# Annual report 2011

Santander

Thousand year old olive trees at Grupo Santander City, Boadilla del Monte, Madrid, Spain

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# Key figures

| Balance sheet and income statement *(Million euros)* | 2011 | 2010 | % 2011/2010 | 2009 |
|---|---|---|---|---|
| Total assets | **1,251,525** | 1,217,501 | 2.8 | 1,110,529 |
| Customer loans (net) | **750,100** | 724,154 | 3.6 | 682,551 |
| Customer deposits | **632,533** | 616,376 | 2.6 | 506,976 |
| Managed customer funds | **984,353** | 985,269 | (0.1) | 900,057 |
| Shareholder's funds[1] | **80,629** | 75,273 | 7.1 | 70,006 |
| Total managed funds | **1,382,980** | 1,362,289 | 1.5 | 1,245,420 |
| Net interest income | **30,821** | 29,224 | 5.5 | 26,299 |
| Gross income | **44,262** | 42,049 | 5.3 | 39,381 |
| Net operating income | **24,373** | 23,853 | 2.2 | 22,960 |
| Profit from continuing operations | **7,881** | 9,129 | (13.7) | 9,427 |
| Attributable profit to the Group | **5,351** | 8,181 | (34.6) | 8,943 |

| Ratios *(%)* | 2011 | 2010 | | 2009 |
|---|---|---|---|---|
| Efficiency (with amortization) | **44.9** | 43.3 | | 41.7 |
| ROE | **7.14** | 11.80 | | 13.90 |
| ROTE[2] | **10.81** | 18.11 | | 21.05 |
| ROA | **0.50** | 0.76 | | 0.86 |
| RoRWA | **1.07** | 1.55 | | 1.74 |
| Core capital (BIS II) | **10.02** | 8.80 | | 8.61 |
| Tier 1 | **11.01** | 10.02 | | 10.08 |
| BIS II ratio | **13.56** | 13.11 | | 14.19 |
| Tangible capital/tangible assets[3] | **4.4** | 4.4 | | 4.3 |
| Ratio of basic financing[4] | **81.2** | 79.6 | | 76.0 |
| Loan-to-deposit ratio[5] | **117** | 117 | | 135 |
| Non-performing loan (NPL) ratio | **3.89** | 3.55 | | 3.24 |
| NPL coverage | **61** | 73 | | 75 |

| The share and capitalisation | 2011 | 2010 | % 2011/2010 | 2009 |
|---|---|---|---|---|
| Number of shares in circulation (million)[6] | **8,909** | 8,329 | 7.0 | 8,229 |
| Share price (euros) | **5.870** | 7.928 | (26.0) | 11.550 |
| Market capitalisation (million euros) | **50,290** | 66,033 | (23.8) | 95,043 |
| Shareholders' funds per share (euros)[1] | **8.62** | 8.58 | | 8.04 |
| Share price/shareholders' funds per share (times) | **0.68** | 0.92 | | 1.44 |
| PER (share price/attributable profit per share) (times) | **9.75** | 8.42 | | 11.05 |
| Attributable profit per share (euros) | **0.6018** | 0.9418 | (36.1) | 1.0454 |
| Diluted attributable profit per share (euros) | **0.5974** | 0.9356 | (36.1) | 1.0382 |
| Remuneration per share (euros) | **0.6000** | 0.6000 | 0.0 | 0.6000 |
| Total shareholder return (million euros) | **5,260** | 4,999 | 5.2 | 4,919 |

| Other figures | 2011 | 2010 | % 2011/2010 | 2009 |
|---|---|---|---|---|
| Number of shareholders | **3,293,537** | 3,202,324 | 2.8 | 3,062,633 |
| Number of employees | **193,349** | 178,869 | 8.1 | 169,460 |
| Continental Europe | **63,866** | 54,518 | 17.1 | 49,870 |
| United Kingdom | **26,295** | 23,649 | 11.2 | 22,949 |
| Latin America | **91,887** | 89,526 | 2.6 | 85,974 |
| Sovereign | **8,968** | 8,647 | 3.7 | 8,847 |
| Corporate activities | **2,333** | 2,529 | (7.8) | 1,820 |
| Number of branches | **14,756** | 14,082 | 4.8 | 13,660 |
| Continental Europe | **6,608** | 6,063 | 9.0 | 5,871 |
| United Kingdom | **1,379** | 1,416 | (2.6) | 1,322 |
| Latin America | **6,046** | 5,882 | 2.8 | 5.745 |
| Sovereign | **723** | 721 | 0.3 | 722 |

(1) In 2011, scrip dividend for May 2012 estimate.
(2) Return on tangible equity.
(3) (Capital +Reserves+Minority Interests+Profits-Treasury stock-Dividends-Valuation adjustments-Goodwill-Intangibles)/(Total assets-Goodwill-Intangibles).
(4) (Deposits+Medium and long-term wholesale financing+net equity/Total assets (excluding derivatives).
(5) Includes retail commercial paper in Spain.
(6) In 2011, includes shares issued to meet the exchange of preferential shares in December 2011.

## Santander posted attributable profit of EUR 5,351 million in 2011 and assigned EUR 3,183 million to provisions, while strengthening its solvency and maintaining shareholder remuneration at EUR 0.60 per share for the third consecutive year.

### Gross income
*Million euros*

+5.3% 2011/2010

### Net operating income
*Million euros*

+ 2.2% 2011/2010

### Attributable profit
*Million euros*

– 34.6% 2011/2010

### Total dividend payout
*Million euros*

+5.2% 2011/2010

### Efficiency
*%*

+ 1.6 p.p. 2011/2010

### Core capital
*BIS II criteria. %*

+ 1.22 p.p. DEC 2011/DEC 2010

# Letter from the Chairman

## Emilio Botín

Emilio Botín

"In the last five years, Banco Santander paid total shareholder remuneration of EUR 24,000 million"

Dear Shareholders

In a very difficult economic, financial and regulatory environment, Banco Santander maintained its policy of giving priority to strengthening its balance sheet in terms of capital, liquidity and provisions and generated an attributable profit of EUR 5,351 million, 34.6% less than in 2010.

This profit was generated after setting aside EUR 1,812 million of gross provisions, which were not required, to clean up our real estate assets. This increased coverage for repossessed property to 50% and put us ahead of the extra provisioning requirements for the financial system approved by the Spanish government on February 3, 2012.

These provisions, together with writing down part of the goodwill of Banco Santander Portugal, reduced net profits for the year by EUR 1,670 million.

Net capital gains in 2011 from the strategic alliance with the insurer Zurich in Latin America and the entry of new partners into the capital of Santander Consumer Finance in the United States amounted to EUR 1,513 million and were used to bolster the balance sheet via other provisions.

Net operating income (gross income less operating expenses) was EUR 24,373 million, underscoring the Group's strength and capacity to generate earnings.

We improved the capital base and liquidity and significantly strengthened our balance sheet. With a core capital ratio of 9.01%, according to the more demanding criteria of the European Banking Authority, Banco Santander complied with the EBA's new capital requirements six months ahead of the deadline.

The requirements recently approved by the government and the Bank of Spain to raise coverage of bad property loans in Spain will require EUR 2,300 million of provisions, over and above those made ahead of time against 2011's earnings. These provisions will be fully charged in 2012.

## Shareholder remuneration

The Group's sound results will enable, as I said at the last shareholders' meeting, the total remuneration per share to be maintained at EUR 0.60 for the third year running. I would like to point out that in the last five years, thanks to recurring profits and international diversification, Banco Santander's shareholder remuneration amounted to EUR 24,000 million.

The Santander Dividendo Elección (scrip dividend) offers our shareholders the option to receive part of the dividend in cash or new shares. Since its launch three years ago, more than 80% of capital has chosen shares. The board agreed to propose to the next shareholders' meeting applying this programme for the fourth dividend payment (May 2012).

In short, Banco Santander demonstrated its capacity to generate results to simultaneously meet the EBA's capital requirements, substantially increase provisions for bad property loans and maintain remuneration at EUR 0.60 per share.

## Banco Santander's response to the challenges of the environment

In my view, the Bank faced three big challenges in 2011. These will continue to determine the international economic and financial situation in the coming quarters:

- Weak economic activity, particularly in developed countries.
- Very unstable financial markets, especially European sovereign debt markets.
- Very significant regulatory measures and changes, particularly higher liquidity and capital requirements for banks.

Banco Santander has four management principles that allow it to confront this scenario from a position of strength and to continue to gain ground over its competitors:

### 1. Geographic diversification and recurring nature of revenues

Banco Santander has achieved a geographic positioning in the last few years centred on its 10 core markets, with an appropriate balance between developed countries (which contribute 46% of the Group's profits) and emerging markets (54%).

The retail banking model, carried out through our 15,000 branches, which provide services to 102 million customers, gives us recurring growth in revenues in most of the countries where we operate.

In 2011, we sold Banco Santander Colombia for $1,225 million. Our market share in Colombia is far from the 10% we aspire to have in the markets in which we are present in order to create value for our shareholders. This transaction generated EUR 615 million of net capital gains, which will be recorded in 2012 and assigned to further clean up bad property loans, in accordance with the new rules.

### 2. Capital and liquidity management and the model for subsidiaries

Our overriding priority in 2011 was to strengthen the balance sheet.

In October 2011, the European Banking Authority announced the core capital requirements for large European banks and set June 30, 2012, as the deadline for meeting them. In December, the EBA said Santander needed a further EUR 15,302 million of capital to comply with these requirements.

Demonstrating once again its flexibility and capacity for execution, Banco Santander reached in just two months the core capital of 9% required by the EBA.

Our goal is to have a core capital ratio of 10%, one percentage point above the EBA's requirement and well above the demands of the new Basel III regulation and those applicable to systemically important financial institutions.

We maintained a comfortable liquidity position by increasing our deposit base without having to pay above market rates. Meanwhile, the maturity profile of our debt, concentrated in the medium and long term, enables us not to have to tap debt markets in Spain and Portugal. All of this, coupled with weak demand for loans in developed countries, produced an improvement in our liquidity situation. The loan-to-deposit ratio reached 117% at the end of 2011, compared to 135% in 2009.

The Group's model for international expansion, through subsidiaries that are autonomous in capital and liquidity and, in many cases, listed, gives us access to markets in an efficient and rapid way and facilitates the funding of acquisitions.

The financial autonomy of these units is very well viewed by the Group's regulator and by local regulators, as it acts as a firewall, limiting the risk of contagion from any problem among the Group's units.

We were the first international bank to present its living will to its regulator thanks to the transparency of our model of autonomous subsidiaries.

**3. Prudent risk management**
Banco Santander's traditional policy of prudence in risk management has enabled the Group to maintain a non-performing loan (NPL) ratio lower than the sector's average in all the countries in which we do business.

The performance of NPLs in Spain was worse than expected for two reasons: on the one hand, the downturn in the economy was more severe than envisaged and, on the other, the fall in lending meant the NPL ratio increased to a greater extent than the volume of non-performing loans.

Real estate risk in Spain continued to fall and, at the end of 2011, represented 4% of the Group's total lending, including foreclosed properties.

**4. Model of operational and commercial efficiency**
Banco Santander is the most efficient international bank among its competitors, with a cost-to-income (efficiency) ratio of 45%, compared to the average of 60% of our competitors.

The model of operational and commercial efficiency, with the same technology for the Group's banks, generates cost synergies and economies of scale, allows for the exchange of best business practices among countries and enables us to make significant investments in innovation, development and security for the benefit of our customers.

These four management drivers are strengthened by the strong, solid and attractive Santander brand. Santander is today the world's fourth most valuable financial brand according to Brand Finance.

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Moreover, in the current socio-economic environment, Santander remains firmly committed to sustainability, focusing on higher education, and also attaches importance to social activities and respect for the environment. The Santander Universities programme continues to grow and already has 990 agreements and has awarded 16,000 travel scholarships. Furthermore, in 2011 Banco Santander launched in Spain an ambitious youth employment plan, with 5,000 grants for internships in small- and medium-sized firms.

"Banco Santander met the EBA's new capital requirements six months ahead of the deadline"

"Net operating income of EUR 24,373 million underscored the Group's strength and capacity to generate results"

## Future prospects: Banco Santander's unique positioning

Some of the factors that have affected the financial sector in recent years are likely to persist in 2012. It is therefore essential that the European Union approves as soon as possible the decisions needed to quickly restore confidence.

In the medium- and long-term, it is likely that, led by European countries, economic growth rates will gradually return to normal, which will make the financial markets more stable and reduce unemployment.

In this scenario, Banco Santander is in a unique position to create value for its shareholders, continue to register strong growth in profits in emerging markets and profitably gain market shares in the most mature markets.

Banco Santander has no significant acquisition or disposal plans for the medium term, but it will be on the look out to take advantage of opportunities to strengthen itself in its core markets. In an environment of higher cost of capital, the strict criteria the Bank has always used for its acquisitions assume even greater importance: attain in the third year a return on investment greater than the cost of capital and a positive contribution to earnings per share.

All of this will enable us, as I said last September at the Bank's Investor Day in London, to boost Santander's ROE to 12%-14% in 2014 and ROTE (return on tangible equity) to 16%-18% from the current 10.81%.

The performance of the Santander share in 2011 was not in line with the Group's level of recurring profits, soundness and solvency or with the stability of earnings per share.

Our share is the most liquid in the Eurostoxx index and ended 2011 with a dividend yield of more than 10%. The share's low price was mainly due to external factors, such as the penalisation of the whole banking sector and pressure on the sovereign debt of various euro zone countries, which made it difficult to assess Banco Santander's profit expectations.

I am confident we will reach all our goals and this will push up the share price significantly. You can rest assured that everyone who works for the Group, from the board to the more than 190,000 people at the service of our 102 million customers, will do all they can to make Banco Santander a safe and profitable investment for its more than three million shareholders.

There were changes in the composition of the board during 2011. In May, Mr Luis Ángel Rojo died and his place was taken by the appointment of Mr Vittorio Corbo. Later, Mr Antoine Bernheim (representing Assicurazioni Generali) and Mr Francisco Luzón left the board. At the next shareholders' meeting, and if the board's proposal is approved, Mr Antonio Basagoiti, Mr Antonio Escámez and Mr Luis Alberto Salazar-Simpson will leave the board and Ms Esther Giménez-Salinas will become a director. On behalf of the board and on my own behalf I would like to thank the outgoing directors for their work. I am sure the contribution to the board of the two new members will be very positive.

Thank you for your support and confidence.

**Emilio Botín**
CHAIRMAN

# Letter from the Chief Executive Officer

Alfredo Sáenz

Alfredo Sáenz

"Banco Santander has given priority to strengthening the balance sheet over short-term results, placing emphasis on capital, liquidity and provisions for real estate assets in Spain"

Dear shareholders,

## Results and the Santander share

Grupo Santander generated an attributable profit, excluding extraordinary items, of EUR 7,021 million, 14.2% less than in 2010. Including provisions and capital gains, profit was 34.6% lower at EUR 5,351 million.

Earnings per share were EUR 0.60, 36.1% less than in 2010.

Both our net profit as well as our share price, which dropped 26% in 2011, are at cyclically low levels as they were affected by the worsening of the international environment due to the euro zone's sovereign debt crisis.

I would like to point out, nevertheless, the good performance of operating profit, which amounted to EUR 24,373 million: net interest income was up 5.5%; net fee income rose 7.6% and net operating income (before provisions) was 2.2% higher. Very few international banks have been able to generate growth in revenue and in net operating income. This reflects the good commercial performance of our businesses, and underlines our strong potential to generate future results.

I would like to transmit a clear message: the results we presented in 2011 do not represent our Group's potential pace of profit generation.

Over the next two or three years we will recover levels of profitability and growth that reflect the potential of our businesses. A vital first step in this process is to absorb, in 2011 and 2012, the impact of the regulatory and economic cycle. Once this has been done, we can return to the profit levels the Group was used to before the crisis.

## Balance sheet soundness

Banco Santander has given priority to strengthening the balance sheet over short-term results. In 2011, we put the emphasis on three corporate initiatives that enabled us to bolster the balance sheet:

1. **Capital:** We achieved the core capital ratio requirement of the European Banking Authority six months ahead of the deadline.

   The core capital ratio, with Basel II criteria, increased from 8.8% in 2010 to 10.0%.

2. **Liquidity:** During the last three years, we have carried out a significant strengthening of our liquidity position. Deleveraging in Spain and Portugal and the improvement in the savings rate enabled us to gradually reduce the gap between loans and deposits, adding liquidity that will finance debt maturities in the coming years.

3. **Provisions for real estate assets in Spain:** We increased coverage of repossessed properties to 50% and in 2012 we will complete the provisions required by Royal Decree-law 2/2012.

We made a significant effort to complete the three measures in the shortest time possible,while most of our competitors are still trying to absorb all these cyclical and regulatory effects.

It is very important for the financial sector to complete this process of balance sheet strengthening. For this to happen, moreover, two external conditions are vital:

- First, **financial stability:** Governments, regulators and central banks have to ensure a macroeconomic environment of financial stability so that banks can capture liquidity normally and in reasonable conditions.
- Second, **regulatory clarity:** Banks must have a clear idea of the capital and liquidity ratios required; how they are calculated; what types of balance sheets are sustainable and other types of costs to be assumed. Only in this way can they make medium- and long-term business plans and assure proper financing to the economy. At the moment, many of the regulatory changes are clearly pro-cyclical and have a negative effect on economic growth.

Only when these two conditions are met will the financial sector return to its role of financing the economy normally.

## Strengths as a Group

We must concentrate all our efforts on taking advantage of our business opportunities and ensuring we return to a level of profitability and growth that befits our business mix and the quality of the organization.

In order to achieve this normalization of profits, we are starting from a privileged position. We have strengths as a Group that set us apart from our international competitors:

1. The **diversification** of our business portfolio is clearly better than that of international banks.
2. We have a major **presence in growing markets.** We generate more than 50% of our profits in high-growth emerging markets.
3. We have **very strong local positions,** with market shares of more than 10%. Many of our competitors have banks without scale in many markets, and this prevents them attaining an acceptable level of profitability.
4. Our **business model is sustainable** in the new regulatory and liquidity environment. Other banks are having to step up the pace of reducing their wholesale balance sheet.
5. Our **solvency and credit quality** are clearly better than those of our local competitors.
6. Lastly, we generate a **high level of profit before provisions.** This gives us the capacity to absorb provisions when the economic cycle is weak and to generate profits and capital when the cycle improves.

## Results and management priorities by units

During 2011, many of our units had to absorb negative factors: a cyclically high level of provisions, in the case of Spain; regulatory effects, as in the UK; and, in other cases, a higher cost of wholesale liquidity and a worse-than-expected economic performance.

However, we are actively managing these factors and are very aware that, in the coming years, an excellent execution will be even more vital.

Banco Santander has the necessary foundations, both in mature and emerging markets, to return to its normal profit levels.

### A. Mature markets

The challenges facing banking units in mature markets are well known: low demand for loans; economies under pressure; low interest rate environments and higher cost of liquidity.

We believe, however, that the leading banks in these markets have a great opportunity to create value in the medium term: to recover attractive profitability; gain market share and become large generators of capital.

#### Spain and Portugal

In 2011, I told you that we were seeing a turning point in these units. However, during 2011 the sovereign debt crisis triggered a downturn in the Spanish and Portuguese economies, and further falls in interest rates, which delayed the process of returning to the average profitability of our businesses in these countries.

Both the results of the **Santander Branch Network and Banesto in Spain,** as well as those of **Portugal**, suffered a sharp setback. The aggregate profit of the three units dropped from EUR 1,722 million in 2010 to EUR 964 million in 2011.

However, our medium-term view has not changed: the crisis is offering the most solid banks opportunities to gain market share and improve their competitive position. We have a unique situation to gain an edge in the Spanish and Portuguese markets, and we are going to exploit it.

The management priorities for the next two years remain as follows: adapt prices to the new environment; maintain firm control on costs and gain profitable market share from competitors immersed in processes of integration and restructuring. Our objective in Spain and Portugal is to recover in the medium-term the level of profits we had in 2008.

### Rest of Continental Europe/Santander Consumer

Santander Consumer posted an attributable profit of EUR 1,228 million, 51.5% more than in 2010, largely due to a lower cost of the provisions made in the main markets where it operates. This result includes the contribution of Santander Consumer USA which, as of 2012, leaves the perimeter of Santander Consumer and will be included in the US.

Santander Consumer can continue over the coming years to take advantage of its position of strength in its markets, maintaining good management of prices and risk.

Moreover, we have a good opportunity to develop retail banking in Germany, on the basis of the business acquired from SEB. As you know, we have been investing in growth in Germany for many years and today we generate close to EUR 500 million of profits there. Our consumer business operations in the rest of Continental Europe are also delivering very good profitability.

### United Kingdom

The profit from our business in the **UK** was 41.7% lower at EUR 1,145 million. It was hit by the provision for payment protection insurance remediation (PPI) and by regulatory impacts on the cost of liquidity which exerted pressure on Santander UK's results.

The objective in the UK is to take the necessary measures to absorb the regulatory impact. This includes actively managing prices, the structure of the balance sheet and the cost base. Moreover, we continue to develop our business with companies, a segment where we still have a presence below that of our natural share.

For this, we have acquired the business from the Royal Bank of Scotland.

### United States

**Sovereign's** attributable profit increased 24.0% to EUR 526 million, largely due to the sharp fall in provisions.

After dedicating three years to strengthening the balance sheet and managing costs, our main challenge in the US for the next few years is to boost revenue generation and establish the technology and operational foundations needed to grow in the country. The generation of fee income is clearly below that of our regional competitors and we will have to work to gradually narrow this divide. Our technology systems enable us to increase the offer of transactional products and improve cross-selling to customers.

### b. Emerging markets

The growth opportunities in emerging markets are well known. However, not all banks that operate in these markets will be able to create value in the medium and long term: it is necessary to have a good local critical mass; a strong culture and business model and an appropiate appetite for risk, with a good understanding of credit. Santander meets all these requirements.

**Brazil's** attributable profit declined 7.2% to EUR 2,610 million. Despite the good growth in net operating income (+10.6%), profits were under pressure from higher provisions and writedowns.

Once the integration of Santander and Banco Real is concluded, the challenge is to narrow the profitability gap with our local competitors. This should give us a sustained 15% growth potential in profits in the coming years.

In **Mexico,** attributable profit was 40.9% higher at EUR 936 million. The management priority for the next few years is to consolidate the business improvement achieved in 2011 and continue to participate in the market's growth opportunities. In my view, our potential in Mexico is very high and we expect profit growth of more than 15% a year.

In **Chile,** attributable profit fell 9.0% to EUR 611 million due to an increase in provisions. We have a privileged position in this market in market share, customer base and quality of management. We have to be able to adapt our price and costs structure to absorb the new regulatory framework.

