SECTOR

NEWSFLASH
Santander UK

29 April 2010

Further to Sector's email yesterday regarding Spain's sovereign rating downgrade, Sector is issuing this note to provide further information about Santander UK and the implications stemming from Spain's downgrade. Sector has been in touch with Santander UK directly and Santander UK has sent the following information in writing regarding their status:

"The credit ratings of both Santander UK Plc and its parent Banco Santander remain unchanged across all three rating agencies, suggesting that despite concerns over Spain itself it remains recognised that Santander is in a strong position. In addition, our CDS spreads also remain relatively low in comparison to many of our peers. Although spreads have risen for both Santander UK and Banco Santander, the banking sector in general has seen increased volatility with spreads for other UK domiciled banks rising, suggesting concerns over the banking/financial sector as a whole rather than Santander specifically.

Banco Santander does not guarantee the deposits of its 100% owned UK subsidiary Santander UK Plc. Instead of an explicit parental guarantee Banco Santander chose to inject capital directly into Santander UK Plc, meaning that we have our own capital to protect our own deposits and therefore do not need to rely on the parent for support. This "subsidiary model" applies across all Santander subsidiaries whereby the local entities are provided with local capital to support local deposits. As such, our capital is there to support our clients deposits, not those located anywhere else. Our Tier 1 core capital ratios remain robust at 8.8% in Q1 2010 for the group (up 1.5% on the previous year) and 6.8% for UK at the end of 2009 (up 0.6% on the previous year).

Santander operate a "firewall" approach to borrowing and lending in the markets in which it operates. Whereas some global banks raise deposits in completely different jurisdictions to where it lends that money, Santander prefers to grow deposits in the same markets it provides lending to, meaning that deposits raised in the UK stay in the UK. The subsidiary model we operate is recognised as a sign of strength.

Santander still remains partly owned by the family who started the business over 150 years ago and this is evident in the extremely low risk approach it takes to running the business. How well this prudent and low risk approach served us during the "credit crunch" was well publicised in the press when many of our peers were unfortunate enough to experience problems caused by having "toxic debt" on their balance sheets.

SECTOR

In terms of support from the UK government, Santander UK is an FSA registered firm (as was Abbey National Plc before the rebranding) and whilst the government is unlikely to ever give an explicit guarantee to any bank, having set a potential precedent with Lloyds or RBS for instance, I think the government would have a difficult time not affording the same protection/intervention to any other UK-registered banks in the event of a serious problem due to the systemic problems it could cause.

Despite Santander being a Spanish bank, only a small proportion of our profits (around 25%) actually come from Spain, the remainder come from the UK, the rest of Continental Europe, and Central and South America. The bank is a global bank and extremely well diversified with the major part of the business focused on the retail and commercial banking sectors - over 70% of total deposits and 87% of income comes from these sectors. The fact that we have 14,000 branches worldwide is further testament to the main focus of the bank being on the retail side. This approach is very different to a lot of other banks who have a greater reliance on the wholesale markets for their funding.

The profitability of the bank remains strong with 2009 figures of 8.9bn euros for Banco Santander and £1.5bn for Santander UK. In addition to this, data released today showed strong Q1 2010 results with the parent posting a profit of 2.215bn euros (an increase of 6%) and Santander UK £426m (an increase of 15%), both of which further demonstrate our continuing strength in the face of difficult trading conditions."

This is consistent with Sector's newsflash released on 5th Feb. 2010 "Spanish Debt Concerns" where we cited our concerns over the Spanish economy and removed Spain from our Suggested Credit List but kept Banco Santander on our list due to its high Tier 1 ratio, strong liquidity position, and good diversification of revenue streams, with a minimal exposure of €17bn to Spanish government debt. As such, Sector will continue to monitor their credit rating, and CDS spread as part of our approach to counterparty risk management and will notify you should these circumstances materially change to warrant a revision to our suggested duration.

If you have any queries on this matter, please contact your designated Client Relationship Manager or Client Executive.