MOODY'S
INVESTORS SERVICE

CREDIT OPINION
16 December 2019

Update

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RATINGS

Santander Bank Polska S.A.

Domicile	Warsaw, Poland
Long Term CRR	A1
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	A3
Type	Senior Unsecured - Fgn Curr
Outlook	Stable
Long Term Deposit	A2
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Santander Bank Polska S.A.

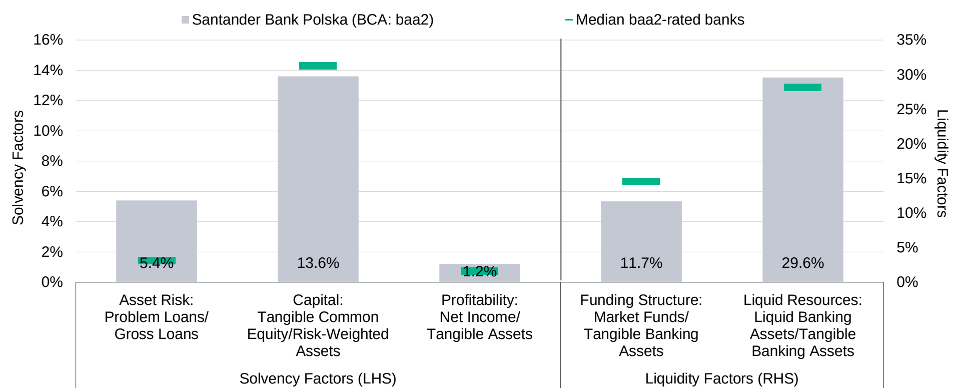
Update to credit analysis

Summary

Santander Bank Polska S.A.'s (SBP, formerly Bank Zachodni WBK) A2/Prime-1 deposit and A3 senior unsecured debt ratings incorporate (1) the bank's standalone Baseline Credit Assessment (BCA) of baa2; (2) our assumption of moderate parental support from Banco Santander S.A. (Spain) (Banco Santander, deposits A2 stable; BCA baa1), which results in one notch of uplift from the bank's BCA to a baa1 Adjusted BCA; (3) the results of our Advanced Loss Given Failure (LGF) analysis, which takes into account the severity of loss faced by different liability classes in resolution and leads to two notches of uplift for SBP's deposit ratings; and (4) our assumption of a moderate likelihood of support from the Government of Poland (A2 stable) if necessary, given the bank's increased market share and importance to the Polish banking system, which does not result in any additional rating uplift.

SBP's BCA of baa2 is supported by Poland's Macro Profile of Strong- and (1) good capitalisation, supported by retained earnings, (2) moderate asset quality and strong, albeit softening profitability; (3) good liquidity and a moderate level of market funding, despite some dependence on medium-term wholesale foreign-exchange funding. The bank's exposure to legacy foreign-currency mortgages is low and the bank is therefore less vulnerable to heightened legal risks following a borrower-friendly ruling by the European Court of Justice in October 2019.

Exhibit 1
Rating Scorecard - Key financial ratios



Source: Moody's Financial Metrics

Credit strengths

» Adequate capitalisation, supported by retained earnings

» Strong profitability, although it is facing challenges

» Good liquidity buffer

Credit challenges

» Moderate asset quality, in line with that of peers

» Limited and declining exposure to Swiss franc (CHF) mortgages which is subject to heightened legal risks

» Some dependence on medium-term wholesale foreign-exchange funding despite a predominantly deposit-funded profile

Outlook

The outlook on SBP's ratings is stable, reflecting limited upward or downward pressure on the bank's ratings over the next 12-18 months.

Factors that could lead to an upgrade

SBP's deposit ratings are at the level of the Polish government's rating and could be upgraded in the event of (1) a higher notching uplift from our Advanced LGF analysis; or (2) an upgrade of the Polish sovereign rating, in combination with an upgrade of the bank's Adjusted BCA.

The bank's A3 senior unsecured debt rating could be upgraded as a result of (1) an upgrade of its Adjusted BCA; (2) an upgrade of the Polish government's rating; or (3) an additional one-notch uplift from the Advanced LGF analysis because of additional volumes of subordinated instruments, which would imply higher protection for senior creditors and a lower loss given failure in resolution.

Upward pressure on the bank's standalone BCA would be largely conditional on a continuous improvement in its asset quality, while maintaining or improving its regulatory capital, profitability and funding. A one-notch upgrade of the BCA will result in the compression of the currently applicable one-notch affiliate support uplift from Banco Santander and no changes to the Adjusted BCA of baa1.

