FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Santander Bank Polska at 'BBB+'; Outlook Negative

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Fitch Ratings - Warsaw - 29 Sep 2020: Fitch Ratings has affirmed the Long-Term Issuer Default Rating (IDR) of Santander Bank Polska (Santander BP) at 'BBB+' with a Negative Outlook. It has also affirmed the bank's Viability Rating (VR) at 'bbb+'. A full list of rating actions is at the end of this rating action commentary.

The affirmation of Santander BP reflects Fitch's view that the bank's ratings have sufficient headroom under our updated assessment to absorb pressure on asset quality, earnings and capitalisation. The Negative Outlook on Santander BP's Long-Term IDR reflects that on the parent IDR and the downside risks to our baseline scenario, as pressure on the ratings would increase substantially if the coronavirus-related downturn is deeper or more prolonged than we expect.

KEY RATING DRIVERS

The outlook for the operating environment for Polish banks remains negative reflecting downside risks to Fitch's base-case economic scenario and related profitability pressures.

The negative impact of the coronavirus pandemic has not yet fed through to the asset-quality metrics at Polish banks. This is mostly due to payment moratoria offered by banks to corporate and retail customers. Corporate customers financial flexibility has been supported by sizeable state support in the form of guarantees, liquidity support and loans. Most of the moratoria and state support measures expire in 4Q20 and only in the following quarters will the magnitude of asset-quality stress become visible. Fitch expects asset quality at large Polish banks to deteriorate, but the scope to be limited, as GDP will contract less than in some countries as Poland's lockdown was shorter and not as severe.

We also expect the economic recovery to be swift. There are signs that the bottom has been reached, with retail sales and industrial production both returning to growth in July. Fitch expects real GDP to contract 3.5% in 2020 before growing by 4.5% in 2021 and 3.3% in 2022.

Larger banks have set up provisions in 1H20 to cover expected credit losses resulting from the weaker performance of the Polish economy. This is why sector-level loan impairment charges increased by about 50% year on year despite only marginal deterioration of the headline non-performing loan (NPL) ratio (Stage 3 loans).

Despite our belief that asset-quality deterioration and related loan impairment charges will be contained, we expect pressures on profitability to be significant and related to weaker revenue generation. Interest rate cuts of 140bp over 1H20 bringing the base rate down to 10bp will materially reduce banks' main revenue component through lower net interest margins (NIMs). This was only partly visible in 1H20 financial statements but we expect stronger impact in 2H20, before NIMs stabilise in 2021.

IDRS, NATIONAL RATINGS AND SENIOR DEBT

The IDRs of Santander BP (and its senior debt rating) are driven by its intrinsic strength (as reflected in its VR) and are also underpinned by potential parental support. Banco Santander, S.A. (A-/Negative/a-) owns 67.5% of Santander BP.

National Ratings reflect the bank's creditworthiness relative to Polish peers.

VR

Santander BP's VR reflects its established domestic franchise, conservative risk appetite, solid capital and funding position. These balance the bank's more vulnerable asset quality than peers' and weakened earnings. Both of which face increased downside pressure from the economic effects of the coronavirus pandemic.

In our view, the bank's franchise is sufficiently strong to withstand the market disruptions caused by the pandemic. Santander BP has a strong and well-entrenched market position in key client segments. Market share of about 10% of sector's assets at end-1H20, well developed universal product offers and good progress in digitalisation supporting quality of service underpin our assessment. The bank's traditional business model has delivered stable results. However, structural revenue generation has weakened, which, coupled with high regulatory burdens and legal risks related to foreign-currency mortgage portfolio, have led to the bank's business model being more vulnerable to changes in the economic cycle.

Santander BP's conservative risk appetite remains a strength in our view, underpinned by its well diversified loan portfolio, solid underwriting and robust control frameworks. These have translated into historically low default rates and in our view are strong enough to contain moderate weakening of the operating environment. The bank's growth appetite has moderated and is now focused on organic growth at levels similar or moderately above the market average.

Santander BP's asset quality remains solid underpinned by conservative underwriting and healthy origination of new loans. These balance risks of the bank's meaningful exposure to legacy foreign-currency mortgage loans, about 8% of gross loans at end-1H20, and higher than peers' share of unsecured consumer loans, almost 20% of gross loans. The bank's ratio of impaired loans increased moderately to 5.1% at end 1H20, but this largely reflects seasoning of the loan book, especially after the acquisition of the Polish operations of Deutsche Bank in late 2018. In our view, the true impact on headline asset-quality metrics from the effect of the pandemic is yet to materialise given the still active sizeable support measures, including loan moratoriums. At end-1H20, about 14% of gross loans were subject to payment suspension. Although early indicators point to reasonable levels of customers resume repayments, most of these will end between third and fourth quarter of 2020.

