D. Risk factors

Risks Relating to Our Operations

Since our loan portfolio is concentrated in Continental Europe, the United Kingdom and Latin America, adverse changes affecting the Continental European, the United Kingdom or certain Latin American economies could adversely affect our financial condition.

Our loan portfolio is concentrated in Continental Europe (in particular, Spain), the United Kingdom and Latin America. At December 31, 2008, Continental Europe accounted for approximately 52% of our total loan portfolio (Spain accounted for 38% of our total loan portfolio), while the United Kingdom and Latin America accounted for 32% and 15%, respectively. Therefore, adverse changes affecting the economies of Continental Europe (in particular, Spain), the United Kingdom or the Latin American countries where we operate would likely have a significant adverse impact on our loan portfolio and, as a result, on our financial condition, cash flows and results of operations. See “Item 4. Information on the Company—B. Business Overview.”

Some of our business is cyclical and our income may decrease when demand for certain products or services is in a down cycle.

The level of income we derive from certain of our products and services depends on the strength of the economies in the regions where we operate and certain market trends prevailing in those areas. Therefore, negative cycles may adversely affect our income in the future.

A sudden shortage of funds could increase our cost of funding and have an adverse effect on our liquidity and funding.

Historically, our principal source of funds has been customer deposits (demand, time and notice deposits). At December 31, 2008, 20.6% of these customer deposits were time deposits in amounts greater than $100,000. Time deposits represented 48.8%, 48.9% and 44.2% of total customer deposits at the end of 2008, 2007 and 2006, respectively. Large-denomination time deposits may be a less stable source of deposits than other type of deposits. The loss of market liquidity, triggered by the deterioration of the US sub-prime credit market, continues to affect the supply and cost of liquidity and funding. The effects of the downturn have spread to the global economy, in particular to issuances in wholesale markets (principally asset-backed securities) and to availability of liquid resources via the interbank markets. In this context, there can be no assurance that we will not incur materially higher funding costs or be required to liquidate certain assets.

We are vulnerable to the current disruptions and volatility in the global financial markets as well as to government action intended to alleviate the effects of the current financial crisis.

Since August 2007, the global financial system has experienced difficult credit and liquidity conditions and disruptions leading to less liquidity, greater volatility, general widening of spreads and, in some cases, lack of price transparency on interbank lending rates. In September 2008, global financial markets deteriorated sharply following the bankruptcy filing by Lehman Brothers Holdings Inc. In the days that followed, it became apparent that a number of other major financial institutions, including some of the largest global commercial banks, investment banks, mortgage lenders, mortgage guarantors and insurance companies, were experiencing significant difficulties.

Following the bankruptcy filing by Lehman Brothers Holdings Inc., there were runs on deposits at several financial institutions and numerous institutions sought additional capital. Central banks around the world have coordinated efforts to increase liquidity in the financial markets by taking measures such as increasing the amounts they lend directly to financial institutions, lowering interest rates and significantly increasing temporary reciprocal currency arrangements (or “swap lines”).

In an attempt to prevent the failure of the financial system, the United States and European governments have intervened on an unprecedented scale. In the United States, the federal government has taken equity stakes in several financial institutions, has implemented a program to guarantee the short-term and certain medium-term debt of financial institutions, has increased consumer deposit guarantees, and has brokered the acquisitions of certain struggling financial institutions, among other measures. In the United Kingdom, the government has effectively nationalized some of the country's largest banks, has provided a preferred equity program open to all financial institutions and a program to guarantee short-term and certain medium-term debt of financial institutions, among other measures. In Spain, the government has increased consumer deposit guarantees, has made available a program to guarantee the debt of certain financial institutions, has created a fund to purchase assets from financial institutions and the Spanish Ministry of Economy and Finance has been authorized, on an exceptional basis and until December 31, 2009, to acquire, at the request of credit institutions resident in Spain, shares and other capital instruments (including preferred shares) issued by such institutions. There is no assurance that these measures will successfully alleviate the current financial crisis. In addition, some of these measures could lead to increased government ownership and control over financial institutions and further consolidation in the financial industry, all of which could adversely affect our business, financial condition and results of operations.