In **Argentina,** attributable profit declined 2.7% to EUR 287 million, but in local currency terms it was 8.0% higher. We expect our significant investment in installed capacity (34 new branches in 2011) to enable us to boost this unit's contribution to profit in the coming years.

In **Poland,** attributable profit from nine months consolidation with the Group was EUR 232 million, and for the whole year EUR 288 million.

Bank Zachodni WBK, our commercial bank in Poland, has a long way to go and is already well positioned to capture growth opportunities. Furthermore, we can add value in the cooperation between this local unit in Poland and the Group's global units.

The good results in 2011 enable us to reaffirm the goal of a profit contribution to the Group of more than EUR 450 million in 2013.

"Our business units must pay particular attention to successfully carrying out the measures put into effect to improve their profitability"

**The combination of cyclical normalisation and the measures taken by our units will enable us to return to normal profits in the coming years.**

In September, we held our Investor Day in London at which we presented our strategy to analysts and investors. The message of these sessions was clear, and I want to reiterate it in this letter: as a Group, our normalised profitability is clearly higher than current levels.

Our goals are:

- A return on equity of between 12% and 14% within three years.
- A return on tangible equity (excluding goodwill) of between 16% and 18%.

We believe that these objectives represent our normalised profitability, i.e. a return to the potential of our businesses, when they are not being dragged down by the current cycle. To attain these levels, we need three conditions:

First, **it is vital to complete the strengthening of the balance sheet** in capital, liquidity and provisions for real estate assets. We will finish this process during 2012.

Second, we see some **cyclical recovery, mainly in Europe**, which we expect to begin in 2013 and consolidate in 2014 and 2015. This means lower needs for specific provisions, reduced liquidity tensions and a rise in interest rates.

Lastly, **our business units must pay particular attention to successfully carrying out measures put into effect to improve their profitability,** adapt to the environment and take advantage of the opportunities that arise. We believe this will be the case as we are very aware that, in a complicated environment, execution is the key and we are not going to fail.

## Conclusions

I want to leave you with four clear messages:

1. The first is that **we have been able to generate excellent operating results,** and this is a good reflection of our business. However, we are very aware that the net profit in 2011 did not reflect at all the potential profitability of our businesses in the medium term.
2. The second is that **we are taking the necessary steps to normalise our profitability.** We do not base our future by trusting the economic recovery will make our profits grow. On the contrary, we are very conscious that it is up to us to define and execute the strategies enabling us to attain our goals.
3. The third message is that, in order to carry out this profit normalisation, **we have the best professionals in international commercial banking.** We have a high quality team which is very motivated and has shown in the past its capacity to assume ambitious goals and meet or even surpass them.
4. Fourth, the Santander share is currently at a level that does not reflect the structural profitability or our medium-term growth potential. As our capacity to normalise our profits becomes clear, this will be reflected in the share price.

I am very optimistic about the prospects for your investment in the coming years.

**Alfredo Sáenz**
CHIEF EXECUTIVE OFFICER

# Corporate governance

Grupo Santander City, Boadilla del Monte, Madrid, Spain

## Banco Santander's corporate governance model

***Equality of shareholders' rights.***

- The principle of ***one share, one vote, one dividend.***
- No anti-takeover measures in the corporate By-laws.
- Informed participation of shareholders in meetings.

***Maximum transparency, particularly in remuneration.***

***A corporate governance model recognised by socially responsible investment indices.***

- Santander has been in the FTSE4Good and DJSI indices since 2003 and 2000, respectively.

## The board of directors

Banco Santander's board of directors is the highest decision-making body, except for matters reserved for the general meeting of shareholders. It is responsible, among other things, for the Group's strategy. Its functioning and activities are regulated by the Bank's internal rules and principles of transparency, efficiency and defence of shareholders' interests guide it. The board oversees compliance with the best international practices in corporate governance and closely involves itself in the Group's risks. In particular, the board, at the proposal of senior management, is the body responsible for establishing and monitoring the Bank's risk appetite.

The board composition is balanced between executive and non-executive directors, all members are recognised for their professional capacity, integrity and independence.

There were changes to the board in 2011. Mr Luis Ángel Rojo Duque, governor of the Bank of Spain between 1992 and 2000, died on May 24. He joined the board in 2005. In July, Mr Vittorio Corbo Lioi, chairman of the Central Bank of Chile between 2003 and 2007, joined the board as a non-executive director and in October Assicurazioni Generali S.p.A., also a non-executive director, left the board after reducing its stake in the Bank.

On January 23, 2012, Mr Francisco Luzón López resigned as an executive director and executive vice-president responsible for the America division.

On the occasion of the next general shareholders' meeting, and if the board's proposal is accepted, Mr Antonio Basagoiti, Mr Antonio Escámez and Mr Luis Alberto Salazar-Simpson will cease to hold office as directors and Ms Esther Giménez-Salinas, rector of the Ramon Llull University, will be appointed as independent director to the board.

The board expressed its gratitude for the outstanding contribution made by the outgoing directors over the years they had formed part of it, highlighting the important executive responsibilities undertaken by several of them throughout their professional careers in the Bank.

With these changes, the size of the board is reduced from 20 directors at the beginning of 2011 to 16.

## The board in 2011

- Held 14 meetings, two of which were dedicated to the Group's global strategy.
- During 2011, the second vice-chairman and chief executive officer presented to the board eight management reports and the third vice-chairman, responsible for the risk division, presented reports on his area.

## Transparency and remuneration policy

Transparency for Banco Santander is vital for generating confidence and security among shareholders and investors, even more so at times of financial uncertainty and volatility such as today's.

In particular, the remuneration policy for directors and the Bank's senior management has transparency as the fundamental principle driven by the board for many years. The other two pillars are:

1. Involvement of the board, as, at the proposal of the appointments and remuneration committee, it approves the report on the remuneration policy for directors, as well as their remuneration and contracts and of those of the other senior members of management and the remunerations of the remaining managers of the identified staff.

   The board submits to the shareholders' meeting on a consultative basis and as a separate item on the agenda the report on the remuneration policy for directors.

2. Anticipation and adapting to regulatory changes, given the importance that Santander has always attached to rigorous management of risk and a remuneration policy consistent with it.

   Towers Watson, an independent expert, certified that Grupo Santander's remuneration policy was in accordance with the new regulatory framework.

### The board's remuneration in 2011

In 2011, the board agreed to reduce all directors' remuneration, for all items, by 8%.

The amount paid to its members for exercising their functions of supervision and collegiate decision-making has been reduced by 6% over 2010. This amount has been unchanged since 2008.

As regards executive directors, the board decided to maintain fixed remuneration for 2012 and reduce 2011 variable remuneration by an average of 16%.

Full details of director compensation policy in 2011 may be found in the report by the appointments & remuneration committee which forms part of Banco Santander's corporate documentation.

# Board of directors of Banco Santander

London, November 21, 2011

**General secretary and of the board**
Mr Ignacio Benjumea Cabeza de Vaca
● ■ ▲ ● ■ △

**Director**
Mr Ángel Jado Becerro de Bengoa

**Director**
Mr Luis Alberto Salazar-Simpson Bos
▲ △

**Director**
Mr Abel Matutes Juan
▲ ■

**Director**
Mr Antonio Basagoiti García-Tuñón
● ■ △

**First vice-chairman**
Mr Fernando de Asúa Álvarez
● ■ ▲ ● △

**Director**
Mr Juan Rodríguez Inciarte
■

**Director**
Ms Ana Patricia Botín-Sanz de Sautuola y O'Shea
● ■ △

**Director**
Mr Rodrigo Echenique Gordillo
● ▲ ● ■

**Fourth vice-chairman**
Mr Manuel Soto Serrano
▲ ● △

**Chairman**
Mr Emilio Botín-Sanz de Sautuola y García de los Ríos
● ■ △

- ● Executive committee
- ■ Risk committee
- ▲ Audit and compliance committee
- ● Appointments and remuneration committee
- ■ International committee
- △ Technology, productivity and quality committee

**Second vice-chairman and chief executive officer**
Mr Alfredo Sáenz Abad
● ■ △

**Director**
Mr Antonio Escámez Torres
● ■ ■ △

**Director**
Ms Isabel Tocino Biscarolasaga
●

**Director**
Lord Terence Burns

**Director**
Mr Vittorio Corbo Lioi

**Third vice-chairman**
Mr Matías Rodríguez Inciarte
● ■

**Director**
Mr Guillermo de la Dehesa Romero
● ● ■

**Director**
Mr Francisco Luzón López*
● ■

**Director**
Mr Javier Botín-Sanz de Sautuola y O'Shea

* Resigned his position on the board January 2012.

# The Santander share

General meeting of shareholders, June 17, 2011, Santander, Cantabria, Spain

- EUR **5,260** million assigned to shareholder remuneration.
- Market capitalization of EUR **50,290** million at the end of 2011.
- The **largest** bank in the euro zone by market value.
- EUR **0.60** remuneration per share in the last three years.
- **3.3** million shareholders.

## Shareholder remuneration

Banco Santander assigned EUR 5,260 million to shareholder remuneration in 2011, 5.2% more than in 2010. The high degree of recurrence of profits and the soundness of Santander's capital enabled the Bank to pay out more than EUR 24,000 million in the last five years.

As part of this remuneration, Santander has the Dividendo Elección programme (scrip dividend), which enables shareholders to opt to receive an amount equivalent to certain dividends in the form of cash or new Santander shares. The Bank offers flexible remuneration, enabling its shareholders to benefit from tax advantages. Some 80% of the Bank's capital chose to receive shares in 2011.

Banco Santander paid against 2011 results:

- A first interim dividend of EUR 0.135 per share (August 2011);
- A dividend of EUR 0.126 per share under the Santander Dividendo Elección programme equivalent to the second interim dividend (November 2011);
- A dividend of EUR 0.119 per share under the Santander Dividendo Elección programme equivalent to the third interim dividend (February 2012).

The board also approved applying the Santander Dividendo Elección programme, with a remuneration of EUR 0.220 per share, at the date when the final dividend is normally paid (April/May 2012). This would bring the total remuneration per share to EUR 0.60 for the third year running.

Investor Day, September 29 and 30, 2011, London, United Kingdom

**Comparative performance of the Santander share and indices**

*Data from December 31 2010 to December 31 2011*

**Distribution of the capital stock by type of shareholder**

*Number of shares and %*

*December 2011*

| | Shares | (%) |
|---|---|---|
| Board | 198,130,573 | 2.22 |
| Institutional | 4,687,628,721 | 52.62 |
| Retail | 4,023,283,909 | 45.16 |
| **Total** | **8,909,043,203** | **100.00** |

## Performance of the Santander share

The Santander share ended 2011 at EUR 5.87, 26% lower than a year earlier. This performance does not reflect the trend in earnings, the soundness of the Bank's balance sheet or its future prospects. Very volatile markets, as a result of the European sovereign debt crisis and doubts about the euro, penalized European stock market indices and, in particular, the financial sector. This situation was accentuated by doubts about the recovery in global economic growth and by the new regulatory requirements for banks.

Santander's performance, however, was better than that of the DJ Stoxx Banks (-32.5%), the main European banking index. Santander remains in a privileged position as the largest bank in the euro zone by market value and the 13th on the world, with a capitalization of EUR 50,290 million at the end of 2011. Furthermore, the Santander share is the most liquid in Eurostoxx.

## Shareholder base and capital

The number of Banco Santander shareholders continued to rise in 2011, by 91,213, to 3.3 million.

At the end of the year, 2.2% of the capital stock was in the hands of the board of directors, 45.2% with individual shareholders and rest with institutional investors. Of the total capital stock, 87.85% is located in Europe, 11.85% in the Americas and 0.30% in the rest of the world.

Banco Santander carried out four capital increases in 2011 to tend to the Santander Dividendo Elección programmes (February and November), the conversion of 3,458 bonds (October) and the exchange of preferred shares for ordinary shares (December). A total of 579,921,105 new shares were issued.

In 2011, Banco Santander continued to strengthen its information and attention channels for shareholders in Spain, the United Kingdom, the United States, Brazil, Argentina, Mexico, Portugal and Chile. These offices tended to 232,430 consultations by telephone and 51,616 e-mails. Also, 19,819 shareholders attended 206 forums and events held in various countries.

On September 29 and 30, 2011 an Investor Day was held in London, at which the chairman and the chief executive officer, together with Banco Santander's senior management, presented the Bank's strategy for the coming years to more than 300 analysts and investors.

# The Santander business model

- Banco Santander's business model provides substantial recurrence in results.
- Retail banking generates 87% of revenues. Santander has 102 million customers who are tended to via 14,756 branches, the largest network of any international bank.
- Geographic diversification in 10 core countries provides Santander with an appropriate balance between mature and emerging markets.
- The Bank's international expansion was achieved with subsidiaries autonomous in capital and liquidity, giving us advantages when financing and limiting the risk of contagion.
- The Group's technology and its control of costs make Santander one of the world's most efficient banks.
- Santander complied with the European Banking Authority's core capital requirement of 9% six months ahead of schedule.
- Santander did not need public funds at any time during the crisis and is one of the world's most solid and solvent banks.
- In an environment of tensions in financial markets, Santander's liquidity position has remained comfortable.
- Grupo Santander's non-performing loans ratio is below the sector's average in the main countries where it operates.
- Santander was recognized by Brand Finance as the fourth most valuable brand in the world.

Santander branch in Madrid, Spain

## Commercial focus

The customer is the focal point of Banco Santander's activity.

Grupo Santander's customer base has grown notably in the last few years and more than doubled between 2003 and 2011 (from 41 million to 102 million). The geographic distribution of customers was as follows: 40.8% in Latin America, 31.3% in continental Europe, 26.2% in the UK and 1.7% in the US.

The Bank's retail business focus sets it apart from other global competitors, underlined by the fact that 99.8% of the Group's customers are in the segments of commercial banking and consumer finance.

Branches help generate and maintain more lasting, greater value-added relationships with customers. Santander has 14,756 branches, the largest network of any international bank. In 2011, Grupo Santander increased its distribution capacity with the addition of 674 branches, mainly as a result of the incorporation of new businesses in Poland and Germany and programmes to open new branches in high growth countries such as Brazil, Mexico and Argentina.

In addition to this network, the Bank also has other channels, available around-the-clock, such as online banking, mobile telephone banking and telephone banking. In 2011, Santander stepped up its investment in its call centres in the UK in order to improve its customer service. It also launched applications that enable it to operate via iPhone and other mobile telephone means in some of the Group's banks.

### Group customers

*(Million)*

| | |
|---|---|
| Santander Branch Network | 9.6 |
| Banesto | 2.4 |
| Portugal | 2.0 |
| Bank Zachodni WBK | 2.4 |
| Santander Consumer Finance | 15.5 |
| Rest | 0.1 |
| **Total continental Europe** | **32.0** |
| **United Kingdom** | **26.7** |
| Brazil | 25.3 |
| Mexico | 9.3 |
| Chile | 3.5 |
| Argentina | 2.5 |
| Uruguay | 0.2 |
| Colombia | 0.3 |
| Puerto Rico | 0.5 |
| Peru | 0.1 |
| Rest | 0.1 |
| **Total Latin America** | **41.7** |
| **United States-Sovereign** | **1.7** |
| **Total customers** | **102.1** |

### Customers

*Million*

### Branches

*Number*

Santander branch in Germany

## Quality of service and customer satisfaction

Quality of service is a fundamental part of Banco Santander's strategy.

In 2011, customer satisfaction with the services provided by Banco Santander through various channels (branches, telephone and Internet) improved. Some 88.2% of customers said they were satisfied, generating greater linkage, proximity and loyalty, as well as higher customer revenues.

In order to improve the quality of service, the Group has a corporate model called META 100, which has been extended to more countries year after year. The main objectives of META 100 are to reflect the voice of customers and integrate it into the Bank's businesses; establish a culture of quality (i.e. an organisation that is closer to and focused on customers) and generate dynamics of continuous improvement, centred on customer satisfaction.

Banco Santander's professionals receive continuous training in order to inform and advise customers transparently and rigorously and provide the best service. In the last quarters of 2011, programmes to foster this culture were put into effect such as *El año del servicio* in Chile, *Nuestro estilo* in Argentina and *Impulsa tu lado Pro* in Banco Santander Spain. The corporate function of Brand Customer Experience was also created, which oversees the consistency and coherence between the promise of the brand and the customer's experience.

Santander has an advanced model for managing incidents called MIRÓ, which channels all the disagreements that the customer transmits to the Bank via various channels.

The objective of MIRÓ is to achieve a quick resolution of complaints. It channels internally its treatment to specialised units and keeps the customer informed of the state of the incident. MIRÓ also identifies the main reasons why customers are not satisfied and the causes of the incidents so that steps can be taken to correct them.

There was also a significant advance in 2011 in implementing the corporate model of complaints, which aims to unify the criteria applied in managing the customer attention services of the Group's various units.

This model revolves around three elements:

- Policies to improve customer attention, confidence and satisfaction.
- Decision-taking structure based on agile and efficient governance systems, with reports made to the first executive level.
- Management of complaints in accordance with the prevailing regulations as well as the good banking practices that regulators require in each country.

**Customer satisfaction**
*% of individual customers satisfied*

| | |
|---|---|
| Santander Branch Network | 88.0 |
| Banesto | 91.2 |
| Portugal | 92.9 |
| United Kingdom | 89.1 |
| Argentina | 91.8 |
| Brazil | 83.0 |
| Chile | 90.4 |
| Uruguay | 83.7 |
| Mexico | 95.6 |
| Puerto Rico | 96.6 |
| **Total** | **88.2** |

**Customer satisfaction by channel**
*% of individual customers satisfied*

Santander branch in Mexico

Santander branch in Brazil

## Products and services

Banco Santander has a wide range of financial products and services based on the risk profile of its customers and characterised, in all its markets, by anticipation and dynamism when launching new value offers. Of note among the products and services launched in 2011 were:

- In the UK, more than 100,000 123 Cashback credit cards, which return money to customers on the basis of the usage, were sold in the first two months after its launch.
- In Spain, Santander gave those customers with difficulties as a result of the crisis the possibility of a three-year moratorium on capital repayments of mortgages on their main home. Almost 6,000 customers have benefitted from the offer.
- In Brazil, agreements were signed with major companies, such as petrol distributor Shell and telecoms company Vivo (Telefónica), to launch credit cards with added advantages for the Bank's customers.
- In the US, the SMEs area of Sovereign launched the Boost Your Business programme, designed to attract new customers and increase the already existing linkage. This programme offers SMEs very attractive interest rates, new financial products and advice shared by specialists.

## Corporate school of commercial banking

In order to improve Grupo Santander's commercial banking skills, the corporate school of commercial banking was created in 2010.

This project is supported and involves Banco Santander's senior management: the governing board of the school is headed by Mr. Alfredo Sáenz, the chief executive officer, and comprises senior executives responsible for the main countries and divisions.

The school's mission is to gather the best commercial and business practices which make up the Group's commercial banking and promote their transmission in order to drive business development in the various units. The school also enables new countries that integrate into the Group to quickly and efficiently adapt to Banco Santander's commercial banking model.

The school is structured into knowledge areas that respond to the various fields and/or segments of commercial banking. Each area has someone in charge and consists of expert teams for each of the matters arising from the countries in which the Group operates. The school capitalises on the best commercial practices of countries, in terms of products, services, quality, business intelligence, etc, and thereby becomes an extra competitive tool for the Group.

The first phase of the school concentrated on individual customers. In 2011, it also began to work on company and SME banking, taking advantage of the experience acquired and incorporated the new countries to its sphere of action (the US, Poland and Germany).

Advertising campaigns in Brazil, the UK and Mexico

Grupo Santander City, Boadilla del Monte, Madrid, Spain

## Disciplined use of capital and financial strength

### Capital

Strengthening the balance sheet is a priority for Banco Santander, which has quickly and efficiently adapted to the new capital requirements of international and European banking authorities, such as Basel III, regarding globally systemic banks, and the new requirements of the European Banking Authority (EBA).

Banco Santander carried out various measures regarding capital in the last months of 2011, allowing it to achieve a core capital ratio of 9% six months ahead of the EBA's deadline of June 30, 2012.

According to the EBA, Banco Santander's additional capital needs amounted to EUR 15,302 million. This amount has been reached as follows:

- EUR 6,829 million of Valores Santander, which have to be converted into shares before October 2012.
- EUR 1,943 million through the exchange of preferred shares for ordinary new shares.
- EUR 1,660 million through the application of the Santander Dividendo Elección (scrip dividend) programme at the time of the final dividend for fiscal year 2011.
- EUR 4,890 million through organic capital generation and the transfer of certain stakes, mainly in Chile and Brazil.

Regarding the latter, Santander reached in December 2011 an agreement (implemented during the first week of 2012) to transfer 4.41% of Santander Brazil to a major international financial institution which will deliver such shares to holders of convertible bonds issued in October, 2010, by Banco Santander, when these mature, pursuant to the terms of said convertible bonds.

Santander is one of the world's most solid and well-capitalised banks, and at no time has had to seek public funds. As a result, it has one of the best ratings among international banks.

### Liquidity

Santander finances most of its loans with customer deposits, maintains comfortable access to wholesale funding and has many instruments and markets in which to obtain liquidity.

In 2011, Banco Santander continued to strengthen its liquidity with an increase of more than EUR 16,000 million in customer deposits, and debt issues that exceeded the year's maturities by more than EUR 8,000 million. All these issues were carried out without state guarantees.

### Active management of the business portfolio

Santander made some selective sales in 2011 and obtained EUR 1,513 million of capital gains:

- The strategic alliance with the insurer Zurich to develop business in Latin America which generated EUR 641 million of capital gains.
- The entry of new partners into the capital of Santander Consumer USA. This operation valued the unit at $4,000 million and produced EUR 872 million of capital gains.

Santander also reached an agreement to sell the Group's businesses in Colombia for $1,225 million (net gain of EUR 615 million to be recorded in 2012).

**Core capital**
*BIS II. criteria. %*

**Loan-to-deposit ratio(*)**
*%*

(*) Includes retail commercial paper in Spain.

Grupo Santander's new data-processing centre in Cantabria, Spain

## Prudent risk management

Prudent risk management has been a hallmark of Banco Santander since it was founded more than 150 years ago. Everyone is involved in risk management, from the daily transactions in branches, where business managers also have risk objectives, to senior management and the board, whose risk committee comprises five directors and meets for some 300 hours a year.

Of note among the corporate risk management principles is that the risk function is independent of business. The head of the Group's Risk Division, Matías Rodríguez Inciarte, third vice-chairman and chairman of the risk committee, reports directly to the executive committee and to the board.

### A low and predictable risk profile

The board sets the Bank's risk appetite at a medium-low level. Some 86% of Grupo Santander's risk comes from retail banking. Proximity to the customer enables us to act rigorously and with anticipation when granting, monitoring and recovering loans. Santander has units dedicated to recovering unpaid loans, which, under a corporate model, are integrated as a business area in the Group's various countries and divisions.

