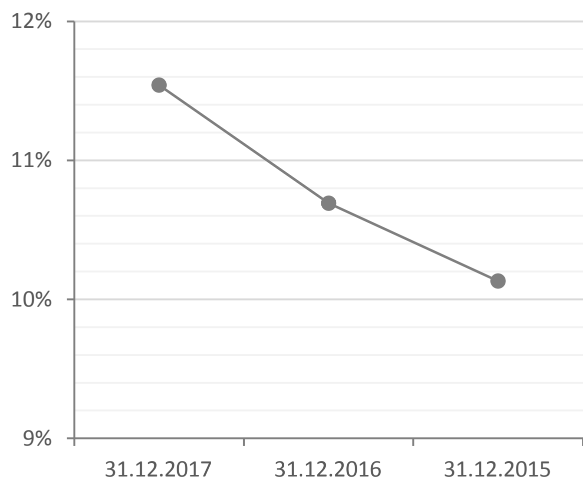
Selected data: Income statement (EUR million)	2017	2016	2015
Net interest income	34,296	31,089	32,812
Net fee and commission income	11,597	10,180	10,033
Adjusted gross profit	**44,325**	**41,426**	**41,461**
Administration costs (incl. depreciation)	-22,993	-21,101	-21,720
Impairment	-9,241	-9,557	-10,194
Gross result at year-end	**12,091**	**10,768**	**9,547**

The described earnings improvement led to a further enhancement of the group's already high profitability. Santander's return on equity, which rose by 0.8 percentage points to 11.5 % according to GBB-Rating's calculation method, underlined its earning power. The cost-income ratio of 51.9 %, calculated as the quotient of administration costs (including depreciation) and adjusted gross profit, remained strong and outperformed most of its peers. Taking into account the impairment losses in the numerator ("cost-income ratio I", see appendix), the indicator improved from 69.4 % to 67.8 %.

Development of adjusted gross profit and operating costs (EUR m)



Return on equity (%)



Interim result as at 31 March 2018

Santander Group continued its positive income development in the first three months of 2018. The attributable profit to the Group grew by 10 % compared to the first quarter of 2017 and by about a third compared to the previous quarter (mainly due to non-recurring items in Q4 2017). Net interest income stayed flat in comparison with prior-year quarter and was nearly 2 % below the Q4 2017 figure. The slight increase in gross income (+1 % in a year-on-year comparison) was driven by net fee income, particularly in the wealth management segment. Compared to Q1 2017, operating expenses climbed by 4 %, leading to a lower net operating income (-2 %). The mentioned increase in profit was ultimately a result of a reduction in loan-loss provisions (-5 %) and other charges.

Selected data: Income statement* (EUR million)	**Q1/2018**	**Q4/2017**	**Q1/2017**
Net interest income	8,454	8,607	8,402
Net fee income	2,955	2,949	2,844
Gross Income	12,151	12,062	12,029
Operating expenses	-5,764	-5,961	-5,543
Net operating income	6,387	6,101	6,486
Net loan-loss provisions	-2,282	-2,181	-2,400
Underlying profit from continuing operations	2,409	2,285	2,186
Attributable profit to the Group	2,054	1,542	1,867

* Based on Santander's interim accounts without GBB adjustments

FX effects strongly influenced the gross income in Brazil, which fell by 7 % compared to the first quarter of 2017. Without consideration of FX effects, the gross income would have risen by about 10 %. Thanks to substantially lower expenses (operating expenses, loan-loss provisions) – which increased excluding FX impact – the underlying profit before tax grew by 15 % compared to the previous-year period.

Santander UK saw a disappointing first quarter of 2018, with a sharp decline in underlying profit before tax by 22 %, which was affected by a decrease in gross income (-6 %), rising administration expenses (including depreciation) and a drastic growth in loan loss provisions. The latter resulted from impairment charges for two corporate clients, including the insolvent construction company Carillion.

On a year-on-year basis, Santander Spain's pre-tax profit was particularly affected by the acquisition of Banco Popular in mid-2017. The jump in pre-tax profit by 18 % was attributable to the remarkable increase in gross income (+34 %), despite a considerable rise in operating expenses and loan-loss provisions.