Despite the extent of the aforementioned intervention, global investor confidence remains low and credit remains relatively scarce. In addition, the world's largest developed economies, including the United States and United Kingdom, are in the midst of economic recessions. Continued or worsening disruption and volatility in the global financial markets could have a material adverse effect on our ability to access capital and liquidity on financial terms acceptable to it, if at all. If capital markets financing ceases to become available, or becomes excessively expensive, we may be forced to raise the rates we pay on deposits to attract more customers. Any such increase in capital markets funding costs or deposit rates would entail a repricing of loans, which would result in a reduction of volumes, and may also have an adverse effect on our interest margins. A further economic downturn, especially in Spain, the United Kingdom, the United States and certain Latin American countries, could also result in a further reduction in business activity and a consequent loss of income for Santander.

Risks concerning borrower credit quality and general economic conditions are inherent in our business.

Risks arising from changes in credit quality and the recoverability of loans and amounts due from counterparties are inherent in a wide range of our businesses. Adverse changes in the credit quality of our borrowers and counterparties or a general deterioration in Spanish, United Kingdom, Latin American, United States or global economic conditions, or arising from systemic risks in the financial systems, could reduce the recoverability and value of our assets and require an increase in our level of allowances for credit losses. Deterioration in the economies in which we operate could reduce the profit margins for our banking and financial services businesses.

The financial problems faced by our customers could adversely affect us.

Market turmoil and economic recession, especially in Spain, the United Kingdom, the United States and certain Latin American countries, could materially and adversely affect the liquidity, businesses and/or financial conditions of our borrowers, which could in turn further increase our non-performing loan ratios, impair our loan and other financial assets and result in decreased demand for borrowings in general. In the context of continued market turmoil, economic recession and increasing unemployment coupled with declining consumer spending, the value of assets collateralizing our secured loans, including homes and other real estate, could decline significantly, which could result in the impairment of the value of our loan assets. Moreover, in 2008 we experienced an increase in our non-performing ratios, a deterioration in asset quality and a slowdown in business volumes, as compared to 2007. In addition, our customers may further significantly decrease their risk tolerance to non-deposit investments such as stocks, bonds and mutual funds, which would adversely affect our fee and commission income. Any of the conditions described above could have a material adverse effect on our business, financial condition and results of operations.

We are exposed to risks faced by other financial institutions.

We routinely transact with counterparties in the financial services industry, including brokers and dealers, commercial banks, investment banks, mutual and hedge funds, and other institutional clients. Defaults by, and even rumors or questions about the solvency of, certain financial institutions and the financial services industry generally have led to market-wide liquidity problems and could lead to losses or defaults by other institutions. These liquidity concerns have had, and may continue to have, a chilling effect on inter-institutional financial transactions in general. Many of the routine transactions we enter into expose us to significant credit risk in the event of default by one of our significant counterparties. A default by a significant financial counterparty, or liquidity problems in the financial services industry in general, could have a material adverse effect on our business, financial condition and results of operations.

Our exposure to Spanish, UK and US real estate markets makes us more vulnerable to adverse developments in these markets.

As mortgage loans are one of our principal assets, comprising 49% of our loan portfolio as of December 31, 2008, we are currently highly exposed to developments in real estate markets, especially in Spain, the United Kingdom and the US. In addition, we currently have exposure to certain real estate developers in Spain. From 2002 to 2007, demand for housing and mortgage financing in Spain increased significantly driven by, among other things, economic growth, declining unemployment rates, demographic and social trends, the desirability of Spain as a vacation destination and historically low interest rates in the Eurozone. The United Kingdom experienced a similar increase in housing and mortgage demand, driven by, among other things, economic growth, declining unemployment rates, demographic trends and the increasing prominence of London as an international financial center. During late 2007, the housing market began to adjust in Spain and the United Kingdom as a result of excess supply (particularly in Spain) and higher interest rates. In 2008, as economic growth came to a halt in Spain and the economy began to contract in the United Kingdom, retail interest rates continued to increase, housing oversupply persisted, unemployment continued to increase and demand continued to decrease in both countries, home prices declined while mortgage delinquencies increased. As a result, our non-performing loan ratio increased from 0.78% at December 31, 2006 to 0.94% at December 31, 2007 to 2.02% at December 31, 2008. These trends, especially higher interest and unemployment rates coupled with declining real estate prices, could have a material adverse impact on our mortgage payment delinquency rates, which in turn could have a material adverse effect on our business, financial condition and results of operations.