Santander has a highly diversified risk profile, with concentration of exposure to customers, business groups, sectors, products and countries subject to limits.

The Group has the most advanced risk management models, such as use of tools for calculating ratings and internal scoring, economic capital, price-setting systems via return on risk-adjusted capital (RoRAC), use of value at risk (VaR) in market risk, and stress testing.

### Risk quality

The Group's non-performing loan ratio increased to 3.89% in 2011, but remains below the average on all the countries where it operates. In Spain, the NPL ratio was 5.49%, also well below the sector's average.

After approval of Royal Decree Law 2/2012, which sets new requirements for cleaning up bad property loans in Spain, the Bank announced that the amount of provisions Grupo Santander in Spain needs to meet these requirements is EUR 6,100 million.

These additional needs will be entirely met in 2012 as follows:

- EUR 1,800 million already charged against the Group's fourth quarter 2011 results, which lifted coverage of repossessed properties to 50% from 31%.
- EUR 2,000 million are a capital buffer required by the rules and which are covered by capital already held by the Group.
- The remaining EUR 2,300 million will be covered through capital gains which may be obtained during the year – including EUR 900 million from the capital gain on the sale of Banco Santander Colombia – and through ordinary contributions to provisions during 2012.

Santander's exposure to real estate developers represented 14% of its total lending in Spain at the end of 2011 and only 4% of the Group's total loans, including repossessed homes. Santander's market share of this business is estimated at 10%, well below that of the Group's total business in Spain (14%).

Moreover, Santander assigned EUR 1,513 million of capital gains obtained in 2011 to strengthening the balance sheet.

***

Banco Santander's risk management principles are treated in more detail on pages 148 to 151 of this annual report.

**Non-performing loan ratio**
%

**Coverage ratio**
%

# Geographic diversification

Grupo Santander has a geographic diversification balanced between mature and emerging markets (46% and 54% of profits, respectively, in 2011).

The Bank focuses on 10 core markets: Spain, Germany, Poland, Portugal, the UK, Brazil, Mexico, Chile, Argentina and the US. The global areas also develop products that are distributed in the Group's commercial networks and tend to global clients.

Main countries.

Other countries where Banco Santander has retail banking businesses: Peru, Puerto Rico, Uruguay, Colombia, Norway, Sweden, Finland, Denmark, Netherlands, Belgium, Austria, Switzerland and Italy.

Santander branch in Sao Paulo, Brazil

## Subsidiaries model

Grupo Santander's international expansion was carried out via subsidiaries that are independent and autonomous in capital and liquidity:

- **Capital:** the local units have the capital required to develop their activity autonomously and meet regulatory requirements.
- **Liquidity:** each subsidiary develops their financial plans, liquidity projections and calculates their finance needs, without counting on funds or guarantees from the parent bank. The Group's liquidity position is coordinated by the ALCO committees (assets and liabilities).

The model of subsidiaries autonomous in capital and liquidity, with some of them listed, such as Santander Brazil, Santander Chile and Banesto, has strategic and regulatory advantages:

- The autonomy of the subsidiaries limits the possibilities of contagion between the various Group units during a crisis, thereby reducing systemic risk.
- The subsidiaries are subject to double supervision (local and global) and internal control.
- This model facilitates crisis management and resolution while generating incentives for good local management.
- The listed subsidiaries allow access to capital efficiently and quickly, always choosing the best alternative for shareholders, and are subject to market discipline.
- The shares of the subsidiaries are an attractive currency for acquisitions in the local market and an alternative to investing the Group's capital.
- They give visibility to various business units in the Group's valuation.
- They guarantee a high level of transparency and corporate governance and reinforce the brand in various countries.

Banco Santander combines the financial flexibility of its subsidiaries with their operations as an integrated group that creates high synergies. The corporate systems and policies that Banco Santander implements in all the Group's units enable the following:

- Synergies in costs and revenues, by developing with global strategies the Santander retail banking model and sharing the best practices among countries and units.
- A stronger Santander culture, with particular importance attached to managing risks at the global level and controlling the business units.
- Greater efficiency in investment by sharing systems globally.

All of this enables the Group to obtain better results than each local bank would have achieved on its own.

Santander branch in Madrid, Spain

Santander branch in London, United Kingdom

## The Santander brand

The Santander brand transmits the Bank's corporate values to customers, shareholders, employees and society in general. These values are: dynamism, strength, innovation, leadership, commercial focus and quality service, professional ethics and sustainability.

Santander has a significant presence in the brand rankings of the main consultancy firms, such as Interbrand, Millward Brown and Brand Finance. In 2011, the brand continued to consolidate itself in the Group's key markets, boosting its recognition in Brazil, the UK and Germany. In the US and Poland, the transition toward the Santander brand continued to make progress. Meanwhile, Santander continues to unify its identity in global segments, such as Select for personal banking, in order to align the positioning in these markets with the Group's values.

Banco Santander has an international advertising strategy, which helps to strengthen and consolidate the Bank's international positioning and business. In 2011, when banking was particularly hard hit, the Bank's corporate message was focused on solvency and the geographically diversified business model, without overlooking our positioning of proximity, confidence and commitment to the customer.

Corporate sponsorships have proved to be a key platform for increasing Santander's brand awareness, consolidate the Bank's international positioning and support business.

- In 2011, Santander sponsored for the second year running the Formula 1 Ferrari team, an excellent business tool, as underlined by more than 370,000 Santander-Ferrari credit cards sold throughout the world. Santander continues to sponsor the McLaren team, the main advertising tool in the UK.
- In Latin America, Santander continued to work to be the football bank, sponsoring the Santander Libertadores Cup, the 2011 America's Cup in Argentina, the South American Cup and the agreement in Brazil with the football player Neymar.

In 2012, and via the strategic committee of corporate marketing and brand, chaired by the CEO, the Bank will continue to foster brand unification in all countries, bolstering its global positioning, maximizing corporate sponsorships and working to create a good brand experience for all customers.

## Efficiency

Santander has a leading-edge IT and operations platform, enhancing its productivity and enabling to know and have a full overview of customers' financial needs. The Bank is also making a continuous effort to improve its processes, customer service and its business support areas in order to provide the best service.

Santander continues to advance in implementing its corporate technology platforms in all its business units, which is creating value through revenue synergies and cost savings. In 2011, integration of Santander's IT platforms and those of Real in Brazil were consolidated. The branches acquired from the Swedish group SEB in Germany, and Bank Zachodni WBK in Poland, were integrated into the Group.

A new data-processing centre began to operate in 2011 in Cantabria, Spain, which joins the Group's network of such centres that provide service from Madrid-Boadilla del Monte (Spain), London (UK), Querétaro (Mexico) and Sao Paulo (Brazil). The new centre boost the capacity for processing the Group's operations, guarantees business growth in the future and reduces operational risk with customers to a minimum.

The Bank's recurring growth in revenues, the culture of controlling costs and the high degree of productivity of branches makes Santander one of the world's most efficient banks, with a cost-to-income ratio of 44.9%.

The continuous improvements in efficiency are leading to greater value-added for customers. The Bank, in some of its core markets, decided to eliminate commissions for its linked customers: in Spain, with the *We want to be your Bank* plan in the Santander Branch Network and in the UK wih the *Santander Zero Current Account*.

# Santander's businesses in 2011

## Grupo Santander results

Santander posted an attributable profit of EUR 5,351 million in 2011, 34.6% less than in 2010, after setting aside EUR 3,183 million for provisions.

- Of note was the EUR 1,812 million gross provision for real estate assets in Spain.
- The recurring profit was EUR 7,021 million (-14.2%).
- Profit before provisions was EUR 24,373 million, one of the largest among international banks.
- Santander reached the core capital ratio of 9% set by the EBA six months ahead of the deadline.
- The loan-to-deposit ratio was 117%, 18 p.p. lower than in 2009.
- The Bank aims to increase its ROE to 12-14% in 2014 and its ROTE to 16-18%.

Grupo Santander conducted its business in 2011 against a backdrop of slower growth in the global economy, continuous tensions in the European sovereign debt markets and in the world's main stock markets and increasing regulatory pressure.

Geographic diversification, with the growing importance of emerging countries, Banco Santander's retail banking model and the incorporation of new businesses, boosted gross income to EUR 44,262 million, a new record.

Operating expenses grew 9.3%, as a result of the integration of new businesses and investment in technology. However, the record diverges among countries: Spain and Portugal, where they are falling; mature countries where the Group is strengthening its franchise (Germany, the UK and the US); and emerging markets, where the Group continues to invest in increasing its business capabilities. The cost-to-income (efficiency) ratio was 44.9%, making Santander one of the world's most efficient international banks.

Profit before provisions was EUR 24,373 million, underscoring Grupo Santander's capacity to generate results. Banco Santander's attributable profit in 2011 was EUR 5,351 million. It would have been EUR 7,021 million (-14,2%) but for the EUR 1,812 million gross provision in the fourth quarter for real estate assets in Spain (which raised coverage of repossessed properties from 31% to 50%), as well as amortisation of EUR 601 million gross of goodwill of Santander Totta in Portugal. The Bank also assigned EUR 1,513 million net of capital gains to other provisions.

Santander branch in London, United Kingdom

**Commercial activity and balance sheet strength**
From the business standpoint, the main strategy is still to capture and link more and better customers and offer them good service, and improve the structure of funding loans with more stable deposits (+3% in 2011). The growth in lending (+3%) varied between mature countries, where demand by households and companies was weak, and emerging countries, where the increase was notable.

This evolution of loans and deposits enabled the Group to improve its liquidity position. The loan-to-deposit ratio was 117%, 18 p.p. lower than in 2009. Moreover, the Group maintained during 2011 its capacity of recourse to the markets for funding, underlined by the fact that the year's total issues exceeded maturities by EUR 8,000 million.

Grupo Santander's core capital ratio at the start of 2012 was 9% (according to the EBA's criteria). The 9% ratio, required by the European Banking Authority for Europe's main banks, was reached six months ahead of the June 30, 2012 deadline.

**Medium- and long-term objectives**

In September 2011, Grupo Santander held a meeting in London for more than 300 investors and analysts. Senior management explained in detail at this Investor Day the Group's strategy and objectives for the medium- and long-term, as well as for the various business units.

Under a scenario for 2012 of continued weak growth in the global economy and assuming as of 2013 a normalization of the economic environment, Santander expects to lift its return on equity (ROE) from 7.1% (9.4% taking into account the recurring profit) to 12%-14% in 2014 and its return on tangible equity from 10.8% (14.2% bearing in mind the recurring profit) to 16%-18%, through:

- A gradual normalization of profits in mature markets, including lower needs for provisions.
- Organic growth in emerging markets.
- Better optimization of costs and revenues.

# Continental Europe

Continental Europe's attributable profit was 15.1% lower at EUR 2,849 million.

Santander has a large network of branches in Continental Europe (6,608), which tend to 32 million customers. It carries out retail banking business in Spain, Portugal, Germany and Poland, and consumer finance in 13 countries. The Group also has wholesale banking, asset management and insurance businesses.

- The commercial strategy is centred on capturing funds in an environment of weak demand for loans. Basic revenues (net interest income, fee income and insurance) grew 8.4%.
- In Spain, the change of trend in revenues was consolidated.
- In Portugal, Santander Totta is the most solvent bank and has the country's best rating.
- In Poland, Bank Zachodni WBK, with 526 branches and 2.4 million customers, was incorporated to the Group.
- Santander Consumer Finance notched up record revenues and profits.
- Santander was named by the prestigious magazine The Banker the best bank in Western Europe, Spain and Portugal in 2011.

## Spain-Santander Branch Network

**In 2011, the Santander Branch Network contributed EUR 660 million to the Group's profits, 22.1% less than in 2010.**

The environment in which business was conducted in Spain was characterized by weak GDP growth, higher unemployment, restructuring in the financial sector and tough competition for deposits. In this scenario, the network's priorities were to actively manage customer spreads, strengthen the balance sheet through capturing deposits, credit risk quality, austerity in costs and capturing, linking and retaining customers.

Gross income grew 2.4%, consolidating the change seen at the end of 2010. Operating expenses were 1.2% lower and the number of branches remained virtually the same. The efficiency ratio improved to 46.5%.

The worsening of the economic environment continued to exert upward pressure on the Group's non-performing loan ratio in Spain (to 5.49%), although it was still below the sector's average. Exposure to the real estate sector continued to decline and at the end of 2011 represented only 4% of the Group's total lending, including repossessed properties.

### Commercial and customer strategy

The Santander Branch Network serves 9.6 million customers, of which almost 8.2 million are individuals, mainly salaried workers, the young and pensioners, more than 260,000 are private and personal banking customers and 1.1 million are companies, SMEs, businesses and institutions.

**Attributable profit**
*Million euros*

- 22.1% 2011/2010

**Net operating income**
*Million euros*

+ 5.7% 2011/2010

Santander branch in Madrid, Spain

Banesto branch in Madrid, Spain

Since 2006, *Queremos ser tu Banco* (We want to be your Bank) has been the strategic plan for capturing new customers and establishing stable and lasting relations with them. The 3.8 million customers in this plan benefit from not having to pay service commissions, which makes them more satisfied and increases the linkage and, thus, more profitable for the Bank. Santander also has a commercial intelligence, backed by its vanguard technology and with an innovative multichannel strategy in products and services.

In 2011, 227,000 loans were granted for a total of EUR 25,000 million. Yet again Santander was the sector's leader in intermediating the ICO finance lines (market share of around 20%).

Santander has been very active in capturing customer funds, reducing at the same time the cost of deposits by taking advantage of its position as a solvent and solid bank. In the last two years, Santander has increased its market share of deposits by more than a percentage point.

In order to support customers with temporary problems due to the economic crisis in Spain, the Santander Branch Network offered, as of August 1, a three-year moratorium on repaying the capital of mortgages for the main residence. At the end of 2011, close to 6,000 customers benefited from this offer for a total of almost EUR 1,000 million.

### Medium- and long-term objectives

- Sustained growth in revenues and improvement in the efficiency ratio to 39%-41%.
- Boost deposits by 5%.
- Consolidate the customer base and increase transactional linkage.
- Strengthen leadership in high-income segments and foster multichannel business.

## Spain-Banesto

**Banesto contributed attributable profit of EUR 130 million to the Group, 68.9% less than in 2010.**

This bank focuses on individual customers, SMEs and companies, which, overall, provide 90% of its revenues.

Despite the complex domestic environment in 2011, Banesto improved its competitive position in terms of profitability, efficiency and quality of risk and increased its customer base and linkage, as well as enhancing the quality of service in its branch network:

- 193,000 new customers were captured and 72,000 companies, SMEs, commerce and the self-employed. More than 50% of customers have their paycheque paid into their account.
- The efficiency ratio was 47.4%.
- Real estate risk was reduced, and only represents 6.1% of total lending.
- The non-performing loan ratio was 5.01%, one of the sector's lowest.

### Medium- and long-term objectives

Banesto will continue to strengthen its competitive position in order to:

- Achieve an efficiency ratio below 40% in 2013, with revenue growth supported by management of prices and strict control of costs.
- Improve the loan-to-deposit ratio.
- Maintain risk quality above the sector's average.

## Portugal

**Santander Totta contributed attributable profit of EUR 174 million, 61.8% less than in 2010.**

The Bank's gross income declined 18.3% due to the reduction in net interest income, caused by the increase in funding costs from greater competition in capturing deposits, and the drop in business. Operating expenses fell 2.1%. Santander Totta's non-performing loan ratio (4.06%) was below the sector's average. Provisions rose 87.7%, due to prudent management in an unfavourable environment.

Following Portugal's financial rescue, the authorities asked Portuguese banks to implement various adjustment measures to reduce their leverage, increase their capital and reduce recourse to the European Central Bank (ECB). Santander Totta is progressing in this process:

- The focus on capturing deposits (+8% to EUR 23,465 million), coupled with the fall in lending (-6% to EUR 28,403 million) is reducing the commercial gap.
- Santander Totta increased its core capital ratio to 11.2% and remained the most solvent bank in the country and with the best rating.
- The level of exposure to the ECB was also reduced (to 3.8% of assets at the end of 2011).

The magazines The Banker, Euromoney and Global Finance chose Santander Totta as the best bank in Portugal.

### Medium- and long-term objectives

- Improve the revenue structure with greater recurrence.
- Reach an efficiency ratio of below 50% in 2013.
- Continue to reduce the commercial gap in line with the Bank of Portugal's requirement (43% of this amount already attained).

## Poland

**Bank Zachodni WBK posted an attributable profit of EUR 232 million in the last three quarters of 2011.**

Santander conducts its retail banking business in Poland through Bank Zachodni WBK, which has the country's third largest distribution network (622 branches, including 96 agencies), 2.4 million customers and more than EUR 20,000 million of loans and deposits. Grupo Santander also carries out consumer finance business through Santander Consumer Bank Poland.

Bank Zachodni WBK has been part of Grupo Santander since April 1, 2011, consolidating the results and business corresponding to the last three quarters of the year. In an environment of strong economic growth and banking business, at rates of close to 10%, its profits grew at an annual rate 22%, thanks to robust revenues.

Bank Zachodni WBK's net lending to customers amounted to EUR 8,479 million and deposits to EUR 10,359 million. Loans and deposits rose 14% in the first nine months under Santander management, due to growth with companies as well as individuals. The efficiency ratio was 47.0% and the non-performing loan ratio 4.89%.

Bank Zachodni WBK's business model fits perfectly into Grupo Santander's commercial banking model: focus on retail customer and company, supplemented by a notable presence in asset management business and brokerage of securities and leasing. This bank offers a significant potential in results in the coming years, both through business as well as from the synergies from its integration into the Group's IT platform.

### Medium- and long-term objectives

- Double-digit growth in gross income.
- Efficiency ratio of between 41% and 43%.
- Gain market share.
- Consolidation as one of Poland's three main banks in terms of profits, efficiency, solvency and customer service.

Santander Totta branch in Lisbon, Portugal

Bank Zachodni WBK branch in Poland

## Santander Consumer Finance

**Santander Consumer Finance generated a record attributable profit of EUR 1,228 million, 51.5% more than in 2010.**

Santander carries out its consumer finance business in 13 European countries, notably Germany, and also in the US. The business model is based on offering financial solutions through more than 135,000 distributors (auto concessionaires and shops). Once a relation is started with a customer, direct commercial actions are taken to link them and make them loyal. With a business centred on auto finance, Santander Consumer Finance has signed 37 agreements with nine car producers in the last three years. SCF also has other products such as personal loans, credit for buying consumer durables and credit cards.

### Results and activity in 2011

In a globally unfavourable economic environment, gross lending stood at EUR 62,959 million, 16%(*) more than in 2010, thanks to organic growth and the incorporation in Germany. Deposits rose 28% to EUR 33,198 million (Germany accounted for 94%). Gross income increased 14.0% (+13.6% net interest income and +18.0% net fee income).

Santander Consumer Finance has the best efficiency ratio (31.8%) and return on assets compared to its main competitors. The non-performing loan ratio continued to decline to 3.77%.

(*) Isolating Santander Consumer USA which consolidated by the equity accounted method in December 2011.

### Germany, the United States and other countries

Santander has 303 branches in Germany, EUR 30,403 million of loans, EUR 31,174 million of deposits and more than 7 million customers. Santander is the market leader in consumer finance and the second in auto finance in Germany. Since January 2011, it has a retail banking unit. Its profit increased 10.0% in 2011, with significant growth in loans and an improvement in credit risk.

Santander Consumer USA's profit surged 99.2% in dollars to EUR 484 million, spurred by the increase in managed credit volumes, the rise in revenues from managing third party portfolios and a lower cost of credit. The entry of new partners into the capital was announced in September, which valued the unit at $4,000 million.

The rest of countries also produced positive results, particularly:

- Nordic countries (+14.5% in profits in local currency).
- UK (+38.1% in sterling)
- Spain, with a positive result in a very weak market.
- Santander Consumer Bank Poland almost doubled its profits.

### Medium- and long-term objectives

- Maintain high profitability.
- Consolidate the Top 3 position in key markets.
- Strengthen leadership in the reference financial entity model for car producers.
- Maintain leadership in efficiency and reinforce specialization in payments and recoveries.

**Lending by countries**
%

**Lending by segments**
%

| Continental Europe | Santander Branch Network | Banesto | Portugal | B. Zachodni WBK | Santander Consumer Finance | Rest | Total |
|---|---|---|---|---|---|---|---|
| Customers (million) | 9.6 | 2.4 | 2.0 | 2.4 | 15.5 | 0.1 | **32.0** |
| Branches (number) | 2,915 | 1,714 | 716 | 526 | 647 | 90 | **6,608** |
| Employees (number) | 18,704 | 9,548 | 6,091 | 9,383 | 15,610 | 4,530 | **63,866** |
| Customer loans on the balance sheet(*) | 102,643 | 68,850 | 28,403 | 8,479 | 60,276 | 46,429 | **315,081** |
| Managed customer funds(*) | 107,469 | 82,444 | 31,188 | 12,383 | 39,008 | 61,571 | **334,064** |
| Net operating income(*) | 2,353 | 1,112 | 443 | 366 | 3,604 | 857 | **8,735** |
| Attributable profit(*) | 660 | 130 | 174 | 232 | 1,228 | 424 | **2,849** |
| Efficiency (%) | 46.5 | 47.4 | 54.4 | 47.0 | 31.8 | 54.6 | **43.1** |

(*) Million euros

# United Kingdom

Santander UK's attributable profit was EUR 1,145 million.

The Bank has 1,379 branches, which tend to 27 million customers, and is the third largest bank in the UK by retail deposits and mortgages.

- The Bank has a comfortable position in liquidity and high levels of capitalization.
- It granted one out of every six mortgages in the UK and increased its market share in lending to SMEs by a full percentage point.
- It is committed to quality of service: it repatriated its call centres to the UK and created 1,100 jobs to improve customer attention.
- Santander UK was recognized by The Banker magazine as the best bank in the UK for the third year running.
- Its goal is to become the most efficient and profitable bank in the UK in 2014.

**Results**

Santander UK carried out is activity in 2011 in an environment of low economic growth, interest rates at minimums and substantial regulatory uncertainty.

Profit was EUR 1,145 million, after setting aside a £538 million fund for possible payment protection insurance remediation (PPI). This measure was also taken by the other main UK banks, although in the case of Santander UK the amount was relatively less than that announced by its competitors.

Gross income was EUR 5,678 million, pressured by market circumstances such as new regulations for liquidity and the increased cost of funding, as well as low interest rates.

Net operating income after provisions was EUR 2,538 million, 8.4% less than in 2010 in local currency.

Loan-loss provisions were 36.3% lower than in 2010. The non-performing loan ratio (1.86%) was better than expected in the current economic environment and all products for individuals, particularly mortgages and personal loans, improved.