Factors that could lead to a downgrade

A downgrade of SBP's deposit ratings could be triggered by (1) a downgrade of its BCA, or (2) a decrease in the uplift from our Advanced LGF analysis, or both. The negative impact on the debt rating from a lower BCA or a reduced uplift from the LGF analysis could be offset by a one-notch uplift from government support.

The bank's BCA could be downgraded in case of (1) a significant deterioration in its asset quality, profitability and/or capital levels; and (2) a substantial increase in its market funding reliance.

Key indicators

Exhibit 2
Santander Bank Polska S.A. (Consolidated Financials) [1]

	09-19[2]	12-18[2]	12-17[2]	12-16[2]	12-15[2]	CAGR/Avg.[3]
Total Assets (PLN Billion)	204.1	205.8	152.7	150.1	138.7	10.8[4]
Total Assets (USD Million)	50,901.8	54,791.1	43,932.9	35,958.1	35,126.7	10.4[4]
Tangible Common Equity (PLN Billion)	21.2	21.6	19.0	17.3	17.5	5.3[4]
Tangible Common Equity (USD Million)	5,280.0	5,744.5	5,470.0	4,153.4	4,421.1	4.8[4]
Problem Loans / Gross Loans (%)	4.5	4.6	5.8	6.6	7.3	5.7[5]
Tangible Common Equity / Risk Weighted Assets (%)	13.6	14.4	15.3	15.0	15.4	14.7[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	25.1	24.9	27.3	32.0	32.2	28.3[5]
Net Interest Margin (%)	3.2	3.4	3.6	3.4	3.2	3.3[5]
PPI / Average RWA (%)	2.9	3.1	3.4	3.1	3.1	3.1[6]
Net Income / Tangible Assets (%)	1.2	1.2	1.7	1.4	1.5	1.4[5]
Cost / Income Ratio (%)	51.9	50.9	48.8	51.3	50.8	50.8[5]
Market Funds / Tangible Banking Assets (%)	9.7	11.7	8.7	9.2	11.1	10.1[5]
Liquid Banking Assets / Tangible Banking Assets (%)	25.4	29.6	24.5	26.3	26.8	26.5[5]
Gross Loans / Due to Customers (%)	97.2	93.6	101.1	95.9	98.8	97.3[5]

[1]All figures and ratios are adjusted using Moody's standard adjustments. [2]Basel III - fully-loaded or transitional phase-in; IFRS. [3]May include rounding differences due to scale of reported amounts. [4]Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime. [5]Simple average of periods presented for the latest accounting regime. [6]Simple average of Basel III periods presented.
Source: Moody's Investors Service; Company Filings

Profile

Santander Bank Polska S.A. (SBP) is a universal commercial bank in Poland. It became the second-largest bank in Poland following a number of acquisitions in recent years, with a reported 11.8% market share each in customer deposits and loans as of 30 September 2019. The bank provides retail and corporate clients with banking and other financial services, including securities trading, leasing, factoring, insurance and asset management.

SBP was established in 2001, following the merger of Bank Zachodni and Wielkopolski Kredytowy. On 7 September 2018, the bank rebranded itself to Santander Bank Polska S.A. from Bank Zachodni WBK S.A. It has been listed on the Warsaw Stock Exchange since 2001 (stock code: SPL). As of 30 September 2019, Banco Santander held a 67.5% stake in SBP.

In its latest corporate transaction, which was completed in the fourth quarter of 2018, SBP acquired the retail and small and medium-sized enterprise (SME) businesses of Deutsche Bank Polska S.A. (core DB Polska) from Deutsche Bank AG (A3 negative, ba1[1]), excluding foreign-currency mortgages and the corporate and investment banking business. The acquired assets (retail and SME loans) accounted for 14% of SBP's 2018 gross loans.