We may generate lower revenues from brokerage and other commission- and fee-based businesses.

Market downturns are likely to lead to declines in the volume of transactions that we execute for our customers and, therefore, to declines in our non-interest revenues. In addition, because the fees that we charge for managing our clients' portfolios are in many cases based on the value or performance of those portfolios, a market downturn that reduces the value of the our clients' portfolios or increases the amount of withdrawals would reduce the revenues we receive from our asset management and private banking and custody businesses.

Even in the absence of a market downturn, below-market performance by our mutual funds may result in increased withdrawals and reduced inflows, which would reduce the revenue we receive from our asset management business.

Market risks associated with fluctuations in bond and equity prices and other market factors are inherent in our business. Protracted market declines can reduce liquidity in the markets, making it harder to sell assets and leading to material losses.

The performance of financial markets may cause changes in the value of our investment and trading portfolios. In some of our business, protracted adverse market movements, particularly asset price decline, can reduce the level of activity in the market or reduce market liquidity. These developments can lead to material losses if we cannot close out deteriorating positions in a timely way. This may especially be the case for assets of the Group for which there are less liquid markets to begin with. Assets that are not traded on stock exchanges or other public trading markets, such as derivative contracts between banks, may have values that we calculate using models other than publicly quoted prices. Monitoring the deterioration of prices of assets like these is difficult and could lead to losses that we did not anticipate.

The increasing volatility of world equity markets due to the current credit crisis is having a particular impact on the financial sector. This may affect the value of our investments in entities in this sector and, depending on their fair value and future recovery expectations, could become a permanent impairment which would be subject to write-offs against our results.

Volatility in interest rates may negatively affect our net interest income and increase our non-performing loan portfolio.

Changes in market interest rates could affect the interest rates charged on interest-earning assets differently than the interest rates paid on interest-bearing liabilities. This difference could result in an increase in interest expense relative to interest income leading to a reduction in our net interest income. Income from treasury operations is particularly vulnerable to interest rate volatility. Since the majority of our loan portfolio reprices in less than one year, rising interest rates may also bring about an increasing non-performing loan portfolio. Interest rates are highly sensitive to many factors beyond our control, including deregulation of the financial sector, monetary policies, domestic and international economic and political conditions and other factors.

As of December 31, 2008, our interest rate risk measured in daily Value at Risk (“VaRD”) terms amounted to €157.7 million.

Foreign exchange rate fluctuations may negatively affect our earnings and the value of our assets and shares.

Fluctuations in the exchange rate between the euro and the US dollar will affect the US dollar equivalent of the price of our securities on the stock exchanges in which our shares and ADSs are traded. These fluctuations will also affect the conversion to US dollars of cash dividends paid in euros on our ADSs.

In the ordinary course of our business, we have a percentage of our assets and liabilities denominated in currencies other than the euro. Fluctuations in the value of the euro against other currencies may adversely affect our profitability. For example, the appreciation of the euro against some Latin American currencies and the US dollar will depress earnings from our Latin American and US operations, and the appreciation of the euro against the sterling will depress earnings from our UK operations. Additionally, while most of the governments of the countries in which we operate have not imposed prohibitions on the repatriation of dividends, capital investment or other distributions, no assurance can be given that these governments will not institute restrictive exchange control policies in the future. Moreover, fluctuations among the currencies in which our shares and ADSs trade could reduce the value of your investment.