Santander UK has a comfortable liquidity position and high levels of capitalisation. The loan-to-deposit ratio was 130% at the end of 2011.

| United Kingdom | |
|---|---|
| Customers (million) | 26.7 |
| Branches (number) | 1,379 |
| Employees (number) | 26,295 |
| Customer loans(*) | 252,154 |
| Managed customer funds(*) | 288,826 |
| Net operating income(*) | 3,123 |
| Attributable profit(*) | 1,145 |
| Efficiency (%) | 45.0 |

(*) Million euros

Santander branch in London, United Kingdom

## Commercial activity

Despite the difficult environment, Santander UK continued to support households and companies. The Bank granted one out of every six mortgages in 2011, which represented a market share in new lending higher than Santander UK's total mortgage share (14%). The customer spread improved, while these new loans had a very conservative loan-to-value of only 65%.

New loans to SMEs grew 25% to more than £2,000 million and surpassed the targets set by the UK government. The market share in this segment rose by almost one percentage point to 4.3%. At the end of the year, Santander UK launched Breakthrough, a new initiative for further promoting loans to SMEs and which makes available to this type of customer a programme of full support, with training, tutorials, international experience and practices.

During 2011 836,000 current accounts were opened as a result of the focus on capturing and linking new and existing customers. Within this strategy, more than 100,000 *123 Cashback* credit cards, which return money to customers on the basis of usage, were sold in the first two months after the launch.

In July 2011, Santander UK repatriated its call centres to the UK from India. As a result, 1,100 jobs were created and the building of a new corporate centre in Leicester was announced, all of it in order to enhance customer service.

## Strategy

Santander UK's strategy is aimed at transforming the bank into a more diversified financial franchise, capable of providing all kinds of services and focused on the customer, via:

- Boosting customer linkage, moving from a model centred on products to one focused on the customer.
- Strengthen business with companies. The integration of the 318 branches acquired from Royal Bank of Scotland will raise by five percentage points the market share of company business.
- Maintain high operational efficiency and improve the quality of service. Santander UK will invest £490 million in its IT platform.

### Medium- and long-term objectives

Santander UK wants to be the most efficient and profitable bank in the UK in 2014 with:

- An efficiency ratio of below 44%.
- Revenue growth of between 15% and 20% a year in company banking.
- The system's lowest non-performing loan ratio.

**Attributable profit**
*Million euros*

- 41.7%(*) 2011/2010

(1) Affected by the provision in the second quarter of 2011 for possible payment protection insurance remediation (PPI).

(*) Excluding the exchange-rate impact: -41.0%

**Net operating income**
*Million euros*

- 16.4%(*) 2011/2010

(*) Excluding the exchange-rate impact: -15.4%

# Latin America

Latin America contributed 51% of the Group's profits and is one of Santander's main growth commitments. The Group has leadership positions in the most dynamic and solid economies such as Brazil, Mexico, Chile and Argentina, through 6,046 branches, which serve 42 million customers.

- Latin America's profit of EUR 4,664 million was 0.1% higher than in 2010 in constant currency.
- The Group's lending continued to grow (+18%).
- Santander Brazil posted an attributable profit of EUR 2,610 million.
- Santander Mexico increased its profit 45.6% in pesos, spurred by strong lending and deposits.
- The magazine The Banker recognized Santander Chile as the bank of the year and the safest one in Latin America by Global Finance.
- Argentina's attributable profit was 8.0% higher in local currency (+24.7% in gross income).

## Brazil

**The attributable profit of EUR 2,610 million accounted for 28% of the global total. Brazil is a strategic market for the Group.**

**Santander Brazil is the country's third largest private sector bank in terms of assets, with 3,775 branches and points of attention, 18,419 ATMs and 25.3 million customers. In 2011, technology integration and brand unification was completed with Banco Real.**

The Brazilian economy, the world's sixth largest, continued to provide a favourable environment for the Group's business. GDP grew around 3% and growth of 3-4% is expected to be maintained in the next few years.

The country has big investment and infrastructure plans, partly due to holding the 2014 World Football Cup and the 2016 Olympic Games.

In this scenario, the financial sector grew strongly (+18% in loans) and is expected to continue to do so on a sustained basis in the coming years, thanks to the rise in the size of the middle class and in the country's "bankarisation" levels.

Santander branch in Brazil

Santander branch in Brazil

## Activity and results

Santander Brazil's attributable profit of EUR 2,610 million was 7.3% lower in local currency. Gross income rose 11.2% and operating expenses 12.3%, due to investments in the new IT platform and the opening of 154 branches in 2011, coupled with inflationary pressure and wage agreements. Net operating income increased 10.6%. Provisions were 21.4% higher due to the moderate rise in the non-performing loan ratio (5.38%).

Lending grew 20%, spurred by the 23% rise to individual customers and the 26% growth to SMEs and companies.

Bank savings, including financial letters, increased 8% (+30% time deposits). Santander Brazil has a 10.5% market share in loans (11.7% for unrestricted credit) and 7.9% in deposits.

**Attributable profit**
*Million euros*

-7.2%(*) 2011/2010

(*) Excluding exchange-rate impact:-7.3%

**Net operating income**
*Million euros*

+10.6%(*) 2011/2010

(*)Excluding exchange-rate impact: +10.5%

## Strategy

Technology integration and brand unification with Banco Real was completed successfully in 2011 and now, with an optimum commercial banking platform and a wider range of products and services, Santander Brazil is best placed to carry out its business.

The Bank's structure in Brazil is difficult for its international competitors to replicate as it has latest generation technology, distribution networks with sufficient capacity to guarantee attention throughout the country and a good brand positioning.

Its strategy is based on the following pillars:

- Be the best bank in quality of service, backed by the strength of its IT platform.
- Intensify relations with customers with the opening of 100 to 120 branches a year between 2011 and 2013.
- Strengthen businesses in the key segments such as SMEs, acquiring business (point-of-sale terminals in shops), cards (association agreements were signed with Shell and other companies, and the offer to non-customers was stepped up), real estate and consumer loans, particularly auto finance.
- Continue to construct and strengthen the Santander brand.
- Maintain strong growth combined with prudent risk management.

### Medium- and long-term objectives

Santander Brazil aims to become the best universal bank in the country, the most efficient in generating shareholder value and the best in customer and employee satisfaction. In 2012-2013 Santander expects:

- 15% growth in profits.
- 15%-17% rise in lending.

Santander Select branch in Mexico

Santander branch in Chile

## Mexico

**Santander Mexico's attributable profit increased 45.6% in local currency to EUR 936 million and contributed 10% of total profits.**

Santander is the third largest bank in the country with more than 9 million customers, 1,125 branches and a market share of 15.2% in banking business.

Gross income rose 4.5% (+7.5% in net interest income), in line with the recovery in commercial business. Operating expenses rose 11.6% due to the increase in installed capacity, while provisions declined 25.7% in line with the improvement in the Bank's risk premium.

Lending increased 31%, partly driven by acquiring the mortgage business of GE Capital Corporation (+22% on a like-for-like basis). Bank savings grew 8%.

Santander Mexico took advantage of the favourable economic situation to strengthen customer linkage and deepen it in high value segments (high income customers and SMEs), while remaining prudent in risks and efficient in management of costs.

The magazine Global Finance recognized Santander Mexico as the safest bank.

### Medium- and long-term objectives

- Continue to implement the strategic plan to become a universal bank (commercial and investment).
- Maintain double-digit profit growth.
- Achieve strong growth in business with SMEs, companies, real estate loans, consumer credit and insurance.
- Double-digit growth in net operating income with good efficiency ratios.

## Chile

**Santander Chile posted an attributable profit of EUR 611 million, 9.3% less in pesos and 7% of the Group's total.**

With 499 branches and 3.5 million customers, Santander is Chile's main bank in terms of assets and profits. It has a market share of 19.7% in loans and 17.3% in savings.

Gross income rose 1.9% in local currency, with fee income up 2.4%. Operating expenses were 10.1% higher and loan-loss provisions 17.3%.

Lending increased 7% and bank savings 11% (+29% in time deposits).

Santander Chile's strategy is aimed at boosting the profitability of various businesses, particularly through loans to and savings from individuals and SMEs, with the emphasis on deposits to reinforce the liquidity position. The improvement in the quality of service remains a priority for increasing linkage and transactions.

In December 2011, Grupo Santander sold 7.82% of Banco Santander Chile as part of its plans to increase the Group's core capital ratio. The $950 million operation was one of the largest so far in the local market. Santander now owns 67% of the bank.

The magazine *The Banker* recognized Santander Chile as the bank of the year in Chile.

### Medium-and long-term objectives

Santander Chile wants to push its commercial banking business, particularly for medium-high income customers and SMEs, control costs and maintain a conservative risk policy for 2011-2013:

- Achieve double-digit growth in gross income.
- Improve the efficiency ratio to 35%-37%.

Santander Río branch in Argentina

Santander branch in Puerto Rico

## Argentina

**The Bank generated an attributable profit of EUR 287 million, 8% more in local currency.**

Santander Río is the country's largest private sector bank in terms of assets and profits, with a market share of 8.9% in loans and 10.1% in bank savings. It has 358 branches which tend to 2.5 million individual customers and more than 125,000 SME and company clients.

In an environment of high growth, mainly fuelled by internal consumption and high employment, gross income increased 24.7%, largely due to fee income (+32.6%).

The strategy is aimed at capturing and linking the largest number of customers through a multichannel commercial network. Santander Río increased its network by 10% in 2011. This expansion largely took place in the interior of the country and within what the Bank considers its strategic corridor: high-income regions, with strong growth prospects and strong trade links with Brazil.

The magazines The Banker, Euromoney and Global Finance named Santander Río as the best bank in Argentina.

### Medium- and long-term objectives

- Improve efficiency through investments in technology and management of costs.
- Maintain high levels of profitability through leadership in transactional banking, and credit and savings growth.

## Other countries

### Uruguay

Santander Uruguay is the main private sector bank by profits, business and branches, with market shares of 18.6% in loans and 16.0% in savings and 78 branches. Its strategy in 2011 centred on driving retail business through new products and channels and increasing business with companies. Profit was 69.9% less in local currency at EUR 20 million.

### Puerto Rico

Santander is one of the main banks in Puerto Rico. It has 121 branches and market shares of 10.2% in loans, 11.8% in deposits and 21.6% in mutual funds. In the context of recession, its attributable profit was EUR 34 million, 5.6% lower in dollars. The Bank was recognized for the fifth year running as the best in Puerto Rico by Global Finance and for the sixth straight year by The Banker.

### Peru

Attributable profit was EUR 11 million, up from EUR 7 million in 2010. Business centres on companies and the Group's global clients.

### Colombia

At the end of 2011, Santander reached agreement to sell its units and businesses in Colombia to the Chilean group CorpBanca for $1,225 million. The transaction will become effective in 2012. This business did not reach a sufficient critical mass for the full development of Santander's retail banking in the country. Colombia contributed EUR 58 million of attributable profit.

| Latin America | Brazil | Mexico | Chile | Argentina | Uruguay | Colombia | Puerto Rico | Peru | Rest | Total |
|---|---|---|---|---|---|---|---|---|---|---|
| Customers (million) | 25.3 | 9.3 | 3.5 | 2.5 | 0.2 | 0.3 | 0.5 | 0.1 | 0.1 | **41.7** |
| Branches (number) | 3,775 | 1,125 | 499 | 358 | 78 | 80 | 121 | 1 | 9 | **6,046** |
| Employees (number) | 54,265 | 13,162 | 12,089 | 6,777 | 1,206 | 1,515 | 1,764 | 48 | 1,061 | **91,887** |
| Customer loans* | 78,408 | 18,185 | 25,709 | 4,787 | 1,452 | 2,213 | 4,335 | 538 | 4,240 | **139,867** |
| Managed customer funds* | 135,859 | 32,214 | 31,908 | 6,639 | 2,742 | 4,253 | 9,886 | 483 | 9,264 | **233,248** |
| Net operating income* | 9,963 | 1,387 | 1,264 | 472 | 40 | 91 | 169 | 14 | 132 | **13,533** |
| Attributable profit* | 2,610 | 936 | 611 | 287 | 20 | 58 | 34 | 11 | 98 | **4,664** |
| Efficiency (%) | 37.5 | 41.8 | 39.2 | 49.0 | 76.5 | 56.2 | 50.9 | 34.8 | 64.5 | **39.7** |

(*) Million euros

# United States-Sovereign

Sovereign's profit amounted to EUR 526 million in 2011.

- Sovereign has 723 branches, 2,303 ATMs and 8,968 employees serving 1.7 million customers. Its headquarters are in Boston and its business concentrated in the northeast of the US.
- In order to respond to the requirements of US supervisors, a structure was created that groups together the various units in the country under the name of Santander US.
- Sovereign received approval from the US federal regulator to become a national bank, enabling it to tend to new customer segments and strengthen its competitive position.

Sovereign's profit was 30.3% higher in dollars than in 2010. These results were supported by solid revenues (+9.2%) thanks to optimum management of volumes and prices. The 9.5% growth in costs reflects the investment in technology and the strengthening of commercial structures. The efficiency ratio was 44.6%.

Sovereign's risk quality continued to improve. Its non-performing loan ratio dropped to 2.85% and coverage rose to 96%.

Lending grew 6%. This growth was funded by a 12% rise in deposits, which ensured the diversification and stability of the bank's financing sources.

### Medium- and long-term objectives

After completing the first phase of the restructuring (2009-2011), Sovereign focused on relaunching itself as a commercial universal bank. Three main objectives were set for the next two years:

- Implement the Group's IT platform.
- Launch a range of products and services that satisfy the needs of the various customer profiles (cards, investment products, treasury management services, insurance and trade finance).
- Positioning in the segment of medium and large companies, a business where Santander's capacities and global reach can be best exploited.

***

Attributable profit generated by all Grupo Santander's units in the US (Sovereign Bank, Santander Consumer USA, Santander Private Banking USA, Puerto Rico and the New York branch) was EUR 1,059 million.

| United States-Sovereign | |
|---|---|
| Customers (million) | 1.7 |
| Branches (number) | 723 |
| Employees (number) | 8,968 |
| Customer loans(*) | 40,194 |
| Managed customer funds(*) | 40,812 |
| Net operating income(*) | 1,212 |
| Attributable profit(*) | 526 |
| Efficiency (%) | 44.6 |

(*) Million euros

Sovereign branch in the United States.

# Global businesses

## Global Wholesale Banking

**Santander Global Banking & Markets posted a profit of EUR 1,872 million (-23.0%). It is the global business unit responsible for satisfying customers' needs which, because of their size, complexity and sophistication, require tailored wholesale services or products of higher value-added. The unit operates in 22 countries and has local and global teams (2,722 professionals) with wide knowledge of financial markets, who cover all financing, lending and coverage needs.**

Santander Global Banking & Markets' profit was lower in 2011 because of the higher cost of funding, due to tensions in European sovereign debt markets and the reduced activity in the business areas of markets, as a result of their instability.

Revenues generated by client business accounted for 87% of total revenues. Those generated within the global relationship model, which includes 759 large international corporations, 186 global sphere banks and 199 financial sponsors, performed well.

### Strategy in 2011

Santander Global Banking & Markets maintained the main pillars of its business model centred on the client, reducing risk and freeing up capital and liquidity.

In 2011, it continued to invest in resources and additional capacities to develop projects, aimed at strengthening operational capacities and distributing basic treasury products, with a particular focus on forex and fixed-income business. This effort had its first results in businesses such as fixed-income distribution to companies in Europe. The generation of recurring revenues and strict management of costs are enabling Santander Global Banking & Markets to absorb these investments and have an efficiency ratio of 35.1%, still the reference among our competitors.

### Large operations in 2011

- Santander participated as co-manager in the listing of the Swiss company Glencore, the world's largest raw materials company. It was the biggest listing ever in Europe.
- Schneider Electric acquired from Abengoa 40% of Telvent. Santander was an advisor in the deal and in the subsequent takeover bid for the rest of the capital.
- SabMiller, the world's second largest beer group by sales volume, acquired the Australian beer company Foster's. Santander was the bookrunner in the loan for a total of $12,500 million.
- Santander advised Iberdrola (Spain), Sempra Energy (US), Empresas Públicas de Medellín (Colombia) and Pampa Energía (Argentina) on buying seven electricity distribution companies in Brazil, Chile, Peru, Panama, Guatemala and Argentina from AEI Energy (US).

### Medium- and long-term objectives

- Increase market share in products with low capital and liquidity consumption.
- Create units in Sovereign and Bank Zachodni WBK.

**Global Wholesale Banking**
*Million euros*

| | |
|---|---|
| Customer loans | 81,000 |
| Customer deposits | 75,134 |
| Net operating income | 3,032 |
| Attributable profit | 1,872 |
| Efficiency (%) | 35.1 |

**Attributable profit**
*Million euros*

-23.0% 2011-2010

## Asset Management

**Santander Asset Management is the Group's asset management business, offering a wide range of savings and investment products which cover customers' different needs and which are distributed globally by all the commercial networks.**

Its activity is organized around three business areas:

- Santander Asset Management, for mutual and pension funds, companies and discretional portfolios.
- Santander Real Estate, specialized in managing real estate investment products.
- Santander Private Equity for venture capital.

In 2011, Santander Asset Management advanced in developing its global business model for identifying synergies between countries and thereby increasing the value added for customers. It strengthened its global investment management capacities and created dedicated teams, took advantage of product synergies through the range of Luxembourg funds and reinforced the relationship models with the distribution and customer networks.

The global management capacities and local knowledge of countries enables customer service to be improved and assume medium and long-term objectives, such as entering new countries and accessing the institutional business.

Over the next few years, Santander will focus on further developing a global investment proposal and common platforms for operations and risks; have a selective presence in institutional markets; develop products based on customer segmentation; create a global team of selection of third party products and develop a new relationship model with commercial networks.

## Global Private Banking

**This business includes the units dedicated to financial advice and wealth management for the Group's high-income customers.**

It carries out business through:

- Banif in Spain.
- Santander Private Banking in Latin America, the UK and Italy.

There are also domestic private banking units in Portugal and Latin America, which are managed on a shared basis with local commercial banks.

Despite the negative impact of markets, assets under management have increased since 2010, backed by the creation of new business and the increase in the customer base. The volume of assets under management stood at EUR 101,411 million, 4% more than in 2010, and attributable profit was EUR 279 million.

Global Private Banking continued to further adapt and implement a corporate business model and a common IT platform in the countries where it operates.

All of this enhances the quality of customer service, enables Santander to align portfolios with objectives and the value offer of all the units and to obtain synergies.

Santander aims to become the reference private bank in the main markets where it operates, with a sustained increase in managed assets.

| Asset Management<br>*Million euros* | |
|---|---|
| Assets under management | 112,256 |
| Gross income | 289 |
| Attributable profit | 53 |
| Efficiency (%) | 56.4 |

| Global Private Banking<br>*Million euros* | |
|---|---|
| Assets under management | 101,411 |
| Gross income | 816 |
| Attributable profit | 279 |
| Efficiency (%) | 50.9 |

## Insurance

**Santander Insurance develops products for protection and household savings, which are distributed through the Group's branches and alternative channels such as the telephone and Internet. It has 15 million customers.**

Insurance generated total revenues for the Group (gross income plus fee income received by the commercial networks) of EUR 3,083 million, 14.7% more than in 2010.

Activity in 2011 concentrated on:

- Strengthening the range of products through selective agreements with insurance leaders.
- Driving the Group's strategy in financial savings management, through competitive savings insurance.
- Developing a model for distribution of auto insurance in Spain and Latin America.
- Install the insurance corporate model in Poland.

Banco Santander and the insurer Zurich agreed to form a strategic alliance to develop bancassurance business in Brazil, Chile, Mexico, Argentina and Uruguay. The aim is to significantly increase revenues from distribution of insurance products in these countries. This operation produced capital gains of EUR 641 million.

Looking ahead, the Santander Insurance model will progress from selling products to providing integral protection for customers, supported by segmentation based on the customer and not on the product.

## Means of Payment

**Santander Cards covers all businesses related to means of payment and offers customers credit and debit cards. It also provides services for capturing and processing payments in shops. The unit currently manages 92 million cards and operates in 16 countries.**

The unit is geographically diverse and is integrated into each country's commercial banking strategy. Its global strategy enables best practices, business innovation and creativity to be incorporated in accordance with the local features of markets. An example of this is the Santander Ferrari card, which is issued in Spain, Portugal, Germany, Mexico and Brazil and has more than 370,000 customers.

The most noteworthy strategies of Santander Cards in 2011 were:

- In Brazil, customer linkage and alliances with partners such as Shell and Vivo, and positioning in acquiring business.
- In the rest of Latin America, continued leadership in and development of cards business. In Mexico, alliances with large companies to offer the Fiesta Rewards card, and segmented products such as the Black Unlimited card. In Chile, business with retails was deepened and programmes with Lan and Movistar were renegotiated.
- In the UK, the Santander 123 Cashback card was launched, which returns to customers part of their spending.
- In Spain and Portugal, continued growth thanks to the development of means of payment campaigns.
- In the US, launching of the debit card with the global Santander design and positioning with innovative promotion campaigns.
- In Poland, the unit's business model was installed.

Santander Cards expects to obtain strong growth in net revenues after provisions with a differentiated strategy in its main markets.

| Insurance<br>*Million euros* | |
|---|---|
| Contribution to the Group: pre-tax profit+fee income | 2,882 |
| Gross income | 799 |
| Attributable profit | 366 |

| Means of payment[1] | |
|---|---|
| Total number of credit cards (million) | 29 |
| Total number of debit cards (million) | 63 |
| Lending (million euros) | 14,989 |
| Gross income (million euros) | 4,115 |

1. Perimeter of retail banks excluding Banesto, Santander Consumer Finance and Open Bank.

# Sustainability

Sustainability, for Banco Santander, means contributing through its business activities to economic and social progress in the communities where it operates, taking into account the impact of its business on the environment and fostering stable relations with its stakeholders.

- Banco Santander's sustainability strategy revolves around three main elements:
  - Support for higher education.
  - Protecting the environment
  - Supporting local communities.
- Santander has stable and lasting relations with its shareholders and investors, customers, employees, suppliers and society on general.
- In 2011, Santander invested EUR 170 million in corporate social responsibility projects: 69% in universities, 20% in the community and the environment and 11% in art and culture.
- During 2011, the sustainability committee, headed by the CEO, promoted, among others, strategic corporate volunteering projects, financial education, microcredit's and energy efficiency.
- The Santander share forms part of the DJSI and FTSE4Good sustainable investment indices.