Adequate sustained capital position

In 2017, Santander was able to further strengthen its capital base via the retention of earnings and the issuance of AT1- and Tier 2 instruments. In consequence of the modest growth of risk weighted assets, the groups phased-in CET1 ratio of 12.26 % at year-end was slightly below previous year's figure of 12.53 %; it declined by a further 1.07 percentage points to 11.19 % by the end of the first quarter 2018. On a fully-loaded basis, the CET1 ratio was 11.00 % as at 31 March 2018, compared to 10.84 % at year-end 2017.

The acquisition of Banco Popular and the resulting rise in risk weighted assets led to a decrease of the groups CET1 ratio by 114 bps. This decline was fully offset by a capital increase of EUR 7 billion, which was successfully carried out in July 2017.

On a consolidated basis, Santander meets the 2018 regulatory minimum requirements of 8.655 % (CET1) defined by the ECB according to the Supervisory Review and Evaluation Process (SREP). They comprise, in addition to the Pillar 1 requirements, a Pillar 2 requirement of 1.5 % and a combined buffer requirement of 2.655 %. The corresponding requirement on a fully-loaded basis is 9.530 %. With regard to the group's sound risk profile and low earnings volatility, the capital base is consistent with Santander's business model. This is also reflected by the comparatively low G-SIB capital surcharge of 1 %.

Nevertheless, compared to its peers and the European average level, the group's capital ratios are (both on a phased-in and fully-loaded basis) at a low level. By taking into account the target CET1 ratio (fully loaded) of at least 11.0 % for 2018, Santander's capital ratios will remain below the average value for the peer group in the short-term.

Capital planning/TLAC

In addition to the organic growth of its CET1 capital, Santander plans to further strengthen its AT1 and Tier 2 capital by about EUR 1.4 billion and EUR 1.6 billion respectively in 2018. It should be noted that Santander already issued EUR 1.5 billion of AT1-instruments (CoCos) as well as Tier 2 instruments in the amount of EUR 1.25 billion in the first three months of the current year. These issuances also serve to meet the TLAC requirements (16 % of the consolidated risk-weighted assets from January 2019). In 2017, the group issued EUR 19.8 billion eligible instruments, thereof EUR 16.2 senior debt. In order to fulfill the TLAC requirements, further emissions of up to EUR 25 billion of TLAC eligible instruments are planned, the majority in form of senior debt. In the first quarter of 2018, the group issued EUR 6.2 billion of TLAC eligible liabilities.

Due to its decentralized business model, which implies an autonomous capital and liquidity management within the subsidiaries, Santander implements a multiple point of entry resolution strategy. Therefore, the TLAC requirements have to be fulfilled at each resolution entity. In addition to issuances of the parent bank, most of the group's funding will be carried out by Santander's entities in UK and USA as well as via Santander Consumer Finance.

In view of the current capital resources of the subsidiaries, the emission volume in 2017 and the buoyant issuing activities at the start of the current year, we expect that Santander will fulfill the TLAC requirements from the year 2019 onwards.

Strong capitalization potential

Based on its internal financing strength and Santander's full access to the capital markets (on level of both the parent bank and the subsidiaries), the capitalization potential is evaluated as strong.

As of the balance sheet date, approximately 61 % of Santander's shares are held by institutional investors, 38 % by individuals and just over 1 % by the board. The vast majority of the shareholders are located in Europe. There are seven institutional shareholders with a stake of more than 3 %, predominantly European and American financial institutions, but it can be assumed that the shares are held on behalf of their clients. Due to the diversified ownership structure, a shareholder's support in case of need is considered unlikely.

Nevertheless, based on its high earnings power and the achieved pre-tax profits in recent years, Santander has a persistently high internal financing capability. This is underpinned by the sustainability of the group's earning capacity – since 2009, the group managed to achieve a net operating income of at least EUR 20 billion on an annual basis – and its low volatility. Most recently, Santander demonstrated its strong capitalization potential by the capital increase of EUR 7 billion in July 2017 following the acquisition of Banco Popular; the issue of 1,458 million new shares was eight times oversubscribed. As of December 2017, Santander was the second largest financial institution in Europe in terms of market capitalization.