As of December 31, 2008, our largest exposures on temporary positions (with a potential impact on the income statement) were concentrated, in descending order, on the pound sterling and the Brazilian real. On that day, our largest exposures on permanent positions (with a potential impact on equity) were concentrated, in descending order, on the Brazilian real, the pound sterling, the Mexican peso and the Chilean peso.

Despite our risk management policies, procedures and methods, we may nonetheless be exposed to unidentified or unanticipated risks.

Our risk management techniques and strategies may not be fully effective in mitigating our risk exposure in all economic market environments or against all types of risk, including risks that we fail to identify or anticipate. Some of our qualitative tools and metrics for managing risk are based upon our use of observed historical market behavior. We apply statistical and other tools to these observations to arrive at quantifications of our risk exposures. These qualitative tools and metrics may fail to predict future risk exposures. These risk exposures could, for example, arise from factors we did not anticipate or correctly evaluate in our statistical models. This would limit our ability to manage our risks. Our losses thus could be significantly greater than the historical measures indicate. In addition, our quantified modeling does not take all risks into account. Our more qualitative approach to managing those risks could prove insufficient, exposing us to material unanticipated losses. If existing or potential customers believe our risk management is inadequate, they could take their business elsewhere. This could harm our reputation as well as our revenues and profits.

Our recent and future acquisitions may not be successful and may be disruptive to our business.

We have recently acquired certain financial institutions, including Sovereign Bancorp and Alliance & Leicester plc. We have also recently acquired the retail deposits, branch network and related employees of Bradford & Bingley plc. Our assessment of these acquisitions, especially Alliance and Leicester plc and Bradford & Bingley plc, is based on limited and potentially inexact information and on assumptions with respect to operations, profitability, asset quality and other matters that may prove to be incorrect. The aforementioned financial institutions have been adversely affected by the current financial crisis and in some cases, principally Alliance & Leicester plc, have material portfolios of securities that have suffered losses and could decline meaningfully in value. There can be no assurances that these institutions will not incur substantial further losses or that we will not be exposed to currently unknown liabilities resulting from these acquisitions. Any such losses or liabilities could have a material adverse effect on our business, financial condition and results of operations.

We can give no assurance that our recent and any future acquisition and partnership activities will perform in accordance with our expectations. We base our assessment of potential acquisitions and partnerships on limited and potentially inexact information and on assumptions with respect to operations, profitability and other matters that may prove to be incorrect. We can give no assurances that our expectations with regards to integration and synergies will materialize.

We may fail to realize the anticipated benefits of our recent acquisitions.

The success of our recent acquisitions will depend, in part, on our ability to realize the anticipated benefits from combining our business with the businesses of Sovereign Bancorp, Alliance & Leicester plc and Bradford & Bingley plc. It is possible that the integration process could take longer or be more costly than anticipated or could result in the loss of key employees, the disruption of each company's ongoing businesses or inconsistencies in standards, controls, procedures and policies that adversely affect the ability of each company to maintain relationships with clients, customers or employees. Our efforts to integrate these companies are also likely to divert management attention and resources. If we take longer than anticipated or are not able to integrate the aforementioned businesses, the anticipated benefits of our recent acquisitions may not be realized fully or at all, or may take longer to realize than expected.

Proposals for the restructuring of the businesses we acquired from ABN AMRO are complex and may not realize the anticipated benefits for the Group.

The restructuring plan in place for the separation and integration of ABN AMRO into and among the businesses and operations of the Group is complex and involves substantial reorganization of ABN AMRO's operations and legal structure. In addition, it contemplates activities taking place simultaneously in a number of businesses and jurisdictions. Implementation of the reorganization and the realization of the forecast benefits within the planned timetable may be challenging. Execution of the restructuring requires management resources previously devoted to the Group's businesses and the retention of appropriately skilled ABN AMRO staff. We may not realize the benefits of the acquisition or the restructuring when expected or to the extent projected. See Item 4 of Part I, "Information on the Company—A. History and Development of the Company—Principal Capital Expenditures and Divestitures—Acquisitions, Dispositions, Reorganizations—ABN AMRO Holding, N.V. ("ABN AMRO")".