**International initiatives in which Banco Santander joined or participated in**

| |
|---|
| UN Global Compact |
| UNEP Finance Initiative |
| Equator principles |
| State council of the Spanish government for social responsibility in business |
| Carbon disclosure project |
| Forge Group |
| Brazilian Institute of Governance |
| Roundtable on Responsible Soy Association |
| Wolfsberg Group |
| Banking & Environment Initiative |
| Principles for Responsible Investment (PRI) |

## Santander Universities global division

Investment in higher education is the centrepiece of the Bank's corporate social responsibility strategy, as it is convinced that this is the best way to contribute to the economic and social development of the countries in which it operates.

The global division, with a team of 2,187 professionals in 17 countries, coordinates and manages Banco Santander's commitment to higher education. Its long-term alliance with universities forged over the last 15 years is unique in the world. Banco Santander's contribution to co-operation projects with universities amounted to more than EUR 110 million in 2011.

Santander co-operates with universities in launching projects to improve education, internationalisation, geographic mobility, innovation and the transfer of knowledge to society. The Bank has agreements with universities in Spain, Germany, Portugal, the UK, Brazil, Mexico, Chile, Argentina, Colombia, Peru, Singapore, Puerto Rico, Uruguay, Poland, the United States, China and Russia.

Banco Santander's co-operation with universities revolves around the following four pillars:

- Integral cooperation agreements, which put into effect in 2011 4,455 academic, financial and technological projects with universities.
- Support for international co-operation programmes between universities, such as national and international travel programmes for students and teachers.
- Fostering co-operation with international academic networks, such as the Latin American University Network for the Incubation of Companies (Red Emprendia).
- Supporting global projects, such as Universia, the largest online network of university co-operation in the Spanish- and Portuguese-speaking world, and the Miguel de Cervantes Virtual Library, the portal with the largest digitalisation of Hispanic culture.

**The Bank's main corporate social responsibility activities are set out in the Sustainability Report, which can be consulted at www.santander.com**

Emilio Botín with Shirley M. Tilghman, president of Princeton University

Delivery of international scholarships at the University of Salamanca, Spain

**Santander Universities in 2011**
The main developments in 2011 were:

- New scholarship programmes were launched to facilitate graduates finding their first job, foster the international mobility of young doctoral students and researchers and strengthen the exchange of students between Asia and Latin America.
- Launch of the Santander Latin America scholarship programmes, presented at the Second Meeting of University Rectors in Guadalajara, Mexico, in June 2010.
- Development of a youth employment plan in Spain, through 5,000 grants for internships in SMEs.
- The international programme for the incubation of companies was launched, as well as the entrepreneurial indicators and scholarships of the Red Emprendia.
- The Santander Universities programme in Germany and Poland was started, and consolidated in the UK and the US.
- Reinforcing the social recognition of Santander's commitment to universities and launch of the ONE THOUSAND programme in Argentina, Brazil, Chile, Mexico, the UK, the US, Portugal, Puerto Rico and Uruguay.
- The I3C project to disseminate science in Spanish and launch of the financial education and culture programme.

In 2012, Santander Universities will strengthen dissemination of its commitment to universities to all society. It will put into effect new Santander scholarship programmes for students studying for a bachelor's degree and scholarships for young researchers. Moreover, it will launch new scholarship programmes to foster international travel by young postgraduate students and researchers and boost the exchange of students between Asia and Latin America, in accordance with the commitment made at the second meeting of Universia rectors.

- **990** co-operation agreements with universities in 17 countries on four continents.
- **5.4** million intelligent university cards in 250 universities.
- **21,000** scholarships and aid for study granted in 2011.
- **1,232** universities grouped in Universia.
- **330,000** first jobs via Universia.

**Growth in co-operation agreements with universities**
*Number*

**Growth in co-operation projects**
*Number*

Corporate volunteering in Chile

Olive trees at Grupo Santander City

## Social actions

Banco Santander developed programmes that support local communities through initiatives in various countries. In order to put them into effect, Santander operates in co-operation with NGOs and other non-profit making organisations with whom it has a close and fluid dialogue.

The main lines of action are:

- **Children's education.** Banco Santander supports projects and initiatives that promote children's education in those countries where the Group operates. The objective, in line with the UN's Millennium Development Goals, is to contribute to universal education. Volunteers throughout the Group participated in various initiatives launched by the human resources division to support the UNICEF project "Todos los niños a la escuela" in the state of Oaxaca, Mexico. Also of note was the Projecto Escola in Brazil, which helps to improve the quality of education in state schools and the Bécalos programme in Mexico, which supports students and teachers in state schools with scholarships.
- **Financial inclusion.** Another key element of Grupo Santander's social investment is its support for the socio-labour integration of people at the risk of social exclusion, through initiatives that promote financial inclusion and entrepreneurship. Of note in this sphere is Santander Brazil's microcredit programme, a model that strives for maximum customer proximity. Also noteworthy were the various financial education programmes.
- **Culture.** Banco Santander is intensely involved in protecting, conserving and disseminating art and culture. In Spain, the Banco Santander Foundation manages the Santander Collection and organizes and promotes art exhibitions in various institutions and museums. The foundation is also very involved in music, research, debate and the publishing world. Santander Cultural Brazil concentrates on integrating and disseminating the diversity of languages and artistic and cultural content.

## The environment

Banco Santander's management of the environment is a central part of the Group's sustainability plan. The Bank fosters the protection, conservation and recovery of the environment and, particularly, the fight against climate change.

The Bank's actions in this sphere revolve around the following lines of work:

- Measurement, control and monitoring of items consumed and emissions from the Bank's installations worldwide through its environmental footprint. Of note is the launch of the 2011-2013 energy efficient plan with global objectives to reduce electricity consumption and $C0_2$ emissions.
- Analysis of the social and environmental risk in loans with a particular focus on project finance operations in accordance with the Equator principles.
- The development of financial solutions to protect the environment and which contribute to the global objective of fighting climate change, and with a leadership position in renewable energy matters at the international level.
- Fostering other types of environmental initiatives such as projects to restore degraded natural spaces via the Banco Santander Foundation, or various local initiatives in each country such as cleaning up beaches, recycling programmes, etc.

The Climate Change Office was created in 2011 as a reference and knowledge centre for the Group.

Banco Santander received in 2011 significant recognitions such as the "Greenest bank in the world" from Bloomberg Markets and "the best global green brands" from Interbrand. These recognitions also reflect the improvement in the score in the environmental category of the Dow Jones Sustainability Index.

# Human Resources

**Banco Santander has 193,349 employees, more than half of whom work in the Americas, one-third in Continental Europe and 14% in the UK. Of the total employees, 54% are women and 49% have university degrees. The average age of employees is 37 and the average number of years spent working for Santander is 11 for men and 8.5 for women.**

Santander continued to consolidate a people management policy focused on talent, knowledge and commitment as the key pillars for supporting business.

## Global management of talent and leadership

Santander's talent and leadership model is one that befits a global group, with a wide geographic diversification and different needs for attracting and retaining professionals in each country.

The Bank has processes and tools to detect and develop internal talent, and to identify the best people for each post. Of note are those for high potential professionals, such as STEP, or the development of female talent, such as the Alcanza plan. There are also mobility programmes such as Mundo Santander and specific plans for certain businesses such as Future Executives (FUDIS) for the Americas Division, Apolo, for retail banking Spain, and those begun in 2011 for the global wholesale banking and technology and operations divisions.

As for external talent, Santander continued to invest in consolidating a strong employer brand which, together with the strategic alliances with more than 1,000 universities and business schools worldwide, enables us to attract the best candidates.

## Shared knowledge

Total investment in training in 2011 amounted to EUR 112.7 million and each of the 193,000 employees received on average 37.5 hours of training.

Santander Learning, an IT platform that every year is extended to more countries with new functions, backs all the Group's training activities. The year 2011 was also the one when the School of Internal Trainers was consolidated, at which executives get involved in the transfer of knowledge and corporate values. In 2011, 2,460 internal and external trainers participated and put in more than 2,294,000 hours.

Santander was a pioneer in the creation of Business Knowledge Schools which share knowledge and exchange best practices. An auditing school joined in 2011 the ones already established for risks (2005) and retail banking (2010).

## Commitment of professionals

The Bank promotes the "Santander is you" programme, which aims to keep on making Santander one of the best companies to work for. This programme has initiatives such as the "Santander is you" week, during which activities are organized in all the countries where the Group operates so that professionals participate as teams and strengthen the pride in belonging; or the "Santander is you" race which has become an example of how to live the corporate values through sports.

In the area of social commitment, Santander launched its committed volunteers programme. The aim is to create a framework for employees to develop solidarity activities. This initiative was first launched in Spain and has UNICEF as a strategic partner in order to support the schooling of children and teenagers in Latin America.

# Corporate governance report

# Corporate governance report

"Banco Santander's corporate governance contributes decisively to the success of its model"

**Emilio Botín, chairman**
General shareholders' meeting, 17 June 2011

- **Equality of shareholders' rights.**
  - The principle of ***one share, one vote, one dividend***.
  - No anti-takeover measures in the corporate By-laws.
  - Informed participation of shareholders in meetings.
- **Maximum transparency, particularly in remuneration.**
- **A corporate governance model recognised by the socially responsible investment indices.**
  Santander has been in the FTSE4Good and DJSI indices since 2003 and 2000, respectively.


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# Main activities of the board on matters reserved thereto

## Board's activities

- During 2011, the board held 14 meetings. Two of them were devoted to the Group's strategy.
- As regards dividends, in 2011 the board maintained the same compensation per share as in financial years 2010 and 2009, i.e., 0.60 euro.

## Control and risk management

- During 2011, the chief executive officer submitted to the board eight management reports, and the third vice-chairman and head of the risk division submitted eight risk reports.
- Each of the heads of internal and external audit reported to the board through their participation in meetings of the audit and compliance committee and of the full board.

## Changes in the size and composition of the board

- Following the death of Mr Luis Ángel Rojo in May 2011, the resulting vacancy was covered by the appointment of Mr Vittorio Corbo. Subsequently, Mr Antoine Bernheim (who represented Assicurazioni Generali) and Mr Francisco Luzón resigned their seats on the board. On the occasion of the next general shareholders' meeting, and if the board's proposal is accepted, Mr Antonio Basagoiti, Mr Antonio Escámez and Mr Luis Alberto Salazar-Simpson will cease to hold office as directors and Ms Esther Giménez-Salinas will be appointed to the board.

## Director remuneration policy

- In 2011, the board submitted the report regarding the director remuneration policy to the shareholders at the general shareholders' meeting held on 17 June, as a separate item on the agenda and as a consultative matter; 95% of the votes were in favour of the report.

  In addition, following the enactment of the Sustainable Economy Act (*Ley de Economía Sostenible*) and the amendment of the Securities Market Act (*Ley del Mercado de Valores*), the shareholders at the aforementioned meeting approved an amendment of the Bylaws in order to expressly provide for the obligation to submit the report regarding director remuneration policy to a vote of the shareholders as a consultative matter and as a separate item on the agenda.

## Director remuneration

- The overall director remuneration with respect to 2011 is 8% lower than that corresponding to 2010

## Bylaw-mandated payments

- In 2011, the board resolved to reduce the annual allocation to which the board members are entitled for the performance of supervisory and collective decision-making duties by 6% vis-à-vis the amounts paid the prior year, which amounts had remained unchanged since 2008.

## Remuneration of executive directors

- As regards executive directors, the board decided not to vary the fixed remuneration payable in 2012 and reduce by an average of 16% in the variable remuneration paid in 2011.

## Financial information periodically published by the Bank

- The board approved the quarterly financial information, the annual accounts, and the management report for 2010, in addition to other documents such as the annual report, the sustainability report, the prudently significant information (Pillar 3), the annual corporate governance report, and the reports of the audit and compliance committee and the appointments and remuneration committee.

# 1. Ownership structure

## Number of shares and significant interests

### Number of shares

During financial year 2011, the Bank carried out four capital increases that became effective on 1 February, 7 October, 2 November and 30 December, and pursuant to which there were issued 111,152,906, 1,223,457, 125,742,571 and 341,802,171 new shares, representing 1.248%, 0.014%, 1.411% and 3.837%, respectively, of the Bank's share capital at year-end 2011. The first and the third increases were carried out within the framework of the Santander Election Dividend (*Santander Dividendo Elección*) programme; the second one, in order to accommodate the conversion of 3,458 mandatorily convertible bonds (*Valores Santander*), and the last one, in connection with the repurchase offer directed to the holders of Series X preferred interests issued by Santander Finance Capital, who, concurrently with the acceptance thereof, made an irrevocable request for subscription of new shares of the Bank in the amount received under the repurchase.

The Bank's share capital at 31 December 2011 was represented by 8,909,043,203 shares, at such date the market capitalisation, on Spain's Electronic Trading System (continuous market) of the Spanish stock exchanges, was 50,290 million euros.

All shares carry the same economic, voting and related rights.

### Significant interests

No shareholder held significant interests (of more than 3% of the share capital(*) or interests that would permit a significant influence on the Bank) at 31 December 2011.

The interests held by State Street Bank & Trust (8.34%), Chase Nominees Limited (7.97%), EC Nominees Ltd. (6.46%), and The Bank of New York Mellon (5.55%), which were the only ones in excess of 3%, were held by them on behalf of their customers. The Bank is not aware of any of them holding individual stakes of 3% or more of its share capital.

Bearing in mind the current number of board members (18), the percentage of capital needed to exercise the right to appoint a director in accordance with article 243 of the Spanish Companies Act (*Ley de Sociedades de Capital*) is 5.56%.

## Shareholders' agreements and other significant agreements

Section A.6 of the annual corporate governance report, which forms part of the management report, contains a description of the shareholders' agreement (*pacto parasocial*) executed in February 2006 by Mr Emilio Botín-Sanz de Sautuola y García de los Ríos, Ms Ana Patricia Botín-Sanz de Sautuola y O'Shea, Mr Emilio Botín-Sanz de Sautuola y O'Shea, Mr Francisco Javier Botín-Sanz de Sautuola y O'Shea, Simancas, S.A., Puente San Miguel, S.A., Puentepumar, S.L., Latimer Inversiones, S.L. and Cronje, S.L. Unipersonal providing for the syndication of the shares of the Bank held by them or in respect of which they have voting rights. Such agreement was also reported to the National Securities Market Commission (*Comisión Nacional del Mercado de Valores*) (CNMV) as a significant event and is described in the public records thereof.

(*) Limit set by Royal Decree 1362/2007, of 19 October, for purposes of the annual corporate governance report.

# Treasury shares

## Key data

At 31 December 2011, the Bank held 42,192,066 treasury shares, representing 0.474% of its share capital; at 31 December 2010, it held 22,291,422 treasury shares, representing 0.268% of the Bank's share capital at such date.

The following table sets out the monthly average percentages of treasury stock in 2011 and 2010.

**Monthly average percentages of treasury stock[1]**
*% of the Bank's share capital [2]*

| | 2011 | 2010 |
|---|---|---|
| January | 0.289% | 0.200% |
| February | 0.126% | 0.516% |
| March | 0.324% | 0.302% |
| April | 0.701% | 0.305% |
| May | 0.630% | 0.603% |
| June | 0.404% | 0.470% |
| July | 0.271% | 0.342% |
| August | 0.253% | 0.253% |
| September | 0.382% | 0.285% |
| October | 0.621% | 0.360% |
| November | 0.643% | 0.544% |
| December | 0.446% | 0.525% |

(1) Further information in this regard can be found in section A.8 of the annual corporate governance report, which forms part of the management report, and in the capital and treasury stock section of this latter report.
(2) Monthly average of daily positions of treasury stock.

The transactions in treasury stock carried out by companies belonging to the consolidated Group in the interest thereof during financial year 2011 entailed the acquisition of 939,773,957 shares, equal to a nominal amount of 469.9 million euros (actual amount of 6.932.5 million euros), and the sale of 925,256,161 shares in the nominal amount of 462.6 million euros (actual amount of 6,855.9 million euros).

The average purchase price of shares of the Bank in financial year 2011 was 7.38 euros per share, and the average sales price of shares of the Bank in such financial year was 7.41 euros per share. The effect on equity (net of taxes) generated by transactions carried out during the financial year with shares issued by the Bank was equal to 31 million euros worth of loss, which was recorded in the Group's equity section under *Shareholders' equity-Reserves.*

### Authorisation

The current authorisation for transactions in treasury shares arises from resolution no. 5 adopted by the shareholders acting at the general shareholders' meeting held on 11 June 2010, item II) of which reads as follows:

*"To grant express authorisation for the Bank and the subsidiaries belonging to the Group to acquire shares representing the share capital of the Bank for valuable consideration in any manner permitted by Law, within the limits of the Law and subject to all legal requirements, up to a maximum number of shares –including the shares they already hold– equal to 10 per cent of the share capital existing at any given time or such greater maximum percentage as is established by the Law while this authorisation is in effect. Such shares shall be fully paid-in at a minimum price per share equal to the par value thereof and a maximum price of up to 3 per cent over the last listing price for transactions in which the Bank does not act on its own behalf on the Continuous Market of the Spanish stock exchanges (including the block market) prior to the acquisition in question. This authorisation may only be exercised within five years of the date of the general shareholders' meeting. The authorisation includes the acquisition of shares, if any, that must be delivered directly to the employees and managers of the Company, or that must be delivered as a result of the exercise of the options held by them."*

### Treasury stock policy

At its meeting of 11 June 2010, the board of directors adopted the current resolution on treasury share policy, which was published on the Group's website (www.santander.com) and which governs aspects such as the purposes thereof, persons authorised to carry out treasury share transactions, general guidelines, prices, time limits and reporting obligations.

The aforementioned policy excludes the use of treasury shares as a defensive mechanism.

## Resolutions in effect regarding the possible issuance of new shares or of bonds convertible into shares

The additional authorised capital amounts to 2,038,901,430.5 euros, pursuant to the authorisation of the shareholders acting at the annual general meeting held on 19 June 2009; of such amount, 170,901,085.5 euros have been used in the repurchase offer announced by the Bank on 2 December 2011, directed to the holders of Series X preferred interests issued by Santander Finance Capital, who, concurrently with the acceptance thereof, made an irrevocable request for subscription of new shares of the Bank in the amount received under the repurchase. The period available to the directors of the Entity to carry out and make capital increases up to such limit expires on 19 June 2012. The resolution adopted by the shareholders at the aforementioned annual general meeting gives the board the power to exclude pre-emptive rights in whole or in part, pursuant to the provisions of article 159.2 of the Companies Act (*Ley de Sociedades Anónimas*) (now, article 506 of the new Companies Act (*Ley de Sociedades de Capital*)).

In addition, the shareholders acting at the annual general meeting held on 17 June 2011 approved the following resolutions in connection with the content of this section:

1. Two share capital increases, each for a maximum number of shares having a market value of one thousand one hundred million euros, within the shareholder compensation scheme (*Santander Dividendo Elección*) whereby the Bank offers the shareholders the possibility of receiving shares under a scrip issue for an amount equal to the dividends, in one or two of the quarters in which they are customarily paid.

   For such purposes, the Bank's executive committee, at its meetings of 2 November 2011 and 31 January 2012, implemented the aforementioned capital increases with a charge to voluntary reserves from undistributed profits.

   The number of shares having a nominal value of 0.5 euro each which were issued in each case under the two capital increases by means of a scrip issue was 125,742,571 and 167,810,197, accounting for 1.411% of the Bank's share capital at 31 December 2011 and 1.849% of the current share capital of the Bank, respectively.

2. Delegation to the board of directors of the power to issue debentures, bonds and other fixed-income securities or debt instruments of a similar nature in any of the forms allowed by Law and convertible into and/or exchangeable for shares of the Bank. Such delegation also includes warrants or similar securities that may directly or indirectly carry the right to subscribe for or acquire shares of the Bank, whether newly-issued or already outstanding, payable by physical delivery or through the set-off of differences.

   The issuance or issuances come to the total maximum amount of 8 billion euros or the equivalent thereof in another currency, and the period available to the directors of the Bank within which to implement this resolution expires on 17 June 2016.

3. Delegation to the board of directors, pursuant to the provisions of article 297.1.a) of the Companies Act, of the broadest powers such that, within one year of the date on which the aforementioned shareholders' meeting is held, it may set the date and the terms and conditions, as to all matters not provided for by the shareholders themselves, of a capital increase in the amount of 500 million euros. If the board does not exercise the powers delegated thereto within the period established by the shareholders for implementation of this resolution, such powers shall be rescinded.

# 2. Banco Santander's board of directors*

## Mr Emilio Botín-Sanz de Sautuola y García de los Ríos

Chairman
*Executive director*

Born in Santander (Spain) in 1934. Joined the board in 1960. Graduate in Economics and Law.

**Committees of the board of which he is a member**
Executive (chairman)
International (chairman)
Technology, productivity and quality (chairman)

## Mr Alfredo Sáenz Abad

Second vice-chairman and chief executive officer
*Executive director*

Born in Getxo (Spain) in 1942. Joined the board in 1994. Graduate in Economics and Law.

Other significant positions: former chief executive officer and first vice-chairman of Banco Bilbao Vizcaya, S.A. and chairman of Banco Español de Crédito, S.A. (Banesto).

**Committees of the board of which he is a member**
Executive
International
Technology, productivity and quality

## Mr Fernando de Asúa Álvarez

First vice-chairman
*Non-executive (independent) director*

Born in Madrid (Spain) in 1932. Joined the board in 1999. Graduate in Economics, Information Technology, Business Administration and Mathematics.

Other significant positions: former chairman of IBM Spain, of which he is currently honorary chairman. He is a non-executive vice-chairman of Técnicas Reunidas, S.A.

**Committees of the board of which he is a member**
Executive
Risk (vice-chairman)
Audit and compliance
Appointments and remuneration (chairman)
Technology, productivity and quality

## Mr Matías Rodríguez Inciarte

Third vice-chairman
*Executive director*

Born in Oviedo (Spain) in 1948. Joined the board in 1988. Graduate in Economics and Government Economist.

Other significant positions: former minister of the Presidency of the Spanish Government (1981-1982). He is the chairman of the Príncipe de Asturias Foundation, non-executive chairman of Banco Santander Totta and a non-executive director of Banesto, of Sanitas, S.A. de Seguros and of Financiera Ponferrada, S.A., SICAV.

**Committees of the board of which he is a member**
Executive
Risk (chairman)

* Unless otherwise specified, the main activity of the members of the board is that carried out at the Bank in their capacity as directors, whether executive or non-executive.

## Mr Manuel Soto Serrano

Fourth vice-chairman
*Non-executive (independent) director*

Born in Madrid (Spain) in 1940. Joined the board in 1999. Graduate in Economics and Business.

Other significant positions: non-executive director of Cartera Industrial REA, S.A. He was formerly non-executive vice-chairman of Indra Sistemas, S.A., chairman of Arthur Andersen's Global Board and a manager for Europe, Middle East, India and Africa (EMEIA) for the same firm.