Detailed credit considerations

Moderate asset quality, which is better than sector average

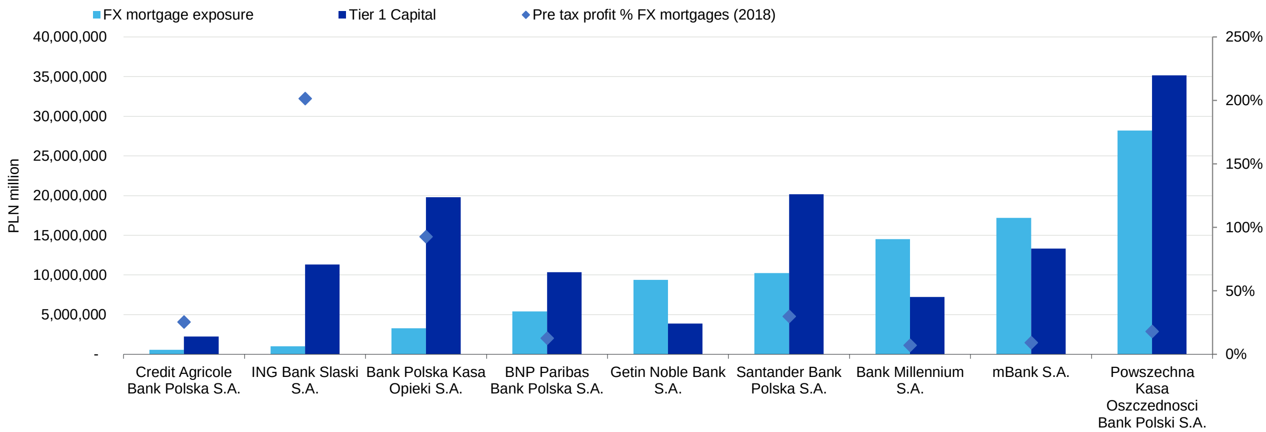
We assign a ba1 Asset Risk score, in line with the Macro-Adjusted score. We believe that SPB's asset quality will likely remain broadly unchanged over the outlook period, driven by the favourable economic environment, a gradual decline in the CHF mortgage book, as well as the seasoning of the loan book, which grew significantly in the past several years.

The bank's nonperforming loan (NPL) ratio decreased to 4.5% in September 2019 from 5.5% a year earlier, helped by the acquisition of DB Polska, which had substantially lower NPLs than SBP. This NPL ratio is below the average for the Polish banking sector, which stood at 5.6% as of year-end 2018 (latest available data). At the same time, we estimate that the bank's NPL coverage ratio increased to 77% as of September 2019 from 68% as of year-end 2018.

One of the primary risk factors for SBP's credit profile is its exposure to foreign-currency mortgages, as CHF mortgages constituted limited 7% of the loan book as of September 2019, below the 10.4% average for the sector as of September 2019. Polish banks are exposed to elevated legal risks stemming from their exposure to foreign currency, mainly CHF mortgages. On 3 October, the European

Court of Justice (ECJ) provided a borrower-friendly judgement, which appears supportive of an annulment of the initial mortgage contract exposing lenders to heightened litigation costs. Although the ECJ's judgement is subject to interpretation by the domestic courts, it risks overturning the legal dynamics with costly implications for Polish banks. However, court battles are likely to be lengthy and so risks for Polish banks are not imminent. At the same time, we expect Polish banks to be called to take collective provisions against their exposures in CHF mortgages in the year-end financial statements, which will reduce their profit.

Exhibit 3
Rated Polish banks' exposure to foreign-currency mortgages



Sources: Banks' financial statements and Moody's Investors Service

Adequate capitalisation, supported by retained earnings

We assign a Capital score of a3, in line with the Macro-Adjusted score, reflecting our expectation that the bank's capital will remain stable over the next 12-18 months.

SBP's Tier 1 capital and total capital ratios stood at 14.3% and 16.1%, respectively, as of 30 September 2019, below the 17.6% and 15.5% reported a year earlier, mainly because of the acquisition of DB Polska's core business. The bank's minimum capital requirement for Tier 1 was 12.35% as of 1 January 2019 and included Pillar 1 requirements, a systemic risk buffer of 3%, an other systemically important bank buffer of 0.5% (which increased to 0.75% as of October 2019), a capital conservation buffer of 2.5% and a foreign-exchange risk buffer (part of the Pillar 2 requirements and applied on an individual basis) of 0.38%. However, in November 2019, the Polish Supervisory Authority (KNF) stated that the bank is no longer obliged to maintain its FC mortgage risk buffer because its exposure dropped below 7% of total gross loans.

The KNF only allows the bank to pay out in dividend a modest 25% of its 2018 earnings. However, the bank is considering paying dividends from its 2016 and 2017 retained earnings as well, in the amount of PLN1.47 billion or 5.6% of the bank's total equity as of 30 September 2019.

Profitability is strong, although it is facing challenges

The assigned baa3 Profitability score, one notch below the Macro-Adjusted score, reflects: (1) our expectation of broadly stable profitability levels owing to growing revenue across the bank's larger franchise and benefits from operating cost reduction efforts, despite headwinds from higher regulatory costs; and (2) a one-notch negative adjustment to reflect the risks that the FC mortgage portfolio poses to the bank's profitability.

In the first nine months of 2019, SBP's net income reached PLN1.82 billion, equivalent to a strong net income/tangible assets (Moody's-adjusted return on assets) of 1.23%. This ratio is, however, lower than the 1.39% reported a year earlier, as a result of the integration of the less profitable core operations of DB Polska.