Increased competition in the countries where we operate may adversely affect our growth prospects and operations.

Most of the financial systems in which we operate are highly competitive. Financial sector reforms in the markets in which we operate have increased competition among both local and foreign financial institutions, and we believe that this trend will continue. In particular, price competition in Europe, Latin America and the US has increased recently. Our success in the European, Latin American and US markets will depend on our ability to remain competitive with other financial institutions. In addition, there has been a trend towards consolidation in the banking industry, which has created larger and stronger banks with which we must now compete. There can be no assurance that this increased competition will not adversely affect our growth prospects, and therefore our operations. We also face competition from non-bank competitors, such as brokerage companies, department stores (for some credit products), leasing and factoring companies, mutual fund and pension fund management companies and insurance companies.

Changes in the regulatory framework in the jurisdictions where we operate could adversely affect our business.

As a result of the current financial crisis and ensuing government intervention, it is widely anticipated that there will be a substantial increase in government regulation of the financial services industry, including the imposition of higher capital requirements, heightened disclosure standards and restrictions on certain types of transaction structures. In addition, novel proposals for new regulatory initiatives, abound in the current environment. If enacted, new regulations could require us to inject further capital into our business as well as in businesses we acquire, restrict the type or volume of transactions we enter into, or set limits on or require the modification of rates or fees that we charge on certain loan or other products, any of which could lower the return on our investments, assets and equity. We may also face increased compliance costs and limitations on our ability to pursue certain business opportunities. Changes in regulations, which are beyond our control, may have a material effect on our business and operations. As some of the banking laws and regulations have been recently adopted, the manner in which those laws and related regulations are applied to the operations of financial institutions is still evolving. Moreover, no assurance can be given generally that laws or regulations will be adopted, enforced or interpreted in a manner that will not have material adverse affect on our business.

Operational risks are inherent in our business.

Our businesses depend on the ability to process a large number of transactions efficiently and accurately. Losses can result from inadequate personnel, inadequate or failed internal control processes and systems, or from external events that interrupt normal business operations. We also face the risk that the design of our controls and procedures prove to be inadequate or are circumvented. We have suffered losses from operational risk in the past and there can be no assurance that we will not suffer material losses from operational risk in the future.

Different disclosure and accounting principles between Spain and the US may provide you with different or less information about us than you expect.

There may be less publicly available information about us than is regularly published about companies in the United States. While we are subject to the periodic reporting requirements of the Securities Exchange Act of 1934 (the "Exchange Act"), the disclosure required from foreign private issuers under the Exchange Act is more limited than the disclosure required from US issuers. Additionally, we present our financial statements under IFRS-IASB which differs from U.S. GAAP.

We are exposed to risk of loss from legal and regulatory proceedings.

We face various issues that may give rise to risk of loss from legal and regulatory proceedings. These issues include appropriately dealing with potential conflicts of interest, legal and regulatory requirements, ethical issues, and conduct by companies in which we hold strategic investments or joint venture partners, could increase the number of litigation claims and the amount of damages asserted against the Group or subject the Group to regulatory enforcement actions, fines and penalties. Currently, the Bank and its subsidiaries are the subject of a number of legal proceedings and regulatory actions. An adverse result in one or more of these proceedings could have a material adverse effect on our operating results for any particular period. For information relating to the legal proceedings involving our businesses, see "Item 8. Financial Information—A. Consolidated statements and other financial information—Legal proceedings".

Credit, market and liquidity risks may have an adverse effect on our credit ratings and our cost of funds. Any reduction in our credit rating could increase our cost of funding and adversely affect our interest margins.

Credit ratings affect the cost and other terms upon which we are able to obtain funding. Rating agencies regularly evaluate us and their ratings of our long-term debt are based on a number of factors, including our financial strength as well as conditions affecting the financial services industry generally.