**Committees of the board of which he is a member**
Audit and compliance (chairman)
Appointments and remuneration
Technology, productivity and quality

## Mr Guillermo de la Dehesa Romero

*Non-executive (independent) director*

Born in Madrid (Spain) in 1941. Joined the board in 2002. Government Economist and head of office of Banco de España (on leave of absence).

Main activity: international advisor to Goldman Sachs International.

Other significant positions: former state secretary of Economy, general secretary of Trade and chief executive officer of Banco Pastor, S.A. He is currently non-executive vice-chairman of Amadeus IT Holding, S.A., a non-executive director of Campofrío Food Group, S.A., chairman of the Centre for Economic Policy Research (CEPR) in London, a member of the Group of Thirty in Washington, chairman of the board of trustees of IE Business School and non-executive chairman of Aviva Grupo Corporativo, S.L. and of Aviva Vida y Pensiones, S.A. de Seguros y Reaseguros.

**Committees of the board of which he is a member**
Executive
Appointments and remuneration
International

## Mr Antonio Basagoiti García-Tuñón

*Non-executive director*

Born in Madrid (Spain) in 1942. Joined the board in 1999. Graduate in Law.

Main activity: non-executive chairman of Banesto.

Other significant positions: former chairman of Unión Fenosa and proprietary non-executive vice-chairman of Faes Farma, S.A. He is a non-executive chairman of Pescanova, S.A.

**Committees of the board of which he is a member**
Executive
Risk
Technology, productivity and quality

## Mr Rodrigo Echenique Gordillo

*Non-executive (independent) director*

Born in Madrid (Spain) in 1946. Joined the board in 1988. Graduate in Law and Government Attorney.

Other significant positions: former chief executive officer of Banco Santander, S.A. (1988-1994).

**Committees of the board of which he is a member**
Executive
Audit and compliance
Appointments and remuneration
International

## Ms Ana Patricia Botín-Sanz de Sautuola y O'Shea

*Executive director*

Born in Santander (Spain) in 1960. Joined the board in 1989. Graduate in Economics.

Main activity: chief executive officer of Santander UK plc.

She joined the Bank after a period at JP Morgan (1981-1988). She has been executive vice president of Banco Santander, S.A. since 1992, and was executive chairwoman of Banesto from 2002 to 2010.

Other significant positions: she is a non-executive director of Alliance & Leicester plc. and a member of the international advisory board of the New York Stock Exchange and of the board of Georgetown University.

**Committees of the board of which he is a member**
Executive
International
Technology, productivity and quality

## Mr Antonio Escámez Torres

*Non-executive (independent) director*

Born in Alicante (Spain) in 1951. Joined the board in 1999. Graduate in Law.

Other significant positions: chairman of Fundación Banco Santander, non-executive chairman of Santander Consumer Finance, S.A., of Open Bank, S.A. and of Arena Media Communications España, S.A., and non-executive vice-chairman of Attijariwafa Bank.

**Committees of the board of which he is a member**
Executive
Risk
International
Technology, productivity and quality

## Mr Javier Botín-Sanz de Sautuola y O'Shea

*Non-executive (proprietary) director*

Born in Santander (Spain) in 1973. Joined the board in 2004. Graduate in Law.

Main activity: chairman and chief executive officer of JB Capital Markets, Sociedad de Valores, S.A.

## Mr Ángel Jado Becerro de Bengoa

*Non-executive (independent) director*

Born in Santander (Spain) in 1945. Appointed as director at the Bank's general shareholders' meeting held on 11 June 2010. Graduate in Law.

Other significant positions: director of Banco Santander from 1972 to 1999. He has been a director of Banco Banif, S.A. since 2001.

## Lord Burns (Terence)

*Non-executive director*

Born in Durham (United Kingdom) in 1944. Joined the board in 2004. Graduate in Economics.

Main activity: non-executive chairman of Santander UK plc and of Alliance & Leicester plc.

Other significant positions: he is non-executive chairman of Channel Four Television Corporation and a non-executive member of the Office for Budget Responsibility. He has been permanent secretary of the UK Treasury, chairman of the Financial Services and Markets Bill Joint Committee of the British Parliament, non-executive chairman of Marks and Spencer Group plc and of Glas Cymru Ltd (Welsh Water), and non-executive director of British Land plc, of Legal & General Group plc and of Pearson Group plc.

## Mr Abel Matutes Juan

*Non-executive (independent) director*

Born in Ibiza (Spain) in 1941. Joined the board in 2002. Graduate in Law and Economics.

Main activity: chairman of Grupo de Empresas Matutes.

Other significant positions: former Spanish Foreign Minister and European Union Commissioner for Loans and Investment, Financial Engineering and Policy for Small and Medium-Sized Enterprises (1989), North-South Relations, Mediterranean Policy and Relations with Latin America and Asia (1989), Transport and Energy, and the Euroatom Supply Agency (1993).

**Committees of the board of which he is a member**
Audit and compliance
International

## Mr Vittorio Corbo Lioi

*Non-executive director*

Born in 1943 in Iquique (Chile). Joined the board in July 2011 following his interim appointment by the board of the directors of the Bank at the proposal of the appointments and remuneration committee. Doctor of Economics.

Other significant positions: From 2003 to 2007, he served as chairman of the Central Bank of Chile. He is currently a senior associate researcher at the Centro de Estudios Públicos in Chile, full professor at Universidad Católica de Chile, professor at Universidad de Chile, director of Banco Santander Chile, chairman of the board of directors of ING-Seguros de Vida Chile, director of ENDESA-Chile, a member of the advisory council for the World Bank Chief Economist, a member of the consulting group on monetary and exchange policy of the money and capital markets department of the International Monetary Fund, a member of the board for resolutions on parliamentary assignments of the Chilean Congress, and a member of the international advisory board of the Center for Social and Economic Research (CASE) in Warsaw, Poland.

## Mr Juan Rodríguez Inciarte

*Executive director*

Born in Oviedo (Spain) in 1952. Member of the board since 2008. Graduate in Economics. Joined the Group in 1985 as director and executive vice president of Banco Santander de Negocios. In 1989, he was appointed executive vice president of Banco Santander, S.A. From 1991 to 1999 he was a director of Banco Santander, S.A.

Other significant positions: he is vice-chairman of Santander UK plc and a director of Alliance & Leicester plc and of Santander Consumer Finance, S.A.

**Committees of the board of which he is a member**
Risk

## Mr Luis Alberto Salazar-Simpson Bos

*Non-executive (independent) director*

Born in Madrid (Spain) in 1940. Joined the board in 1999. Graduate in Law and holder of a Degree in Treasury and Tax Law.

Main activity: chairman of France Telecom España, S.A.

**Committees of the board of which he is a member**
Audit and compliance
Technology, productivity and quality

## Ms Isabel Tocino Biscarolasaga

*Non-executive (independent) director*

Born in Santander (Spain) in 1949. Joined the board in 2007. Doctor of Laws. She has undertaken graduate studies in business administration at IESE and the Harvard Business School.

Main activity: full professor at Universidad Complutense de Madrid.

Other significant positions: former Spanish Minister for the Environment, former chairwoman of the European Affairs Committee and of the Foreign Affairs Committee of the Spanish Congress and former chairwoman for Spain and Portugal and former vice-chairwoman for Europe of Siebel Systems. She is currently an elected member of the Spanish State Council and a member of the Royal Academy of Doctors.

**Committees of the board of which he is a member**
Appointments and remuneration

## Mr Ignacio Benjumea Cabeza de Vaca

*General secretary and secretary of the board*

Born in Madrid (Spain) in 1952. Joined the Group in 1987 as general secretary and secretary of the board of Banco Santander de Negocios. He was appointed general secretary and secretary of the board of Banco Santander, S.A. in 1994. Graduate in Law, ICADE-E3, and Government Attorney.

Other significant positions: he is executive vice president of Banco Santander, S.A., a non-executive director of Sociedad Rectora de la Bolsa de Valores de Madrid, S.A., Bolsas y Mercados Españoles, Sociedad Holding de Mercados y Sistemas Financieros, S.A. and La Unión Resinera Española, S.A.

**Secretary of committees of the board**
Executive
Risk
Audit and compliance
Appointments and remuneration
International
Technology, productivity and quality

# Re-election and ratification of directors at the 2012 annual general shareholders' meeting

Pursuant to article 55 of the Bylaws* and article 22 of the Rules and Regulations of the Board*, directors are appointed to three-year terms (the maximum term being six years under Spanish law), such that one-third of the board is renewed each year.

At the 2012 ordinary general shareholders' meeting, planned for 29 and 30 March at first and second call, respectively, the appointment of Ms Esther Giménez-Salinas i Colomer (as an independent director) will be proposed.

Likewise, the ratification of the appointment and re-election of Mr Vittorio Corbo Lioi, as external, non-propietary and non-independent director, will be submitted to the general shareholders' meeting for approval, as well as the re-election of the directors Mr Juan Rodríguez Inciarte, Mr Emilio Botín-Sanz de Sautuola y García de los Ríos, Mr Matías Rodríguez Inciarte , and Mr Manuel Soto Serrano. The first three as executive directors and Mr Soto as independent external director, the professional profiles and activity descriptions appear on the preceding pages.

The re-elections and the ratification will be submitted separately to a vote of the shareholders at the general shareholders' meeting (article 21.2 of the Rules and Regulations for the General Shareholders' Meeting). In view of the fact that this election practice has been followed since the 2005 annual general shareholders' meeting, the election of all of the current directors has been submitted to a separate vote at a general shareholders' meeting, except for the case of Mr Vittorio Corbo Lioi, whose ratification will be proposed at the 2012 annual general shareholders' meeting, as set forth above.

* The Bylaws and the Rules and Regulations of the Board of Banco Santander are published on the Group's website, www.santander.com.

## Composition and structure of the board of directors

| Board of directors | | Executive | Non-executive | Committees: 1. Executive committee | 2. Risk committee | 3. Audit and compliance committee | 4. Appointments and remuneration committee | 5. International committee | 6. Technology, productivity and quality committee |
|---|---|---|---|---|---|---|---|---|---|
| Chairman | Mr Emilio Botín-Sanz de Sautuola y García de los Ríos (1) | ● | | C | | | | C | C |
| First vice-chairman | Mr Fernando de Asúa Álvarez | | I | ● | V | ● | C | | ● |
| Second vice-chairman and chief executive officer | Mr Alfredo Sáenz Abad | ● | | ● | | | | ● | ● |
| Third vice-chairman | Mr Matías Rodríguez Inciarte (2) | ● | | ● | C | | | | |
| Fourth vice-chairman | Mr Manuel Soto Serrano | | I | | | C | ● | | ● |
| Members | Mr Antonio Basagoiti García-Tuñón (3) | | N | ● | ● | | | | ● |
| | Ms Ana Patricia Botín-Sanz de Sautuola y O'Shea (1) | ● | | ● | | | | ● | ● |
| | Mr Javier Botín-Sanz de Sautuola y O'Shea (1) (4) | | P | | | | | | |
| | Lord Burns (Terence) | | N | | | | | | |
| | Mr Vittorio Corbo Lioi | | N | | | | | | |
| | Mr Guillermo de la Dehesa Romero | | I | ● | | | ● | ● | |
| | Mr Rodrigo Echenique Gordillo | | I | ● | | ● | ● | ● | |
| | Mr Antonio Escámez Torres (3) | | I | ● | ● | | | ● | ● |
| | Mr Ángel Jado Becerro de Bengoa | | I | | | | | | |
| | Mr Francisco Luzón López (5) | ● | | ● | | | | ● | |
| | Mr Abel Matutes Juan | | I | | | ● | | ● | |
| | Mr Juan Rodríguez Inciarte | ● | | | ● | | | | |
| | Mr Luis Alberto Salazar-Simpson Bos (3) | | I | | | ● | | | ● |
| | Ms Isabel Tocino Biscarolasaga | | I | | | | ● | | |
| | **Total** | | | | | | | | |
| | | | | | | | | | |
| General secretary and secretary of the board | Mr Ignacio Benjumea Cabeza de Vaca | | | ● | ● | ● | ● | ● | ● |

(1) Mr Emilio Botín-Sanz de Sautuola y García de los Ríos has the right to vote, at the general shareholders' meeting, 91,866,035 shares owned by Fundación Marcelino Botín (1.03% of the share capital), 8,096,742 shares owned by Mr Jaime Botín-Sanz de Sautuola y García de los Ríos, 9,042,777 shares owned by Mr Emilio Botín-Sanz de Sautuola y O'Shea, 9,118,885 shares owned by Ms Ana Patricia Botín-Sanz de Sautuola y O'Shea and 9,470,988 shares owned by Mr Javier Botín-Sanz de Sautuola y O'Shea. Accordingly, this table includes the direct and indirect interests of each of the two last named, who are directors of the Bank, but in the column showing the total percentage of share capital that such interests represent they are computed together with those owned or also represented by Mr Emilio Botín-Sanz de Sautuola y García de los Ríos.

(2) Mr Matías Rodríguez Inciarte has the right to vote 80,095 shares owned by two of his children.

(3) Upon resolution by the board of directors, at the proposal of the appoinmets and remuneration committee, the re-election of these three directors will be not submitted to the general shareholders meeting for appoval.

(4) Mr Javier Botín-Sanz de Sautuola y O'Shea is a proprietary non-executive director because on the board of directors he represents 2.007% of the share capital, representing the aggregate interests owned by Fundación Marcelino Botín, Mr Emilio Botín-Sanz de Sautuola y García de los Ríos, Ms Ana Patricia Botín-Sanz de Sautuola y O'Shea, Mr Emilio Botín-Sanz de Sautuola y O'Shea, Mr Jaime Botín-Sanz de Sautuola y García de los Ríos, Ms Paloma O'Shea Artiñano and his own interest.

## Powers and duties

The basic responsibility of the board of directors is to supervise the Group, delegating the day-to-day management thereof to the appropriate executive bodies and the various management teams.

The Rules and Regulations of the Board (article 3) reserve thereto the power to approve general policies and strategies and, in particular, strategic plans, management objectives and the annual budget, corporate governance, corporate social responsibility and dividend and treasury stock policies, the general risk policy, and the policies for the provision of information to and for communication with the shareholders, the markets and the public opinion, which power cannot be delegated.

The board also reserves for itself, and likewise cannot delegate, the following matters, among others: decisions regarding the acquisition and disposition of substantial assets (except when the decisions come within the purview of the shareholders at a general shareholders' meeting) and major corporate transactions; the determination of the remuneration of each director and the approval of the contracts governing the performance by the directors of duties other than those of a director, including executive duties, as well as the remuneration to which they are entitled for the discharge thereof; the appointment, remuneration and, if appropriate, removal of the other members of senior management and the determination of the basic terms of their contracts, as well as the creation or acquisition of interests in special purpose entities or in entities registered in countries or territories regarded as tax havens. On the matters mentioned in this paragraph, the executive committee may make any appropriate decisions, by delegation of the board and whenever justified by reasons of urgency.

The Bylaws (article 40) as well as the aforementioned Rules and Regulations (article 5) establish the board's obligation to ensure that the Bank faithfully complies with applicable law, observes usage and good practices of the industries or countries where it does business and abides by the social responsibility principles that it has voluntarily accepted.

In addition, the board of the Bank plays a special role in the Group's risk management. 13 of its 18 members are members of at least one of the three board committees with responsibilities in the area of risks: the executive committee, the risk committee and the audit and compliance committee. Of these 13 directors, one is the first vice-chairman of the Bank, who is a member of all three committees, and another 4 directors sit on two of the committees with responsibilities in the area of risks.

Shareholding at 31 December 2011

| Direct | Indirect | Shares represented | Total | % of share capital | Date of first appointment | Date of last appointment | Expiration date [7] | Date of last proposal of the appointments and remuneration committee |
|---|---|---|---|---|---|---|---|---|
| 8,259,445 | 42,916,473 | 109,005,554 | 160,181,472 | 2.007% | 04.07.1960 [6] | 21.06.2008 | First six months of 2012 | 17.02.2012 |
| 66,167 | 52,469 | - | 118,636 | 0.001% | 17.04.1999 | 11.06.2010 | First six months of 2014 | 21.04.2010 |
| 1,100,332 | 1,304,950 | - | 2,405,282 | 0.027% | 11.07.1994 [6] | 11.06.2010 | First six months of 2014 | 21.04.2010 |
| 1,035,739 | 86,594 | 80,095 | 1,202,428 | 0.013% | 07.10.1988 [6] | 19.06.2009 | First six months of 2013 | 27.04.2009 |
| 63,721 | 454,466 | - | 518,187 | 0.006% | 17.04.1999 | 19.06.2009 | First six months of 2013 | 27.04.2009 |
| 719,217 | - | - | 719,217 | 0.008% | 26.07.1999 | 23.06.2007 | First six months of 2012 | 19.03.2007 |
| 5,142,749 | 4,024,136 | - | 9,166,885 | 0.000% | 04.02.1989 [6] | 17.06.2011 | First six months of 2014 | 11.04.2011 |
| 4,793,481 | 4,677,507 | - | 9,470,988 | 0.000% | 25.07.2004 | 11.06.2010 | First six months of 2013 | 21.04.2010 |
| 30,105 | 27,001 | - | 57,106 | 0.001% | 20.12.2004 | 17.06.2011 | First six months of 2014 | 11.04.2011 |
| 1 | - | - | 1 | 0.000% | 22.07.2011 | 22.07.2011 | First six months of 2012 | 17.02.2012 |
| 105 | - | - | 105 | 0.000% | 24.06.2002 | 19.06.2009 | First six months of 2014 | 27.04.2009 |
| 658,758 | 9,736 | - | 668,494 | 0.008% | 07.10.1988 | 17.06.2011 | First six months of 2014 | 11.04.2011 |
| 783,261 | - | - | 783,261 | 0.009% | 17.04.1999 | 23.06.2007 | First six months of 2012 | 19.03.2007 |
| 2,000,000 | 4,950,000 | - | 6,950,000 | 0.078% | 11.06.2010 | 11.06.2010 | First six months of 2013 | 21.04.2010 |
| 1,611,691 | 81,685 | - | 1,693,376 | 0.019% | 22.03.1997 [6] | 23.06.2007 | First six months of 2012 | 19.03.2007 |
| 129,479 | 2,357,399 | - | 2,486,878 | 0.028% | 24.06.2002 | 19.06.2009 | First six months of 2013 | 27.04.2009 |
| 1,400,296 | - | - | 1,400,296 | 0.016% | 28.01.2008 [6] | 21.06.2008 | First six months of 2012 | 17.02.2012 |
| 253,205 | 14,082 | - | 267,287 | 0.003% | 17.04.1999 | 21.06.2008 | First six months of 2012 | 16.04.2008 |
| 40,674 | - | - | 40,674 | 0.000% | 26.03.2007 | 11.06.2010 | First six months of 2014 | 21.04.2010 |
| **28,088,426** | **60,956,498** | **109,085,649** | **198,130,573** | **2.224%** | | | | |

(5) He resigned from his position as a director as of 23 January 2012.

(6) The date on which they were appointed for the first time as executive directors coincides with their first appointment as a director.

(7) However, and pursuant to the provisions of article 55 of the Bylaws, as amended by resolution adopted at the annual general shareholders' meeting of 17 June 2011, one-third of the board will be renewed each year, based on length of service and according to the date and order of the respective appointment.

C Chairman of the committee  I Independent  P Proprietary

V Vice-chairman of the committee  N Non-executive, neither proprietary nor independent

# Commitment of the board and main areas of experience of its members

**Board's interest in the Bank's capital**
*Data at year-end 2011*

- NUMBER OF SHARES OF THE BOARD
  **198,130,573** equal to **2.224%** of share capital
- STOCK EXCHANGE VALUE
  **1,163** million euros
- STOCK LISTING PRICE
  **5.87** euros

**Main areas of professional experience of the board members**

# Corporate governance in risk management

**Average attendance rate at meetings of the committees of the board %**

- Mr Matías Rodríguez Inciarte, third vice-chairman of Banco Santander and chairman of the risk committee, reports directly to the executive committee and to the board, which guarantees the independence of the risk function.
- The risk committee held 99 meetings in 2011, each of which lasted approximately 3 hours.
- The executive committee held 59 meetings in 2011 and devoted a significant amount of time to discussions on risks.

**Participation in the executive committee, the risk committee and the audit and compliance committee**

**Number of meetings of the executive committee, the risk committee and the audit and compliance committee**

| Committees | 2007 | 2008 | 2009 | 2010 | **2011** |
|---|---|---|---|---|---|
| Executive | 55 | 59 | 56 | 55 | **59** |
| Risk | 98 | 102 | 99 | 99 | **99** |
| Audit and compliance | 13 | 11 | 11 | 11 | **12** |
| Total meetings | 166 | 172 | 166 | 165 | **170** |

# Size and composition of the board

In 2006, the shareholders acting at a general shareholders' meeting approved a bylaw amendment whereby the maximum number of directors was reduced from 30 to 22, with the minimum remaining at 14.

The board presently comprises 18 members, following the resignation due to pre-retirement on 23 January of Mr Francisco Luzón López as a director, executive vice president of Banco Santander and head of the America division.

Pursuant to article 6.3 of the Rules and Regulations of the Board, the appointments and remuneration committee, at its meeting of 17 february 2012, verified the status of each director. Its proposal was submitted to the board, which approved it at its meeting of 20 february 2012 and established the composition of the board upon the terms set forth below.

Of the 18 directors currently sitting on the board of directors, 5 are executive and 13 are non-executive. Of the 13 non-executive directors, 9 are independent, one is proprietary and three are, in the opinion of the board, neither proprietary nor independent.

## Executive directors

Pursuant to the Rules and Regulations of the Board (article 6.2.a)), the following are executive directors: Mr Emilio Botín-Sanz de Sautuola y García de los Ríos, Mr Alfredo Sáenz Abad, Mr Matías Rodríguez Inciarte, Ms Ana Patricia Botín-Sanz de Sautuola y O'Shea and Mr Juan Rodríguez Inciarte.

## Non-executive proprietary directors

Since 2002, the standard used by the appointments and remuneration committee and the board of directors as a necessary but not sufficient condition to designate or consider a director as a non-executive proprietary director (as expressly set forth in article 6.2.b) of the Rules and Regulations of the Board of Directors) is that he/she hold at least 1% of the share capital of the Bank. This percentage was set by the Bank exercising its powers of self-regulation.

Taking into account the circumstances of the case, and upon the prior report of the appointments and remuneration committee, the board believes that Mr Javier Botín-Sanz de Sautuola y O'Shea is a non-executive proprietary director.

## Independent non-executive directors

Independent non-executive directors account for 50% of the Board.

The Rules and Regulations of the Board (article 6.2.c)) include the definition of independent director established in the Unified Code. In the light thereof, taking into account the circumstances of each case, and upon a prior report of the appointments and remuneration committee, the board considers the following to be independent non-executive directors: Mr Fernando de Asúa Álvarez, Mr Manuel Soto Serrano, Mr Guillermo de la Dehesa Romero, Mr Rodrigo Echenique Gordillo, Mr Antonio Escámez Torres, Mr Ángel Jado Becerro de Bengoa, Mr Abel Matutes Juan, Mr Luis Alberto Salazar-Simpson Bos and Ms Isabel Tocino Biscarolasaga.