SBP's net interest margin slightly deteriorated to 3.2% as of Sept 2019 from 3.5% a year earlier (although still high), and its pre-provision income/average total assets fell to 2.2% from 2.5% as of September 2019. The bank's cost of risk remained broadly stable at 0.9%.

Since February 2016, Polish banks are required to pay an annual bank tax equal to 0.44% of their adjusted assets. As a result, SBP recognised regulatory fees of PLN285 million cost in the first nine months of 2019.

We expect the bank to improve its earnings over the coming years through the generation of synergies, which the bank expects to amount to PLN411 million in the period 2019-2021. This will help improve efficiency levels, which at the moment stand at 52%, as measured by the cost-to-income ratio (51% a year earlier).

Deposit-funded profile, but some dependence on medium-term wholesale foreign-currency funding because of the foreign-currency mortgage portfolio

We assign a baa2 score for Funding Structure, two notches lower than the unadjusted score to reflect our expectation that the share of market funding will gradually increase given the fast loan growth and the medium-term need for new debt issuances driven by the minimum requirement for own funds and eligible liabilities (MREL), which have yet to be formally established by the resolution authorities.

At present, SBP is predominantly deposit funded, with deposits from retail customers accounting for 60% of the total deposits as of September 2019. The bank's loan-to-deposit ratio increased to 96.0% as of the same date from 95.5% a year earlier. SBP has a currency funding gap because of the CHF mortgage portfolio, most of which is covered through medium-term swaps. In our view, this exposes the bank to the volatile nature of the derivatives market at times of increased market volatility.

Given the recent improvement in SBP's liquid assets, we do not expect any significant reduction beyond the assigned baa2 score, in line with the Macro-Adjusted score. SBP's stock of liquid banking assets is at an adequate level, accounting for 29.6% of its total banking assets as of 30 September 2019.

Environment, social and governance considerations

In line with our general view on the banking sector, SBP has a low exposure to environmental risks. See our environmental risk heat map for further information.

Overall, we expect banks to face moderate social risks, which in particular applies to SBP. See our Social risk heat map for further information. For Polish banks, we have identified rising legal risks related to foreign-currency mortgages as a key social risk. At this stage, there is high uncertainty surrounding how the borrower-friendly judgement of the ECJ will affect Polish banks. However, the sector is exposed to the risk of significant potential losses, as well as reputational damage, because of the growing number of law suits the banks face from their customers who claim their contracts contained abusive terms. For SBP, the Swiss franc mortgage portfolio has been gradually amortising. This exposure represented 7% of its gross loan book as of September 2019, below the 10.4% average for the banking sector. For more information, please refer to the asset quality subsection.

Governance is highly relevant for SBP, as it is to all competitors in the banking industry. Corporate governance weaknesses can lead to a deterioration in a bank's credit quality, while governance strengths can benefit its credit profile. Governance risks are largely internal rather than externally driven. For SBP, we do not have any particular governance concern. Nonetheless, corporate governance remains a key credit consideration and requires ongoing monitoring.

Support and structural considerations

Affiliate support

We assess a moderate probability of parental support for SBP from its parent Banco Santander, given its 67.5% ownership stake in SBP and Banco Santander's commitment to its Polish business. This assessment results in one notch of uplift from the baa2 BCA of SBP to an Adjusted BCA of baa1.

Loss Given Failure (LGF) analysis

Santander Polska is subject to the EU Bank Recovery and Resolution Directive, which we consider to be an Operational Resolution Regime. We assume residual tangible common equity of 3% and post-failure losses of 8% of tangible banking assets, a 25% runoff in "junior" wholesale deposits, a 5% runoff in preferred deposits and a 26% proportion of junior deposits (EU average), and assign a 25% probability to deposits being preferred to senior unsecured debt. These are in line with our standard assumptions.

This results in a Preliminary Rating (PR) Assessment of a2 for the deposit ratings, two notches above the Adjusted BCA, reflecting a very low loss given failure.

The PR Assessment for the senior unsecured debt rating is a3, which reflects a low loss given failure.

Government support considerations

We incorporate a moderate likelihood of government support for Santander Polska's deposits and senior unsecured debt in the event of its failure, given the bank's increased importance to the Polish banking system. However, this does not provide any rating uplift.