Any downgrade in our ratings could increase our borrowing costs, limit our access to capital markets and adversely affect the ability of our business to sell or market their products, engage in business transactions—particularly longer-term and derivatives transactions—and retain our customers. This, in turn, could reduce our liquidity and have an adverse effect on our operating results and financial condition.

While the Group's long-term debt is currently rated investment grade by the major rating agencies (Aa1 by Moody's Investors Service España, S.A. and AA by each of Standard & Poor's Ratings Services and Fitch Ratings Ltd., respectively), following the Group's announcement of its proposed acquisition of Sovereign, Fitch Ratings Ltd. lowered the Group's outlook to negative until all the necessary approvals relating to this acquisition have been received and they can better assess the scope of the risks of integration. In March 2009, Standard & Poor's Ratings Services revised the outlook of the Group to negative based on lower expectation for economic growth in the countries in which the Group operates. In light of the difficulties in the financial services industry and the financial markets, there can be no assurance that the rating agencies will maintain their current ratings or outlooks, or with regard to those rating agencies who have a negative outlook on the Group, there can be no assurances that such agencies will revise such outlooks upward. The Group's failure to maintain favorable ratings and outlooks could increase the cost of its funding and adversely affect the Group's interest margins.

Our Latin American subsidiaries' growth, asset quality and profitability may be adversely affected by volatile macroeconomic and political conditions.

The economies of the nine Latin American countries where we operate have experienced significant volatility in recent decades, characterized, in some cases, by slow or regressive growth, declining investment and hyperinflation. This volatility has resulted in fluctuations in the levels of deposits and in the relative economic strength of various segments of the economies to which we lend. Latin American banking activities (including Retail Banking, Global Wholesale Banking, Asset Management and Private Banking) accounted for €2,945 million of our profit attributed to the Group for the year ended December 31, 2008 (an increase of 10% from €2,666 million for the year ended December 31, 2007). Negative and fluctuating economic conditions, such as a changing interest rate environment, impact our profitability by causing lending margins to decrease and leading to decreased demand for higher margin products and services. Negative and fluctuating economic conditions in some Latin American countries could also result in government defaults on public debt. This could affect us in two ways: directly, through portfolio losses, and indirectly, through instabilities that a default in public debt could cause to the banking system as a whole, particularly since commercial banks' exposure to government debt is high in several Latin American countries in which we operate.

In addition, revenues from our Latin American subsidiaries are subject to risk of loss from unfavorable political and diplomatic developments, social instability, and changes in governmental policies, including expropriation, nationalization, international ownership legislation, interest-rate caps and tax policies.

No assurance can be given that our growth, asset quality and profitability will not be affected by volatile macroeconomic and political conditions in the Latin American countries in which we operate.

Recent events concerning our Venezuelan subsidiary.

In August 2008 we announced that we were considering the sale of Banco de Venezuela to a Venezuelan private investor group, with whom certain undertakings were entered into; however, no agreement was reached and the sale did not occur.

We have subsequently become aware of the interest of the Government of Venezuela in Banco de Venezuela. On May 22, 2009, we announced that we had reached a preliminary agreement for the sale of our stake in this bank to the Republic of Venezuela for $1,050 million.

The parties aim at entering into a definitive agreement and closing the transaction in early July 2009. No assurances can be given, however, that this sale will occur.

The profit attributed to the Group obtained from Banco de Venezuela in 2008 amounted to €352 million, which accounted for 3.97% of our results in that fiscal year.

Latin American economies can be directly and negatively affected by adverse developments in other countries.

Financial and securities markets in the Latin American countries where we operate are, to varying degrees, influenced by economic and market conditions in other countries in Latin America and beyond. Negative developments in the economy or securities markets in one country, particularly in an emerging market, may have a negative impact on other emerging market economies. These developments may adversely affect the business, financial condition and operating results of our subsidiaries in Latin America.