At 31 December 2011, the average length of service of independent non-executive directors in the position of board member was 11.1 years.

## Other non-executive directors

Lord Burns is a non-executive, non-proprietary director. Since he currently receives remuneration in his capacity as non-executive chairman of the Group's subsidiaries, Santander UK plc and Alliance & Leicester plc, in the opinion of the board of directors and upon a prior report of the appointments and remuneration committee, he cannot be classified as an independent director.

The same applies to Mr Antonio Basagoiti García-Tuñón, who, in his capacity as non-executive chairman of Banesto, receives remuneration in addition to his remuneration as a director of Banco Santander.

Mr Vittorio Corbo Lioi is also a non-executive, non-proprietary director. As he provides remunerated professional services to the Group other than the collective management and supervision services inherent in his position as director —he receives remuneration as a director of Banco Santander Chile and as an advisor of the aforementioned entity—, Mr Corbo, in the opinion of the board of directors and upon a prior report of the appointments and remuneration committee, cannot be classified as independent.

## Changes in the size and composition of the board

On the occasion of the next general shareholders' meeting, and if the board's proposal is accepted, Mr Antonio Basagoiti, Mr Antonio Escámez and Mr Luis Alberto Salazar-Simpson will cease to hold office as directors and Ms Esther Giménez-Salinas i Colomer will be appointed to the Board.

With these changes, the size of the board would be reduced from 20 directors at the beginning of 2011 to 16, of which 5 would be executive and 11, external (1 proprietary, 8 independent and 2 external, neither proprietary nor independent).

## Executive chairman and chief executive officer

The Bank has chosen to have an executive chairman because it believes that it is the position that best suits its circumstances.

The chairman of the board is the highest-ranking officer of the Bank (article 48.1 of the Bylaws and article 8.1 of the Rules and Regulations of the Board) and accordingly, all the powers that may be delegated under the Law, the Bylaws and the Rules and Regulations of the Board have been delegated to him. He is responsible for directing the Bank's management team, always in accordance with the decisions and standards set by the shareholders acting at a general shareholders' meeting and by the board within their respective purview.

The chief executive officer, acting by delegation from and reporting to the board of directors and the chairman, as the highest-ranking officer of the Bank, is charged with the conduct of the business and the highest executive duties.

There is a clear separation of duties between the executive chairman, the chief executive officer, the board and the committees thereof, as well as various checks and balances that assure proper equilibrium in the corporate governance structure of the Bank, including the following:

- The board and its committees exercise supervisory and control duties over the actions of both the chairman and the chief executive officer.
- The first vice-chairman, who is an independent non-executive director, is the chairman of the appointments and remuneration committee and acts as coordinator of non-executive directors.
- The powers delegated to the chief executive officer are the same as those delegated to the chairman, which powers do not include, in either case, those reserved by the board for itself.

## Succession plans for the chairman and the chief executive officer

Succession planning for the main directors is a clear element of the good governance of the Bank, tending to assure an orderly leadership transition at all times. Along these lines, article 24 of the Rules and Regulations of the Board provides that:

*"In the cases of withdrawal, announcement of renunciation or resignation, legal incapacitation or death of the members of the board of directors or its committees or withdrawal, announcement of renunciation or resignation of the chairman of the board of directors or of the chief executive officer or officers, as well as from other positions on such bodies, at the request of the chairman of the board of directors or, in his absence, at the request of the highest-ranking vice-chairman, the appointments and remuneration committee will be convened in order for such committee to examine and organise the process of succession or replacement in an orderly manner and to present the corresponding proposal to the board of directors. Such proposal shall be communicated to the executive committee and subsequently submitted to the board of directors on the following meeting scheduled to be held by the board's annual calendar of meetings or on another extraordinary meeting which, if deemed necessary, is called."*

Article 44.2 of the Bylaws sets out interim replacement rules for the temporary performance (in cases of absence, inability to act or indisposition) of the duties of the chairman of the board in the absence of the vice-chairmen.

The board determines the numerical sequence for such purpose every year based on the directors' seniority. In this regard, at its meeting of 17 June 2011, the board unanimously resolved to assign the following order of priority for the temporary performance of the duties of chairman in the absence of the vice-chairmen of the board:

1) Mr Rodrigo Echenique Gordillo
2) Ms Ana Patricia Botín-Sanz de Sautuola y O'Shea
3) Mr Antonio Escámez Torres
4) Mr Luis Alberto Salazar-Simpson Bos
5) Mr Antonio Basagoiti García-Tuñón
6) Mr Guillermo de la Dehesa Romero
7) Mr Abel Matutes Juan
8) Mr Francisco Javier Botín-Sanz de Sautuola y O'Shea
9) Lord Burns
10) Ms Isabel Tocino Biscarolasaga
11) Mr Juan Rodríguez Inciarte
12) Mr Ángel Jado Becerro de Bengoa

## Secretary of the board

The Bylaws (article 45.2) include among the duties of the secretary those of caring for the formal and substantive legality of the activities of the board, safeguarding observance of the good governance recommendations assumed by the Bank, and ensuring that governance procedures and rules are observed and regularly reviewed.

The secretary of the board is the general secretary, who also acts as secretary of all of the committees of the board.

Article 17.4.d) of the Rules and Regulations of the Board provides that the appointments and remuneration committee must report on proposals for the appointment or withdrawal of the secretary of the board prior to submission thereof to the board.

## Proceedings of the board

There were 14 meetings during financial year 2011.

The board holds its meetings in accordance with an annual calendar. The Rules and Regulations of the Board provide that the board shall hold not less than nine annual ordinary meetings. The board shall also meet whenever the chairman so decides, acting on his own initiative or at the request of not less than three directors (article 46.1 of the Bylaws).

When directors cannot attend a meeting personally, they may give a proxy to any other director, in writing and specifically for each meeting, to represent them for all purposes at such meeting.

Any member of the board may request the inclusion of any other item not included in the draft agenda that the chairman proposes to the board (article 46.2 of the Bylaws).

Meetings of the board shall be validly held when more than one-half of its members are present in person or by proxy.

Except in instances in which a greater majority is specifically required pursuant to legal provisions, the Bylaws or the Rules and Regulations of the Board, resolutions are adopted by absolute majority of the directors attending in person or by proxy. In the event of a tie, the chairman has a tie-breaking vote.

## Conduct of meetings

In 2011, the board was kept continuously and fully informed of the running of the various business areas of the Group through the 8 management reports and the 8 risks reports presented by the chief executive officer and the third vice-chairman in charge of the risk division, respectively, at the 14 meetings held during the financial year. Furthermore, in addition to reviewing the various units and businesses of the Group, the board analysed the liquidity situation, the self-evaluation of capital and the Investor Day held in September, among other matters.

During the year, the board of directors also addressed other matters that come within its area of supervision, as the internal control model and off-shore centres.

Finally, the board was informed of the conclusions of the external and internal audits.

The chart below shows a breakdown of the approximate time dedicated to each duty at the meetings held by the board in financial year 2011.

**Approximate time devoted to each duty**

## Strategy meetings

In addition to the ordinary meetings, the board held specific meetings to discuss Santander's strategy. In 2011, the directors held two meetings: the first one, on 18 January, and the second one, on 17 and 18 December.

Among the matters discussed were:

- The macroeconomic environment and the financial sector, with a focus on the Spanish and European cases and Santander´s positioning and challenges facing Santander vis-à-vis the leading European financial institutions.
- Objectives of the Investor Day.
- Adjustment to the new liquidity and capital environment.
- Management of the Group's business portfolio.

## Training of directors and information programme

As a result of the self-evaluation of the board carried out in 2005, an on-going director training programme was put in place.

Eight meetings were held in 2011 with the attendance of an average of thirteen directors, who devoted approximately one hour and a half to each session. Various issues were reviewed in depth at such meetings in connection with trends in human resources management, the Commercial Banking school and Grupo Santander's technology .

The Rules and Regulations (article 21.7) provide that the board shall make available to new directors an information programme providing quick and adequate understanding of the Bank and its Group, including its governance rules. This programme was thus made available to the newest directors.

## Self-evaluation by the board

The self-evaluation process (carried out, as in previous years, with the support of the firm Spencer Stuart on the basis of a questionnaire and personal interviews with directors) also included a special section for the individual evaluation of the chairman, the chief executive officer and the rest of the directors. This is in line with the recommendations of the Unified Code and is included in the Rules and Regulations of the Board.

Once again this year, the self-evaluation of the board focused on the organisation, operation and content of the meetings of the latter and its committees, comparing them with those of other international banks, and open questions on issues relating to the future (strategy, internal and external factors).

As strong features of the Group's corporate governance, directors highlighted the following: the knowledge of banking business and experience of the directors, the balance between executive and external directors, dedication of members of the board and involvement in risk control.

Furthermore, the committee structure enables the board to be more closely involved with the Group's day-to-day operation and activities emphasising the dedication and involvement of directors.

In the opinion of the directors, these strengths have made the Group a reference point in the present crisis, thanks to the board's involvement in controlling its credit risk and other risks, including reputational and operational risk.

The renewal and internationalisation of the board continues, with the addition of a new director from Latin America.

Likewise, with respect to the organisation, working and content of the board meetings, the following aspects were highlighted: the high level of strategic debate with the organisation of a monographic strategy meeting; the knowledge; the training programme and their high level of commitment.

## Appointment, re-election and ratification of directors

The proposals for appointment, re-election and ratification of directors, regardless of the status thereof, that the board of directors submits to the shareholders for consideration at a general shareholders' meeting, as well as the appointment decisions made by the board itself in the exercise of its powers to make interim appointments as permitted by law, must, in turn, be preceded by the corresponding proposal of the appointments and remuneration committee.

Although the proposals of such committee are not binding, the Rules and Regulations of the Board provide that if the board does not follow them, it must give reasons for its decision.

Currently, all directors have been appointed or re-elected at the proposal of the appointments and remuneration committee.

# Remuneration

## Remuneration system

Article 58 of the Bylaws provides that the directors shall have the right to receive, in consideration for the performance of their duties as board members and as a share in the profits for each financial year, remuneration equal to 1% of the Bank's net profits for the respective financial year, although a director may agree to reduce such percentage. In exercise of its powers, the board set the amount for financial year 2011 at 0.275% of the Bank's profits for the year. This percentage was calculated by including in the numerator not only the annual allocation, but also the attendance fees accrued by the directors during the financial year, as provided in such article 58.

The remuneration of directors is approved by the board at the proposal of the appointments and remuneration committee, except for such remuneration as consists of the delivery of shares or options thereon, or that is paid under other remuneration systems established by reference to the value of the shares of the Bank, the approval of which, under the law and the Bylaws, is within the purview of the shareholders acting at a general shareholders' meeting, at the proposal of the board made after a report of the appointments and remuneration committee.

The Group's policy provides that only executive directors can be beneficiaries of remuneration systems consisting of the delivery of shares or rights thereon.

## Remuneration of the board in 2011

In 2011, the board agreed to reduce all directors' remuneration, for all items, by 8%.

The amount paid to its members for exercising their functions of supervision and collegiate decision-making has been reduced by 6% over 2010. This amount has been unchanged since 2008.

As regards executive directors, the board decided to maintain the fixed remunerations for 2012 and reduce by an average of 16% the variable ones for 2011.

Full details of director compensation policy in 2011 may be found in the report by the appointments & remuneration committee which forms part of Banco Santander's corporate documentation.

## Anticipation and adjustment to the regulatory framework

For several years now, the board of directors, at the proposal of the appointments and remuneration committee, has promoted measures based on the need to have a remuneration system in place that encourages a rigorous management of risks.
This initiative is implemented together with on-going monitoring of the recommendations issued by the principal national and international bodies with authority in this field.

## Report on the director remuneration policy

As provided in the Bylaws (article 59.1), the board of directors annually approves a report on the director remuneration policy, which sets forth the standards and grounds that determine the remuneration for the last and current financial year, making such report available to the shareholders on occasion of the call to the annual general shareholders' meeting.

In 2011, such report was submitted to the shareholders at the general shareholders' meeting held on 17 June, as a separate item on the agenda and as a consultative matter; 95.110% of the votes were in favour of the report.

In addition, following the enactment of the Sustainable Economy Act (*Ley de Economía Sostenible*) and the inclusion of a new article 61 ter in the Securities Market Act (*Ley del Mercado de Valores*), the shareholders at the aforementioned meeting approved an amendment of the Bylaws in order to expressly provide for the obligation to submit the report regarding director remuneration policy to a vote of the shareholders as a consultative matter and as a separate item on the agenda, a practice that the Bank already followed since 2010.

## Transparency

Pursuant to the Bylaws (article 59.2), the annual report includes itemised information on the remuneration received by each director, with a statement of the amounts for each item of remuneration. The report also sets forth, on an individual basis for each item, the remuneration for the executive duties entrusted to the executive directors of the Bank.

All such information is contained in note 5 to the Group's legal report.

# Duties of directors, related-party transactions and conflicts of interest

## Duties

The duties of the directors are governed by the Rules and Regulations of the Board, which conform both to the provisions of current Spanish law and to the recommendations of the Unified Good Governance Code (*Código Unificado de Buen Gobierno)*.

The Rules and Regulations expressly provide for the duties of diligent management, loyalty, secrecy and inactivity in the event of knowledge of confidential information.

The duty of diligent management includes the directors' duty to inform themselves adequately of the running of the Bank and to dedicate to their duties the time and effort needed to carry them out effectively. The directors must inform the appointments and remuneration committee of their other professional obligations, and the maximum number of boards of directors on which they may sit is governed by the provisions of Act 31/1968, of 27 July.

## Related-party transactions

To the best of the Bank's knowledge, no member of the board of directors, no person represented by a director and no company of which such persons, or persons acting in concert with them or through nominees therein, are directors, members of senior management or significant shareholders, has made any unusual or significant transaction with the Bank during financial year 2011 and through the date of publication of this report.

## Control mechanisms

As provided in the Rules and Regulations of the Board (article 30), directors must inform the board of any conflict of interest, whether direct or indirect, that they may have with the interests of the Bank. If the conflict relates to a transaction, the director may not carry it out without the approval of the board, following a report of the appointments and remuneration committee.

The director involved must refrain from participating in the discussion and voting on the transaction to which the conflict refers.

In the case of directors, the body in charge of resolving any disputes is the board of directors itself.

## Specific situations of conflict

In financial year 2011 there were 75 cases in which directors, including those who are members of senior management, abstained from participating and voting in the discussions of the board of directors or of the committees thereof.

The breakdown of the 75 cases is as follows: on 49 occasions, the matter under consideration was the approval of terms of remuneration and other terms of the contracts with the directors; on 11 occasions, proposals were discussed regarding the financing of companies or entities related to various directors or to those abstaining, and projects were discussed regarding the provision to such companies of other financial services and regarding sales of interests therein; on 7 occasions, the situation of conflict was due to proposals for appointment or re-election of the directors; on 5 occasions, the situation arose from the annual verification of the status of the directors made by the appointments and remuneration committee at its meeting of 16 March 2011 pursuant to article 6.3 of the Rules and Regulations of the Board; on 2 occasions, the conflict was related to the non-existence of the circumstances set forth in article 23.2 of such Rules and Regulations; and on one occasion, the matter at hand was the approval of a corporate social responsibility activity in favour of a foundation chaired by a director.

# Committees of the board

## General

The board has set up, as decision-making committees, an executive committee, to which it has delegated general decision-making powers, and a risk committee, to which it has delegated powers specifically relating to risks.

The board also has the following committees with supervisory, reporting, advisory and proposal-making powers: the audit and compliance committee, the appointments and remuneration committee, the international committee, and the technology, productivity and quality committee.

## Executive committee

The executive committee is a basic instrument for the corporate governance of the Bank and its group. Its duties and composition are established in the Bylaws (article 51) and in the Rules and Regulations of the Board (article 14).

There are currently 9 directors sitting on the committee, of whom 4 are executive and 5 are non-executive directors. Of the latter, 4 are independent and 1 is neither proprietary nor independent.

The executive committee proposes to the board those decisions that are within its exclusive purview. It also reports to the board on the matters dealt with and the resolutions adopted by making the minutes of its meetings available to the directors (article 14.7 of the Rules and Regulations of the Board), among other ways of reporting.

## Risk committee

It is governed by the Bylaws (article 52) and the Rules and Regulations of the Board (article 15), which define the composition and duties of this committee, including within its powers and duties the responsibilities set forth in the Unified Code regarding risk control and management.

The committee is currently made up of five directors, of whom two are executive and three are non-executive. Of these three non-executive directors, two are independent and one is neither proprietary nor independent. Its chairman is a vice-chairman with executive duties pursuant to the Rules and Regulations of the Board (article 15.1).

Pages 144 to 203 of this annual report contain broad information regarding the risk committee and the Group's risk policies, the responsibility for which (article 3 of the Rules and Regulations of the Board) is part of the board's general duty of supervision.

## Audit and compliance committee

As provided in the Bylaws (article 53) and the Rules and Regulations of the Board (article 16), the audit and compliance committee must be made up of non-executive directors, the majority of whom must be independent. Its chairman shall be an independent director. It is currently composed of independent non-executive directors only.

Its duties, listed in the above-mentioned provisions, conform to the recommendations of the Unified Code for audit committees and the internal audit function.

The audit and compliance committee has prepared a report regarding its activities in 2011, which is provided to the shareholders as a part of the annual documents.

## Appointments and remuneration committee

The Bylaws (article 54) and the Rules and Regulations of the Board (article 17) provide that this committee is also to be made up exclusively of non-executive directors and that its chairman shall be an independent director, as is in fact the case. All its current members are independent non-executive directors.

During financial year 2011, none of the members of the appointments and remuneration committee was an executive director, member of senior management or employee of the Bank, and no executive director or member of the senior management of the Bank sat on the board (or on the remuneration committee) of companies that employed members of the appointments and remuneration committee.

The Rules and Regulations of the Board establish the duties of this committee, including responsibilities in addition to those recommended by the Unified Code for appointments and remuneration committees.

Since 2004, the appointments and remuneration committee has published an activities report which, since 2006, also includes the report on director remuneration policy.

## Technology, productivity and quality committee

The technology, productivity and quality committee (article 13 of the Rules and Regulations of the Board) has the duty to review and report on plans and activities regarding information systems and programming of applications, investments in computer equipment, design of operating processes in order to increase productivity, and programmes for the improvement of service quality and measuring procedures, as well as those relating to means and costs.

It is made up of eight directors, three of whom are executive and five are non-executive; of the five non-executive directors, four are independent and one is neither proprietary nor independent.

## International committee

The international committee (article 13 of the Rules and Regulations of the Board) has the duty to monitor the development of the Group's strategy and of the activities, markets and countries in which the Group desires to have a presence through direct investments or the conduct of specific transactions. It is kept informed of the initiatives and commercial strategies of the various units within the Group and of the new projects arising for it. It is also responsible for reviewing the performance of financial investments and of the business, as well as the international economic situation, in order to make, if appropriate, proposals calculated to correct country-risk limits, the structure and profitability thereof and their allocation by business and/or unit.

It is made up of seven directors, of which three are executive and four are independent non-executive.

### Main committees of the board

| | Executive committee | Risk committee | Audit and compliance committee | Appointments and remuneration committee |
|---|---|---|---|---|
| Nº of members(*) | 10(**) | 5 | 5 | 5 |
| Executive | 5(**) | 2 | - | - |
| Non executive | 5 | 3 | 5 | 5 |
| Nº of meetings | 59 | 99 | 12 | 11 |
| Hours(***) | 295 | 297 | 60 | 33 |

(*) Data at year-end 2011.
(**) At the date of publication of this report, 9 members of which 4 are executive directors.
(***) Estimated hours of average dedication per director.

# International advisory board

Since 1997, the board of directors has an international advisory board, made up of members of various nationalities and from various areas of activity, all of whom come from outside the Bank and none of whom serve as directors; such international advisory board cooperates with the board of directors in the design, development and, if applicable, implementation of the overall business strategy by contributing ideas and suggesting business opportunities.

During 2011, the international advisory board held 2 meetings, during which the following issues were discussed, among others: the euro crisis and the mechanisms for stabilisation of and support for this currency; the situation in Portugal; the Group's results in 2010 and its performance in 2011; the acquisition of Bank Zachodni WBK; the oil market situation; the Investor Day and the political and economic situation in the US.

It is currently composed of the following 9 members, representing 6 nationalities:

**Chairman**
Mr Antonino Fernández, former chairman of Grupo Modelo in Mexico

**Members**
Mr Bernard de Combret, chairman of Total Trading Geneve

Mr Carlos Fernández González, chairman and executive vice president of Grupo Modelo in Mexico

Mr Santiago Foncillas, former chairman of Grupo Dragados

Mr Richard N. Gardner, former US ambassador to Spain

Mr Francisco Pinto Balsemâo, former prime minister of Portugal

Sir George Mathewson, former chairman of the Royal Bank of Scotland

Mr Antoine Bernheim, honorary chairman of Assicurazioni

Generali S.p.A.

Mr Fernando Masaveu, chairman of Grupo Masaveu

**Secretary**
Mr Ignacio Benjumea Cabeza de Vaca

**Composition of the international advisory board by nationality**

**Main areas of professional experience of the international advisory board members**

# Attendance at meetings of the board of directors and its committees in 2011

Pursuant to the Rules and Regulations of the Board (article 20.1), absences from meetings must be limited to unavoidable cases. The average attendance rate at board of directors' meetings in financial year 2011 was 91.5%.

