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Fitch Affirms Santander BP at 'BBB+'; Outlook Stable

Fitch Ratings - Warsaw - 23 Sep 2021: Fitch Ratings has affirmed Santander Bank Polska S.A.'s (Santander BP) Long-Term Issuer Default Rating (IDR) at 'BBB+' with a Stable Outlook and Viability Rating (VR) at 'bbb+'. A full list of rating actions is below.

The affirmation of the IDRs reflects our view of balanced risks to the bank's Standalone Credit Profile and no material change to our assessment of support available to the bank from its parent, Banco Santander S.A. (A-/Stable/a-). The former reflects our revision of the operating environment assessment to stable from negative and related reduction of operating environment risks to Santander BP's company profile and financial profile.

Key Rating Drivers

IDRS, NATIONAL RATINGS AND SENIOR DEBT

Santander BP's IDRs and senior debt ratings are driven by its intrinsic strength, as reflected in the VR, and also underpinned by potential parental support. Banco Santander owns 67.5% of Santander BP.

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

VR

Santander BP's VR reflects its established domestic franchise, conservative risk appetite, and solid capital and funding positions. However, the bank's earnings remain subdued as revenue generation has not yet recovered from a pandemic-related slump reflecting both margin pressure and weaker lending growth. Additionally, the need to set aside legal risk provisions related to the bank's foreign-currency (FC) mortgage portfolio further drag on the bottom line.

The share of legacy Swiss franc mortgages at Santander BP is moderate, at around 6% of gross loans. At end-1H21, provisions set aside to cover legal risks related to this portfolio covered around 14% of the gross exposure. The relative size of the portfolio coupled with the bank's solid capitalisation levels mean the risk to the bank's credit profile from this exposure is moderate. Under different scenarios, the pressure from a materialisation of risks on this portfolio should not be sufficient to result in a downgrade.

We have revised our outlook on the operating environment for Polish banks to stable from negative. We believe that the impact of the pandemic on Polish banks' credit profiles has been broadly contained and any residual risks are mitigated by the country's sound economic recovery prospects.

Additionally, in our view, any material weakening of the credit profiles of banks significantly exposed to FC mortgages is unlikely to have a material contagion effect on the broader sector.

We view Santander BP's capitalisation as strong, underpinned by high regulatory capital ratios (common equity Tier 1 of 19.1% at end-1H21), a higher Basel leverage ratio (10.5%) than peers and solid capital buffers over regulatory minimums. In our assessment, we also consider the low encumbrance of capital by unprovisioned impaired loans and a conservative risk appetite. We expect the bank's capital metrics to gradually moderate as lending growth gathers pace and the bank resumes dividend distributions. However, under our various scenarios the bank should maintain solid loss absorption capacity, allowing it to withstand even a quite severe stress scenario, despite weakened profitability.

The bank's asset quality has remained fairly resilient to the effects of the pandemic to date. At end-1H21, the bank's impaired loans ratio improved to about 4.3% as new defaults remained modest and payment discipline among borrowers that have exited moratoria has been solid. The bank has also continued to offload legacy problem loans, with the level of sales broadly recovering to pre-pandemic levels, supporting headline asset quality metrics. Coverage of problem loans is robust, with total loan loss provisions exceeding impaired loans, while specific coverage is also strong at about 77%. This will support the bank's ability to effectively resolve bad debts.

Santander's profitability remains under pressure, given the only gradual recovery in lending growth to pre-pandemic levels and the burden of booking legal risk provisions related to its FC mortgage book. The latter is among the key reasons that the bank's operating profit/risk-weighted assets ratio of 1.2% in 1H21 remained below even that recorded in 2020. The net interest margin showed early signs of stabilisation, but remained well below pre-pandemic levels.

We expect the bank's profitability to improve in the near term as loan impairment charges are on track to normalise after the elevated levels recorded in 2020, but a meaningful improvement will depend on the speed of market interest rate normalisation and the avoidance on large further provision charges on the Swiss franc mortgage portfolio. In our view, the bank is strongly positioned to benefit from interest rate hikes, should these come.

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-1H21, the gross loans-to-customer deposits ratio stabilised at about 87% on the back of slowing deposit growth. The bank's liquidity is strong and well covers its moderate refinancing needs over the next 12 months. Regulatory liquidity ratios remain well above requirements with liquidity coverage ratio of 224% at end-1H21.

SUPPORT RATING

The Support Rating (SR) of '2' reflects Fitch's view of a high probability of support from Banco Santander, for whom Poland is a strategically important market in our view. Santander BP's synergies with its parent are strong and underpinned by a solid record of supporting its parent's objectives, which is likely to continue. In our opinion, any required support for the bank should 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

IDRS, NATIONAL RATINGS AND SENIOR DEBT

Factors that could individually or collectively lead to negative rating action/downgrade:

- The parent's IDR is downgraded or its propensity to support the bank weakens; and

- Santander BP's VR is downgraded.

Factors that could individually or collectively lead to positive rating action/upgrade:

- An IDR upgrade would require an upgrade of the parent's IDR; or

- An upgrade of the VR.

VR

Factors that could individually or collectively lead to negative rating action/downgrade:

- Weakening of 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 above 8% on a sustained basis.

- Weakening of the bank's capitalisation metrics, whether due to fast growth not matched by a recovery in internal capital generation, or asset quality deterioration. In particular, a sustainable fall in the common equity Tier 1 ratio below 14% without prospects for improvement could result in a downgrade.

- Changes in the bank's risk appetite that would weaken our assessment of the bank's asset quality, earnings and capitalisation.

- Downgrade of the operating environment assessment.

Factors that could individually or collectively lead to positive rating action/upgrade:

- A VR upgrade is unlikely in the near term given its already high level, and would require an upgrade of the operating environment assessment (bbb+) coupled with continued 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's IDRs, senior debt ratings and SR are linked to Banco Santander's Long-Term 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

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Santander Bank Polska S.A.	LT IDR	BBB+	Affirmed		BBB+
	ST IDR	F2	Affirmed		F2
	Natl LT	AA(pol)	Affirmed		AA(pol)
	Natl ST	F1+(pol)	Affirmed		F1+(pol)
	Viability	bbb+	Affirmed		bbb+
	Support	2	Affirmed		2
• senior unsecured	LT	BBB+	Affirmed		BBB+
• senior unsecured	ST	F2	Affirmed		F2

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

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

National Scale Rating Criteria (pub.22 Dec 2020)

Additional Disclosures

Solicitation Status

Endorsement Status

Santander Bank Polska S.A.	EU Issued, UK Endorsed

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