

Fitch Ratings

Fitch Assigns Santander New CH Issue Final 'AAA' Rating
28 May 2009

Fitch Ratings-London-28 May 2009: Fitch Ratings has today assigned Banco Santander's (Santander, rated 'AA/RWN/F1+') EUR1.5bn new issue of cédulas hipotecarias (CHs), due in May 2014, a final 'AAA' rating. Fitch has simultaneously affirmed all the other rated outstanding CHs of the bank at 'AAA'.

The 'AAA' rating is based on Santander's Long-term Issuer Default Rating (IDR) of 'AA' and a Discontinuity Factor (D-Factor) of 35.4%, the combination of which allows the mortgage covered bonds to be assigned a 'AA+' rating on a probability of default (PD) basis, and a 'AAA' rating after taking into account recoveries from the total mortgage book in the event of a covered bonds default. The rating is further based on overcollateralisation (OC) between the cover assets and the covered bonds being sufficient to sustain 'AA+' and 'AAA' stress scenarios, respectively.

Fitch D-Factors are measured on a scale between 0% and 100%, with 0% reflecting a perfect continuity and 100% being equivalent to an interruption of payments due on covered bonds upon an issuer default. Fitch has modelled the credit risk of Santander's total mortgage book backing outstanding CHs, and compared stressed cash flows from the assets to scheduled payments under the outstanding CHs.

Santander's total mortgage book as of March 2009 was EUR53.39bn, of which EUR35.89bn complied with the legal eligibility criteria for setting issuance limits. The mortgage book consists of loans for residential purposes, mainly to private individuals, loans granted to developers and commercial loans to SMEs. The weighted average current (WA) loan-to-value (LTV) ratio is 41.48%. In a 'AAA' scenario, Fitch assumes a WA cumulative PD of the entire cover pool of 33.67%, and WA recoveries of 42.63%. The WA residual maturity of the mortgage assets stands at 20.25 years, whereas the WA residual maturity of the CHs, including the new issue, is 6.3 years. Nearly all of the assets (96.62%) are granted at a variable rate of interest, whereas 94.6% of the outstanding CHs, including the planned issue, have a fixed rate. There is no privileged hedge in place.

Nominal OC between the entire mortgage book and the existing and new CHs issues of EUR25.69bn stands at 107.83% and at 39.74% when considering only the eligible portfolio. A nominal OC of 107.83% calculated on the total mortgage book is sufficient, in Fitch's opinion, to compensate for potential credit losses in the cover pool and for maturity and interest rate mismatches between the mortgage book and the covered bonds in a 'AA+' scenario. The nominal OC is also sufficient to sustain stressed recoveries of at least 51% of outstanding CHs in a 'AAA' scenario, resulting in a corresponding one notch uplift above Santander's CH rating on a PD basis.

Fitch is in the process of reviewing the agency's assumptions related to liquidity risks within covered bond programmes (please see the 11 March 2009 comment, entitled "Exposure Draft on Assessment of Liquidity Risks in Covered Bonds", for further information which is available on the agency's subscriber website, www.fitchresearch.com). Overall, the agency's proposed amendments would lead to a tighter relationship between the IDR of the issuer and its covered bond rating. In addition, the level of OC in line with a given scenario is expected to increase. Other aspects of the Fitch covered bonds rating methodology remain unchanged.

Should the new criteria be implemented as proposed, the maximum rating achievable on a PD basis would still be 'AA+', all else staying equal, and 'AAA' after taking into account recoveries from the total mortgage book in the event of a covered bonds default. This limit applies irrespective of the percentage of OC supporting the covered bonds.

Due to the dynamic nature of Santander's mortgage book and covered bonds, Fitch will closely monitor the key characteristics of the cover assets and periodically check whether OC provides protection that is commensurate with the assigned rating.

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