Adequate risk profile

Credit and counterparty risk

The positive development of the group's credit risk (measured by the volume of non-performing loans, the NPL ratio and the forbearance exposure) can be seen as an indicator for an effective risk management. The NPL portfolio as well as the NPL ratio noticeably declined in all geographic core markets (except in the USA) in recent years. At the end of 2017, the NPL ratio of the total group excluding Banco Popular was 3.4 %, compared with the previous year's figure of 3.9 %. Due to the weaker credit quality of Banco Popular's loan portfolio, the NPL ratio of the Group including Banco Popular was 4.0 % at the end of March 2018. Banco Popular's NPL ratio amounted to 10.8 % at year-end, following a ratio of about 20 % at the time of the acquisition. In August 2017, Santander sold 51 % of Banco Popular's real estate business to Blackstone. The agreement is subject to approval by the relevant regulatory authorities.

The group's most important markets in terms of customer lending are Spain, the UK, Santander Consumer Finance, Brazil and the USA. NPL ratios are at a generally low level in the UK and the USA as well as at Santander Consumer Finance; however, they remain high in parts of Continental Europe (e. g. Spain, Portugal, Poland) and Latin America (Brazil, Chile), despite a declining trend.

Customer lending in the UK is characterized by the large individuals mortgage portfolio (EUR 175 billion at the end of 2017) and the very low NPL ratio of 1.2 % as of March 31, 2018. In Spain, the customer loan portfolio is dominated by business loans and household mortgages, though the comparatively small real estate business exposure (EUR 5.2 billion by the end of March 2018) remains the largest risk driver. Excluding the remaining Popular portfolio, the real estate portfolio further declined as in previous years. The NPL ratio in Spain amounted to 4.7 % at year-end without Popular. At the end of the first quarter of 2018, it amounted to 6.3 %

(including Popular activities). The NPL ratio of 5.3 % in Brazil remains high, but improved compared to previous years (6 % in 2015). In the USA, Santander's business activities are basically divided into retail and commercial banking activities via Santander Bank, N.A., and vehicle financing via Santander Consumer USA Holdings Inc. (SC USA). Whereas the US-activities in total show a moderate NPL ratio of 2.8 % as at year-end 2017, the portfolio of SC USA entails a higher level of risk (NPL ratio of 5.9 %, cost of credit 9.8 %).

Santander's exposure to sovereign risk at the end of 2017 reflects the geographical distribution of its business activities, particularly worth mentioning are the exposures to Brazil (EUR 27.3 billion) and Spain (EUR 62.6 billion). The latter increased by 36 % to EUR 62.6 billion as at balance sheet date compared to previous year. With reference to the recent upgrades of Spain's credit rating, we evaluate the related risks as moderate.

Overall, the implemented risk management enables the group to effectively monitor und reduce credit risks, although it remains challenging in selected markets. The risks associated with Banco Popular are adequately managed.

Market price risk

Reflecting the business focus on retail banking and the minor importance of trading activities, the group faces limited and manageable market price risks, namely FX risks and interest rate risks. A rise in interest rates would have opposing effects in the group's core markets: in Europe and the USA, where interest rates are at a historically low level, it would have a positive effect on the net interest income and the economic value of equity; in Latin America, both values would decrease. In total, the group's sensitivity to interest rate risks is limited.

The average Value at Risk (VaR[*]) of the trading activities (largely carried out in the unit "Global Corporate Banking") in 2017 was just EUR 22 million. The average VaR[*] of the banking book (excluding trading activities) is on a higher level and amounted to EUR 878 million (taking into account diversification effects). Overall, the maximum VaR[*] in 2017 (EUR 992 million) is relativized by the group's capital resources (EUR 91 billion as at balance sheet day) and it's earning power (gross result at year-end EUR 12 billion).

Funding and liquidity

In view of the sound balance sheet structure, the diversified funding structure and the attained level of the regulatory liquidity ratios, no significant liquidity risks can be determined. Santander is primarily funded by deposits from retail customers, based on the group’s extensive branch network and the autonomous liquidity management model. As at balance sheet date, customer deposits (EUR 778 billion) accounted for about 54 % of the balance sheet total. Wholesale funding is the second funding pillar of the group, although this (medium- and long-term

[*] 99 % confidence level, 1-day horizon

oriented) form of refinancing is less important. It primarily comprises senior debt- and covered bond issuances amounting to EUR 52 billion in 2017.

The loan-to-deposit ratio slightly decreased from 114 % to 109 % year-on-year, well below the internally defined threshold of 120 % and in line with the average figure in the European banking sector. The groups Liquidity Coverage Ratio (LCR) was 133 % at year-end and above the future regulatory minimum requirement of 100 % in all group units.