Santander BP's profitability is set to weaken as effects of interest rate cuts, weaker lending growth and pressures on asset quality materialise. The bank's operating profit to risk-weighted assets contracted to 1.3% at end-1H20 driven by front-loading of credit losses. The full effect of the interest rate cut on the bank's profitability is still to materialise, but we view that underlying profitability has weakened. We expect the bank will need to adjust its business model to generate consistently high earnings. Downside risks to profitability remain as loan impairment charges stay high and legal risks related to foreign-currency mortgages remain elevated.

We view Santander BP's capitalisation as strong, underpinned by high regulatory capital ratios (common equity Tier 1 of 16.8% at end-1H20), moderate Basel leverage ratio (10.3%) compared with peers' and solid capital buffers over regulatory minimums. In our assessment, we also consider the bank's low encumbrance by unprovisioned impaired loans and conservative risk appetite. In our view, the bank's capital position could withstand even a quite severe stress scenario, despite weakened profitability.

Santander BP's robust funding and liquidity reflects its high self-financing capacity, funding based on granular customer deposits, strong coverage of short-term liabilities by liquid assets and potential ordinary parental support. At end-1H20, the gross loans-to-customer deposits ratio had fallen to 91% on the back of weaker loan growth and high deposits inflows, from an average of about 100% in 2016-2019. The bank's strong liquidity is shown by a high liquidity coverage ratio of 209%.

Support Rating

The Support Rating (SR) of '2' reflects Fitch's view of a high probability of support from Banco Santander. In our opinion, Poland is a strategically important market for Banco Santander. The bank's synergies with its parent are strong and underpinned by solid record of supporting its parent's objectives, which is likely to continue. In our opinion, any required support for the bank would be immaterial relative to its parent's ability to provide it. This view reflects Banco Santander's solid credit profile and the small size of Santander BP relative to its parent.

RATING SENSITIVITIES

IDR, SR, Senior Debt, National Ratings Factors that could individually or collectively lead to a negative rating action or a downgrade: - Parent's IDR is downgraded or its propensity to support the bank weakens. The latter we view as unlikely; and - Santander BP's VR is downgraded. Factors that could individually or collectively lead to a positive rating action or an upgrade: - An IDR upgrade would require an upgrade of the parent's IDR, which is unlikely given the Negative Outlook on its rating or upgrade of the VR. VR Factors that could individually or collectively lead to a negative rating action or a downgrade: - Downgrade of the operating environment assessment. The operating environment could be downgraded to 'bbb', if a decline in real GDP is prolonged and recovery to pre-crisis GDP levels are delayed compared with Fitch's baseline expectation; - Weakening of Santander BPs asset quality due to a rise in bad debts not adequately provided for and without clear prospects for improvement, in particular, if the impaired loans ratio rises sustainably above 8%; and - Deterioration of the bank's operating profitability without prospects for recovery. In particular if the bank's operating profit to risk-weighted assets ratio falls sustainably below 1.5%, which typically indicates an earnings and profitability assessment in the 'bb' range. Factors that could individually or collectively lead to a positive rating action or an upgrade: - A VR upgrade is unlikely in the near term given its already high rating level and would require significant strengthening of the operating environment, coupled with maintaining solid financial metrics.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit [https://www.fitchratings.com/site/re/10111579]

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

Santander BP IDR and SR are linked to Banco Santander's IDR.

ESG CONSIDERATIONS

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

RATING ACTIONS

ENTITY/DEBT	RATING			PRIOR
Santander Bank Polska S.A.	LT IDR	BBB+ Rating Outlook Negative	Affirmed	BBB+ Rating Outlook Negative

ENTITY/DEBT	RATING			PRIOR
	ST IDR	F2	Affirmed	F2
	Natl LT	AA(pol) Rating Outlook Negative	Affirmed	AA(pol) Rating Outlook Negative
	Natl ST	F1+(pol)	Affirmed	F1+(pol)

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Bank Rating Criteria (pub. 28 Feb 2020) (including rating assumption sensitivity)

National Scale Rating Criteria (pub. 08 Jun 2020)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

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Banks Europe Poland