Counterparty Risk Ratings (CRRs)

CRRs are opinions of the ability of entities to honour the uncollateralised portion of non-debt counterparty financial liabilities (CRR liabilities) and also reflect the expected financial losses in the event such liabilities are not honoured. CRR liabilities typically relate to transactions with unrelated parties. CRRs are distinct from ratings assigned to senior unsecured debt instruments and from issuer ratings because they reflect that, in a resolution, CRR liabilities might benefit from preferential treatment compared with senior unsecured debt. Examples of CRR liabilities include the uncollateralised portion of payables arising from derivatives transactions and the uncollateralised portion of liabilities under sale and repurchase agreements.

Santander Bank Polska's CRRs are positioned at A1/P-1

The bank's CRRs are positioned three notches above the Adjusted BCA of baa1, reflecting extremely low loss given failure from a high volume of subordinated instruments.

Counterparty Risk (CR) Assessment

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than both the likelihood of default and the expected financial loss suffered in the event of default, and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR Assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (for example, swaps), letters of credit, guarantees and liquidity facilities.

Santander Bank Polska's CR Assessment is positioned at A1(cr)/P-1(cr)

The CR Assessment of Santander Polska is positioned at A1(cr), three notches above the Adjusted BCA of baa1, based on the buffer against default provided to the senior obligations. In addition, the low probability of government support does not result in any uplift.

Methodology and scorecard

About Moody's Bank Scorecard

Our scorecard is designed to capture, express and explain in summary form our Rating Committee's judgement. When read in conjunction with our research, a fulsome presentation of our judgement is expressed. As a result, the output of our scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

Rating methodology and scorecard factors

Exhibit 4
Santander Bank Polska S.A.

Macro Factors							
Weighted Macro Profile	**Strong -**	**100%**					

Factor	Historic Ratio	Initial Score	Expected Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	5.4%	ba1	←→	ba1	Expected trend	
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	13.6%	a3	←→	a3	Expected trend	
Profitability						
Net Income / Tangible Assets	1.2%	baa2	↓	baa3	Expected trend	
Combined Solvency Score		baa2		baa2		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	11.7%	a3	↑	baa2	Extent of market funding reliance	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	29.6%	baa2	←→	baa2	Expected trend	
Combined Liquidity Score		baa1		baa2		
Financial Profile				baa2		
Qualitative Adjustments				Adjustment		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint				A2		
BCA Scorecard-indicated Outcome - Range				baa1 - baa3		
Assigned BCA				baa2		
Affiliate Support notching				1		
Adjusted BCA				baa1		

Balance Sheet	in-scope (PLN Million)	% in-scope	at-failure (PLN Million)	% at-failure
Other liabilities	36,893	18.3%	52,362	26.0%
Deposits	151,659	75.2%	136,189	67.5%
Preferred deposits	112,227	55.7%	106,616	52.9%
Junior deposits	39,431	19.6%	29,573	14.7%
Senior unsecured bank debt	4,365	2.2%	4,365	2.2%
Dated subordinated bank debt	2,661	1.3%	2,661	1.3%
Equity	6,049	3.0%	6,049	3.0%
Total Tangible Banking Assets	201,626	100.0%	201,626	100.0%

Debt Class	De Jure waterfall		De Facto waterfall		Notching		LGF Notching Guidance vs. Adjusted BCA	Assigned LGF notching	Additional Notching	Preliminary Rating Assessment
	Instrument volume + subordination	Sub-ordination	Instrument volume + subordination	Sub-ordination	De Jure	De Facto				
Counterparty Risk Rating	21.2%	21.2%	21.2%	21.2%	3	3	3	3	0	a1
Counterparty Risk Assessment	21.2%	21.2%	21.2%	21.2%	3	3	3	3	0	a1 (cr)
Deposits	21.2%	4.3%	21.2%	6.5%	2	2	2	2	0	a2
Senior unsecured bank debt	21.2%	4.3%	6.5%	4.3%	2	-1	1	1	0	a3

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Rating	3	0	a1	0	A1	A1
Counterparty Risk Assessment	3	0	a1 (cr)	0	A1(cr)	
Deposits	2	0	a2	0	A2	A2
Senior unsecured bank debt	1	0	a3	0	(P)A3	A3

[1]Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
Source: Moody's Investors Service

Ratings

Exhibit 5

Category	Moody's Rating
SANTANDER BANK POLSKA S.A.	
Outlook	Stable
Counterparty Risk Rating	A1/P-1
Bank Deposits	A2/P-1
Baseline Credit Assessment	baa2
Adjusted Baseline Credit Assessment	baa1
Counterparty Risk Assessment	A1(cr)/P-1(cr)
Senior Unsecured	A3

Source: Moody's Investors Service

Endnotes

1 The bank ratings shown in this report are the bank's deposit rating and Baseline Credit Assessment

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