Operational and legal risks

Legal risks primarily arise from customer complaints about the mis-selling of payment protection insurance (PPI) in UK. Although these claims, which affect the UK banking sector as a whole, are sufficiently provisioned, they might increase once more due to the advertising campaign of the Financial Conduct Authority (FCA) regarding the deadline for claiming compensation on August 29, 2019. Provisions for customer remediation account for 15 % of total provisions for taxes and other legal contingencies (EUR 5.8 billion). Furthermore, judicial cases in Brazil are also of major importance, notably concerning employment-related proceedings.

As in previous years, operational risks mainly refer to the risk category "practices with customers, products and business practices", which include, inter alia, customer complaints for improper marketing, and inaccurate information on products. This category has a share of 68 % of net losses in 2017 (excluding Banco Popular), and is followed by external frauds (17 %). A possible material effect on Santander's earnings and financial position is not discernible.

Appendix

Assets (EUR million)	**31.12.2017**	**31.12.2016**	**31.12.2015**
Cash and cash balances at central banks	110,995	76,454	77,751
loans and receivables due from banks	65,845	63,397	54,775
loans and receivables due from customers	819,625	763,370	770,474
Classification of financial instruments (net)	334,369	336,133	337,793
financial assets held for trading	125,458	148,187	146,346
financial assets designated at fair value through profit or loss	34,782	31,609	45,043
non-trading / hedging derivates	8,537	10,377	7,727
fair value changes of the hedged items in portfolio	1,287	1,481	1,379
held-to-maturity financial assets	31,034	27,705	15,262
available-for-sale financial assets	133,271	116,774	122,036
Investments accounted at equity / in associates	6,184	4,836	3,251
Intangible assets	2,914	2,697	2,470
Goodwill	25,769	26,724	26,960
Tangible assets	22,974	23,286	25,320
Assets held for sale	15,280	5,772	5,646
Tax assets	30,243	27,678	27,814
Other assets	10,107	8,778	8,006
Total assets	**1,444,305**	**1,339,125**	**1,340,260**

Liabilities and equity (EUR million)	**31.12.2017**	**31.12.2016**	**31.12.2015**
Classification of financial instruments	1,301,683	1,201,872	1,208,440
financial liabilities held for trading	107,624	108,765	105,218
financial liabilites designated at fair value through profit or loss	59,616	40,263	54,768
non-trading / hedging derivates	8,044	8,156	8,937
fair value changes of the hedged items in portfolio	330	448	174
financial liabilities at amortised cost	1,126,069	1,044,240	1,039,343
Provisions	14,489	14,459	14,494
Tax liabilities	7,592	8,373	7,725
Other liabilities	13,708	11,722	10,848
Equity	106,833	102,699	98,753
Total liabilities and equity	**1,444,305**	**1,339,125**	**1,340,260**

Income statement (EUR million)	**2017**	**2016**	**2015**
Net interest income	34,296	31,089	32,812
Net fee and commission income	11,597	10,180	10,033
Result from categories of financial instruments	1,926	4,072	-773
Gains (losses) from insurance business	57	63	98
Other net operating income	-3,551	-4,000	-992
Impairment on goodwill	0	22	283
Adjusted gross profit	**44,325**	**41,426**	**41,461**
Administration costs	-20,400	-18,737	-19,302
Depreciation	-2,593	-2,364	-2,418
Impairment	-9,241	-9,557	-10,194
Operating result after impairments and other appraisable modifications	**12,091**	**10,768**	**9,547**
Income (expenses) related to extraordinary events	0	0	0
Gross result at year-end	**12,091**	**10,768**	**9,547**
Tax expenses (income) related to profit or loss from continuing operations	-3,884	-3,282	-2,213
Net income for the year	**8,207**	**7,486**	**7,334**

Credit and Counterparty risk cluster	2017	2016	2015
Gross profitability 1 Adjusted gross profit / AverageTotal assets	3.2%	3.1%	3.2%
Gross profitability 2 Net interest income and net credit risk provisions / Average risk-weighted exposure amounts 1)	4.8%	4.4%	4.5%
Net profitability 1 Operating result after provisions for cr and val. adjustments / Average total risk exposure amount	2.0%	1.9%	1.6%
Net profitability 2 Gross annual profit / Average Adjusted total assets 2)	0.8%	0.8%	0.7%
Return on equity 1 Operating result after provisions for credit risks and valuation adjustments / Average total capital	11.5%	10.7%	10.1%
Return on equity 2 Gross annual profit / Average total capital	11.5%	10.7%	10.1%
Cost income ratio 1 Administration costs and provisions for credit risks / Gross profit	67.8%	69.4%	77.8%
Cost income ratio 2 Administration costs / Adjusted gross profit	51.9%	50.9%	52.4%

Indicators of sustained capital position	31.12.2017	31.12.2016	31.12.2015
Total capital ratio Own funds / Total risk exposure amount	15.0%	14.7%	14.4%
Tier 1 capital ratio Tier 1 capital / Total risk exposure amount	12.8%	12.5%	12.5%
Common equity Tier 1 ratio Common equity tier 1 capital / Total risk exposure amount	12.3%	12.5%	12.5%

Financial data (TEUR)	31.12.2017	31.12.2016	31.12.2015
Net interest income	34,296	31,089	32,812
Gross profit	47,575	44,178	41,038
Adjusted gross profit	44,325	41,426	41,461
Administration costs (incl. depreciation)	-22,993	-21,101	-21,720
Administration costs and provisions for credit risks	-32,234	-30,658	-31,914
Operating result after provisions for credit risks and valuation adjustments	12,091	10,768	9,547
Gross annual profit	12,091	10,768	9,547
Average risk-weighted exposure amounts 1)	525,926	493,548	500,448
Average total risk exposure amount	613,714	581,748	599,713
Average total assets	1,391,715	1,339,693	1,303,278
Average Adjusted total assets 2)	1,463,661	1,407,942	1,372,267
Average total capital	104,766	100,726	94,234
Own funds	90,706	86,337	84,350
Tier 1 capital	77,283	73,709	73,479
Common equity tier 1 capital	74,173	73,709	73,479
Total risk exposure amount	605,064	588,088	585,633

1) Risk weighted exposure amount for credit, counterparty credit and dilution risks and free deliveries
2) Comprises on-balance sheet total assets, contingent liabilities and loan-loss allowances

Regulatory disclosure requirements

Name and function of the analysts:

- Daniel Bittner, Lead Rating Analyst, GBB-Rating, Cologne
- Angelika Komenda, Rating Analyst, GBB-Rating, Cologne

Company address:

- GBB-Rating Gesellschaft für Bonitätsbeurteilung mbH, Kattenbug 1, 50667 Cologne

Members of the Rating Committee:

- Sebastian Podporowski, Certified Public Accountant, Cologne
- Manfred Kühnle, Certified Public Accountant, Cologne
- Bernd Bretschneider, Managing Director GBB-Rating, Cologne
- Oliver Mohr, Managing Director GBB-Rating, Cologne

Date	Rating Committee	Notification	Issue
▪ First rating	16.05.2018	17.05.2018	22.05.2018

Validity:

- Rating: 12 months
- Outlook: 24 months

Subsequent rating changes after notification to client:

- None

Major sources of information for the rating:

- Annual report 2017
- Quarterly Report Q1 2018
- Various conference calls
- Further disclosures and company specific information

Statement about the quality of information available (including potential restrictions):

- The quality and extent of information (interviews and documents) were suitable to obtain a comprehensive picture of the bank and to assign an objective, transparent and professional credit rating

Applicable rating methodology, rating type and release:

- Solicited rating
- Methodology for Rating Banks and Building Societies (Version 3.0.03) – cluster credit and counterparty credit risk (CRR)
- www.gbb-rating.eu/en/presse/eu-veroeffentlichungen/Pages/default.aspx

Meaning of the rating category:

- www.gbb-rating.eu/en/ratings/ratingskala/Pages/default.aspx

Business relationship:

- Besides the rating mandate there are further rating mandates within the group

Legal remarks

GBB-Rating Gesellschaft für Bonitätsbeurteilung mbH does not make any guarantees regarding the accuracy, completeness or timeliness of the present rating. GBB-Rating shall not have any responsibility or liability for the suitability of the rating for particular purposes or losses arising from the use thereof. The current rating report is not an investment recommendation.

Future events are uncertain. Ratings are based on predictions of these and thus inevitably rely upon estimates. Therefore they solely represent statements of opinion rather than statements of fact or investment advice.

Credit ratings are performed with proficiency and due professional care. Ratings are based on the information provided by the applicant. This information is used in reaching an opinion about the future viability as well as the strengths and weaknesses of the rated company as of the date of rating issuance.