**Attendance rate at meetings of the board**
%

*The attendance rate at meetings of the board has exceeded 90% in each of the last five years.*

**Attendance at meetings of the board of directors and its committees in 2011**
%

| | | Committees | | | | | |
|---|---|---|---|---|---|---|---|
| | | Decision-making | | Reporting | | | |
| | Board | Executive | Risk | Audit and compliance | Appointments and remuneration | Technology, productivity and quality | International |
| **Average attendance** | 91.54% | 89.15% | 87.47% | 95.38% | 96.23% | 93.75% | 87.50% |
| **Individual attendance:** | | | | | | | |
| Mr Emilio Botín-Sanz de Sautuola y García de los Ríos | 13/14 | 52/59 | – | – | – | 2/2 | 1/1 |
| Mr Fernando de Asúa Álvarez | 13/14 | 55/59 | 91/99 | 12/12 | 11/11 | 2/2 | – |
| Mr Alfredo Sáenz Abad | 13/14 | 54/59 | – | – | – | 2/2 | 1/1 |
| Mr Matías Rodríguez Inciarte | 14/14 | 59/59 | 99/99 | – | – | – | – |
| Mr Manuel Soto Serrano | 13/14 | – | – | 12/12 | 11/11 | 2/2 | – |
| Assicurazioni Generali S.p.A. (1) | 7/9 | – | – | – | – | – | – |
| Mr Antonio Basagoiti García-Tuñón | 14/14 | 57/59 | 94/99 | – | – | 2/2 | – |
| Ms Ana Patricia Botín-Sanz de Sautuola y O'Shea | 12/14 | 37/59 | – | – | – | 1/2 | 0/1 |
| Mr Javier Botín-Sanz de Sautuola y O'Shea | 13/14 | – | – | – | – | – | – |
| Lord Burns (Terence) | 10/14 | – | – | – | – | – | – |
| Mr Vittorio Corbo Lioi (2) | 4/5 | – | – | – | – | – | – |
| Mr Guillermo de la Dehesa Romero | 14/14 | 54/59 | – | – | 11/11 | – | 1/1 |
| Mr Rodrigo Echenique Gordillo | 14/14 | 51/59 | – | 12/12 | 11/11 | – | 1/1 |
| Mr Antonio Escámez Torres | 14/14 | 59/59 | 91/99 | – | – | 2/2 | 1/1 |
| Mr Ángel Jado Becerro de Bengoa | 14/14 | – | – | – | – | – | – |
| Mr Francisco Luzón López | 13/14 | 48/59 | – | – | – | – | 1/1 |
| Mr Abel Matutes Juan | 13/14 | – | – | 12/12 | – | – | 1/1 |
| Mr Juan Rodríguez Inciarte | 12/14 | – | 58/99 | – | – | – | – |
| Mr Luis Ángel Rojo Duque (3) | 3/6 | – | – | 3/5 | 3/5 | – | – |
| Mr Luis Alberto Salazar-Simpson Bos | 13/14 | – | – | 11/12 | – | 2/2 | – |
| Ms Isabel Tocino Biscarolasaga (4) | 13/14 | – | – | – | 4/4 | – | – |

Note: the denominator refers to the number of meetings held during the year during which a director served as such or as a member of the respective committee.
(1) Withdraws from the board on 24 October 2011.
(2) Member of the board since 22 July 2011.
(3) Vacates office upon death on 24 May 2011.
(4) Member of the appointments and remuneration committee since 21 July 2011.

# 3. Shareholder rights and the general shareholders' meeting

## *One share, one vote, one dividend*. No defensive mechanisms contemplated in the Bylaws

The Bank has eliminated all defensive mechanisms in the Bylaws, fully conforming to the *one share, one vote, one dividend* principle.

The Bylaws of Banco Santander provide for only one class of shares (ordinary shares), granting all holders thereof the same rights.

There are no non-voting or multiple-voting shares, or preferences in the distribution of dividends, or limitations on the number of votes that may be cast by a single shareholder, or quorum requirements or qualified majorities other than those established by law.

Any person is eligible for the position of director, subject only to the limitations established by law.

## Quorum at the annual general shareholders' meeting held in 2011

The informed participation of shareholders at general shareholders' meetings is an objective expressly acknowledged by the board (article 31.3 of the Rules and Regulations of the Board).

The quorum at the 2011 annual general shareholders' meeting was 53.710%, above 50% for the fifth consecutive year.

**Quorum at annual general shareholders' meetings**
*% of capital present in person and by proxy*

## Encouragement of informed participation of shareholders at shareholders' meetings

The Bank continues to implement measures designed to encourage the informed participation of shareholders at shareholders' meetings. Thus, at the annual general meeting held in 2011, the shareholders had access to the electronic shareholders' forum, in compliance with the provisions of the Companies Act *(Ley de Sociedades de Capital)*.

Such forum, which the Bank made available on the corporate website (www.santander.com), enables the shareholders to post proposed supplements to the agenda announced in the call to meeting, requests for adherence to such proposals, initiatives aimed at reaching the percentage required to exercise a minority right contemplated by Law, as well as voluntary proxy offers or solicitations.

Furthermore, the annual accounts and the corporate management of the Bank and its consolidated group, all for financial year 2010, were for the first time put to a vote under separate items on the agenda at the 2011 annual general shareholders' meeting.

# Information provided to the shareholders and communication with them

On occasion of the 2011 annual general shareholders' meeting, the chairman once again sent a letter to all shareholders inviting them to suggest the matters they would like to see dealt with, without prejudice to their rights to receive information and make proposals.

1,017 letters and e-mails were received, all of which were duly answered.

During 2011, the Bank held 598 meetings with investors and maintained an on-going relationship with analysts and rating agencies, which entailed personal contact with more than 1,350 investors/analysts. In September it was held in London the Group's Investor Day. During two days the top management analysed with the investment community the outlook, trends and strategic and financial vision for Santander and its most important business units. More than 300 people attended the event.

For the fourth consecutive year, the department of relations with investors and analysts was chosen by investors (buy side) as the best IR Team in the financial industry in Europe, and this year it was also so chosen by analysts (sell side), according to the survey conducted by the specialised magazine Institutional Investor. The department also continued to inform the main investors and analysts of the Group's policies in the area of corporate social responsibility.

Santander has continued to strengthen the channels for shareholder information and service through the seven shareholder's offices it has in significant markets in which it is present (Spain, United Kingdom, United States of America, Brazil, Mexico, Portugal and Chile).

**Channels for shareholder information and service**

| | | |
|---|---|---|
| Telephone service lines | 232,430 | questions |
| Shareholder's mailbox | 51,616 | e-mails answered |
| | 234,065 | subscriptions |
| Forums | 19,819 | participants |
| | 206 | held |
| Letters | 677,060 | letters answered |

Finally, in compliance with recommendations of the National Securities Market Commission (CNMV) on meetings with analysts and investors, both notices of meetings and the documentation to be used thereat are being published sufficiently in advance.

# General shareholders' meeting held in 2011

## Information on the call to meeting, the establishment of a quorum, attendance, proxy-granting and voting

**Annual general shareholders' meeting of 17 June 2011**
Notice of the call to meeting was published on 9 May, 38 days prior to the date of the meeting. A total of 274,517 shareholders attended, in person or by proxy, with 4,533,243,123 shares. The quorum was thus 53.710% of the share capital of the Bank.

The average percentage of affirmative votes upon which the proposals submitted by the board were approved was 94.027%.

The following data are stated as percentages of the Bank's share capital:

**Meeting of 17 June 2011**

| | |
|---|---|
| Physically present | 0.408% (1) |
| By proxy | 34.784% (2) |
| Remote votes | 18.517% (3) |
| Total | 53.710% |

(1) Of such percentage (0.408%), 0.002% is the percentage of share capital that attended by remote means through the Internet.
(2) The percentage of share capital that granted proxies through the Internet was 0.024%.
(3) Of such percentage (18.517%), 18.512% is the percentage of votes cast by postal mail, and the rest is the percentage of electronic votes.

## Resolutions adopted at the general shareholders' meeting held in 2011

The full text of the resolutions adopted at the 2011 annual general shareholders' meeting is available on the websites of both the Group (www.santander.com) and the CNMV (www.cnmv.es).

# 4. Banco Santander's senior management

## Composition

The Bank is managed at the highest level through the executive vice presidents, under the control of the chairman and the chief executive officer. Accordingly, the chairman, the chief executive officer and the following executive vice presidents make up the Bank's senior management, regardless of their positions, if any, on the board of directors:

| Banco Santander´s senior management | |
|---|---|
| **America** | Mr Jesús Mª Zabalza Lotina |
| **Internal Audit** | Mr Juan Guitard Marín |
| **Retail Banking Spain** | Mr Enrique García Candelas |
| **Global Wholesale Banking** | Mr Adolfo Lagos Espinosa<br>Mr Jorge Maortua Ruiz-López |
| **Global Private Banking, Asset and Insurance Management** | Mr Javier Marín Romano |
| **Banesto** | Mr José García Cantera(*) |
| **Brazil** | Mr Marcial Portela Álvarez |
| **Communication, Corporate Marketing and Research** | Mr Juan Manuel Cendoya Méndez de Vigo |
| **United States** | Mr Jorge Morán Sánchez<br>Mr Juan Andrés Yanes Luciani |
| **Strategy and Asia** | Mr Juan Rodríguez Inciarte |
| **Consumer Finance** | Ms Magda Salarich Fernández de Valderrama |
| **Financial and Investor Relations** | Mr José Antonio Álvarez Álvarez |
| **Financial Accounting and Control** | Mr José Manuel Tejón Borrajo |
| **Human Resources** | Mr José Luis Gómez Alciturri |
| **Risk** | Mr Matías Rodríguez Inciarte<br>Mr Javier Peralta de las Heras<br>Mr José María Espí Martínez |
| **Santander Totta** | D. Antonio Vieira Monteiro(**) |
| **Santander UK** | Ms Ana Patricia Botín-Sanz de Sautuola y O'Shea<br>Mr José María Nus Badía |
| **General Secretariat** | Mr Ignacio Benjumea Cabeza de Vaca<br>Mr César Ortega Gómez |
| **Technology and Operations** | Mr José María Fuster van Bendegem |

(*) Chief executive officer of Banesto (not an executive vice president of Banco Santander).
(**) Santander's counntry head in Portugal (not an executive vice president of Banco Santander).

In addition, Mr Ramón Tellaeche Bosch, a deputy executive vice president of the Bank, is the head of the Payment Means division, and Mr José Antonio Villasante Cerro, also a deputy executive vice president of the Bank, is the head of the Santander Universidades global division.

## Remuneration

Information on the remuneration of executive vice presidents is provided in note 5 to the Group's legal report.

## Related-party transactions and conflicts of interest

### Related-party transactions

To the knowledge of the Bank, no member of senior management who is not a director, no person represented by a member of senior management who is not a director, and no company in which such persons or persons with whom they act in concert or who act through nominees therein are directors, members of senior management or significant shareholders, has made any unusual or significant transaction with the Bank during financial year 2011 and through the date of publication of this report.

### Conflicts of interest

The control mechanisms and the bodies in charge of resolving this type of situation are described in the Code of Conduct in Securities Markets, which is available on the Group's website (www.santander.com).

# 5. Transparency and independence

## Financial information and other significant information

### Financial information

Pursuant to the provisions of its Rules and Regulations (article 34.2), the board has taken the necessary actions to ensure that the quarterly and semi-annual financial information and the other information made available to the markets is prepared following the same principles, standards and professional practices as are used to prepare the annual accounts. To such end, the aforementioned information is reviewed by the audit and compliance committee prior to the release thereof.

As regards the annual accounts, they are reported on by the audit and compliance committee and certified by the head of financial accounting prior to the preparation thereof by the board.

### Other significant information

Pursuant to the provisions of the Code of Conduct in Securities Markets, the compliance area is responsible for communicating to the CNMV the significant information generated in the Group.

Such communication shall be simultaneous to the release of significant information to the market or the media, as soon as the decision in question is made or the resolution in question has been signed or carried out. Significant information shall be disseminated in a true, clear, complete and equitable fashion and on a timely basis and, whenever practicable, such information shall be quantified.

In financial year 2011, the Bank published 124 material fact notices, which are available on the websites of the Group and the CNMV.

## Relationship with the auditor

### Independence of the auditor

The shareholders acting at the general shareholders' meeting of 17 June 2011 approved the re-election of Deloitte, S.L. as auditor for one year, with the affirmative vote of 97.775% of the capital present in person or by proxy.

The Bank has mechanisms in place to preserve the independence of the auditor; worth noting is the obligation of the board to refrain from hiring audit firms in which the fees intended to be paid to them for any and all services are more than two per cent of the total income thereof during the last financial year.

In addition, the Rules and Regulations of the Board establish limits upon hiring the audit firm for the provision of services other than audit services that could jeopardise the independence thereof and impose on the board the duty to make public the overall fees paid by the Bank to the auditor for services other than audit services. The information for financial year 2011 is contained in note 48 to the Group's legal report.

The Rules and Regulations determine the mechanisms to be used to prepare the accounts such that there is no room for qualifications in the auditor's report. Nevertheless, the Bylaws as well as the Rules and Regulations also provide that, whenever the board believes that its opinion must prevail, it shall provide an explanation, through the chairman of the audit and compliance committee, of the content and scope of the discrepancy and shall endeavour to ensure that the auditor issue a report in this regard. The annual accounts of the Bank and of the consolidated Group for financial year 2011 are submitted without qualifications.

At its meeting of 13 febrero 2012, the audit and compliance committee received from the auditor a written confirmation of its independence in respect of the Bank and the entities directly or indirectly related thereto, as well as information regarding additional services of any kind provided to such entities by the auditors or by entities related thereto, pursuant to the provisions of Legislative Royal Decree 1/2011, of 1 July, approving the Consolidated Audit Act.

At its meeting of 13 febrero 2012, such committee issued a report setting forth a favourable opinion regarding the independence of the auditors and passing, among other matters, upon the provision of the additional services mentioned in the preceding paragraph.

The aforementioned report, issued prior to the audit report, has the content provided by the Securities Market Act (*Ley del Mercado de Valores*).

## Intra-group transactions

There were no intra-group transactions in financial year 2011 that were not eliminated in the consolidation process and that are not part of the ordinary course of business of the Bank or of the companies of its Group as regards the purpose and conditions thereof.

## Website

Since 2004, the Group's website (www.santander.com) has disclosed in the Information for Shareholders and Investors section of the main menu all information required by the Companies Act (*Ley de Sociedades de Capital*) and under Order ECO/3722/2003, thus carrying out the resolution adopted by the board at its meeting of 23 January 2004.

The website contents are presented with specific sections for institutional investors and shareholders and the information is accessible in Spanish, English and Portuguese.

The information available on such website includes:

- The Bylaws.
- The Rules and Regulations for the General Shareholders' Meeting.
- The Rules and Regulations of the Board.
- The professional profiles of and other information regarding the directors, in line with recommendation 28 of the Unified Code.
- The annual report.
- The annual corporate governance report.
- The Code of Conduct in Securities Markets.
- The General Code of Conduct.
- The sustainability report.
- The reports of the audit and compliance committee and the appointments and remuneration committee.
- The Santander-Banesto relationship framework established by application of recommendation 2 of the Unified Code.

The announcement of the call to the 2012 annual general shareholders' meeting will be viewable as from the date of publication thereof, together with the information relating thereto, including proposed resolutions and mechanisms for the exercise of the rights to receive information, to grant proxies and to vote, as well as an explanation of the mechanisms for the exercise of such rights by means of data transmission and the rules applicable to the electronic shareholders' forum that the Bank will make available on its website (www.santander.com).

# 6. Unified Good Governance Code

In 2007, Banco Santander carried out a process of adjustment to the Unified Good Governance Code, approved by the National Securities Market Commision (CNMV) on 22 May 2006, based on the principle of self-regulation, which was completed in 2008 with the approval of new Bylaws and, in 2009, with new Rules and Regulations of the Board of Directors.

Banco Santander follows practically all of the recommendations of the Unified Code, and does not follow (i.e., does not adopt in full) a small number of them (3 out of 58). Such recommendations from which the Bank departs are described in the following sections, together with the rationale for the board's position.

## Number of members of the board of directors

Although the current number of directors (18) exceeds the maximum number of 15 proposed by recommendation 9, the board believes that its size is commensurate with the scale, complexity and geographical diversification of the Group. In the opinion of the board, the manner in which it operates, sitting both as a full body and through committees —with delegated supervisory, advisory, reporting and proposal-making powers—, guarantees its effectiveness and the participation of its members.

However, should the board's proposal regarding the appointment, re-election and ratification of directors is approved by shareholders at the general meeting in March 2012, the number of board members would be reduced to 16, from the 20 existing at the beginning of 2011.

## Independent directors

In the opinion of the board, no different treatment should be established for independent directors vis-à-vis other directors.

Accordingly, it believes that it would not be in keeping with the aforementioned principles to adopt recommendation 31 to the effect that the board of directors should not propose the withdrawal of any independent director prior to the expiration of the term fixed by the bylaws for which he was appointed, except for just cause, determined by the board following a report of the appointments and remuneration committee, with just cause being deemed to exist whenever such director fails to perform the duties inherent in his position or if he becomes subject to any of the circumstances that deprive him of independence. In this case, the decision of the board not to adopt recommendation 31 is also based on the fact that there may be reasons of corporate interest which, in the opinion of the board itself, may lead to a proposal for withdrawal from the board for reasons other than those contemplated in the recommendation.

The board has also not deemed it appropriate to adopt recommendation 29 to the effect that the term of office of independent directors be limited to a maximum of 12 years, as this would lead to having to dispense with the services of directors whose continuation on the board serves the corporate interest because of their qualifications, contribution and experience, without such continuation affecting their independence.

# Economic and financial review

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# Economic and financial review

## General background

The global economy continued to slowdown, due to worsening of European sovereign debt crisis and a fall in confidence, with new episodes of uncertainty as of the summer which, sparked tougher funding conditions. This scenario was partly offset by a general softening of monetary policy: injections of liquidity in the case of the European Central Bank, a prolongation of low interest rates in the US and cuts in official interest rates in Latin America.

The US economy grew 1.7%, after growth of 2.8% annualised in the fourth quarter, which helped to offset part of the drop in growth in the first half of 2011. This growth, basically due to investment in equipment and the external sector, gradually gave way to greater participation of consumption and investment in non-residential construction, which will remain in coming quarters and put the growth rate at around its potential.

The impact of oil prices and greater use of installed capacity raised inflation to more than 3% in the middle of the year. However, the underlying rate remained under control at around 1.5%, enabling the Federal Reserve to maintain a very accommodating monetary policy in favour of growth and re-establish the interbank market.

Latin America kept up good growth rates for the year as a whole, although lower than in 2010. In the second half the impact of the downturn in the global economy and the drop in raw material prices began to be felt. In order to counter the impact on growth, some central banks began to soften their monetary policies, which is still going on. This strategy is likely to be replicated by other central banks during 2012.

Brazil's growth eased to 3.0% from 4.2% year-on-year in the first quarter and subsequent deceleration, which reached a low in the third quarter. The downturn led the central bank to begin to gradually cut the Selic rate from 12.50% in September to 10.50% in January 2012, a trend that will continue in the coming months.

A softer monetary policy and buoyant domestic demand, backed by a solid labour market (jobless rate at its lowest, less than 5%), will continue to fuel growth. Inflation remained high (6.5% in December) and in some months above the central bank's target (4.5+2%). As regards the currency, the evolution of interest rates in the second half of the year and the measures to control an excessive appreciation of the real produced a depreciation for the year as a whole. The real ended 2011 at BRL 1.87/$1 (BRL 1.66/$1 in 2010).

Mexico showed considerable resistance to the international financial turbulence and weakening of the global economy. Based on figures for the first nine months (+4.5% year-on-year growth in the third quarter), GDP growth for the whole year was around the potential rate of 4%. This was due to industrial output, investment and the recovery in lending to the private sector, particularly consumer credit, which is expected to remain solid in coming quarters despite the external uncertainties.

The good activity growth, moderate inflation (3.4% average in 2011), which remained within the Bank of Mexico's target range (2%-4%), and an external position favoured by higher oil prices enabled the central bank to hold its key interest rate at 4.5%, keeping its leeway. The peso depreciated during the year, after ending the year at MXN 13.95/$1, the result of international financial tensions in the second half of the year.

The Chilean economy grew 6.3%, partly due to the weakness in the beginning of 2010 following the earthquake. Growth was on a downward trend, more so in the second half of the year because of international tensions, which is expected to continue because of a weaker external environment and flagging private consumption.

Inflation remained under control (3.3% average), enabling the central bank to stop raising interest rates in the second half of the year (+200 b.p. between January and June to 5.25%). The spurt in inflation in the last part of the year (4.4% in December) is considered temporary, which would allow the central bank to maintain leeway for softening monetary policy and fostering growth, as reflected in January when it cut the rate by 25 b.p. to 5%. The peso, like other main currencies in the region, depreciated, ending the year at CLP 519/$1.

The euro zone grew 1.6% in 2011. After a robust start, activity slowed due to risks appearing that threatened the recovery (greater than envisaged impact of the rise in raw material prices and Japan's earthquake), coupled with, in the second half of the year, management of the sovereign debt crisis that did not convince the markets. Fourth quarter GDP shrank 0.3%, a fall expected to carry on into early 2012.

Inflation remained above the ECB's target throughout the year (2.7% vs. 2%) and in December began a downward path (from 3.0% to 2.8%) that could see inflation moving towards the target.

In this context of sharp slowdown and uncertainty, the ECB undid in the fourth quarter the two rises in its rates carried out in the first half of the year (from 1.0% to 1.5%) and ended 2011 with a repo rate of 1%. Furthermore, it re-established unconventional liquidity facilities and in December made a new auction (3 years without a volume limit) which will be repeated in February 2012. The intensified tensions in the euro zone and the slower growth caused the euro to gradually weaken against the dollar and end the year at EUR 1/$1.29 (EUR 1/$1.34 in 2010).

There are significant divergences and prospects in the euro zone. The worst countries are the so called peripheral ones, which face a greater loss of confidence and high funding costs combined with the shrinkage effect of fiscal adjustment policies. Germany, on the other hand, is in a better situation, with GDP growth of 3.0% in 2011 and an unemployment rate of 6.8%, the lowest rate since 1991. However, like the euro zone, fourth quarter growth shrunk 0.2% which could be corrected in the short term.

The Spanish economy expanded 0.7% in 2011, fuelled by exports, which offset the weak domestic demand. Growth slowed and GDP contracted 0.3% in the fourth quarter, due to anaemic consumption. The continuation of these trends, combined with the impact of the large deficit reduction process, point to a return to recession, according to all forecasts. In this context, inflation, which remained high (3.2% average), largely due to higher energy prices, fell significantly in the last part of the year (2.4% in December).

The UK showed similar growth levels and profiles: +0.9% for the whole of 2011 and shrinkage in the fourth quarter (0.8% annualised). This reflected the worsening international financial and trade situation, and weak domestic demand, which is expected to continue in coming quarters, although partly offset by a more stable labour market.

Inflation was high throughout the year (4.5% average) but on a downward path (4.2% in December as against 5.2% in September) which will continue in 2012. The Bank of England, which held its base rate at 0.5%, increased its programme to buy bonds by £75,000 million in October, which was added to the £200,000 million already acquired. Sterling appreciated against a euro weakened by the sovereign debt crisis to £1/EUR 1.20 (£1/EUR 1.16 in 2010).

## Summary of 2011 for Grupo Santander

Grupo Santander registered attributable profit of EUR 5,351 million in 2011, a decline of 34.6% from 2010. Profit would have been EUR 7,021 million, a decline of 14.2%, if the bank had not made pre-tax provisions in the fourth quarter against property exposure in Spain of EUR 1,812 million and a pre-tax amortisation of EUR 601 million from goodwill related to Santander Totta. The bank also applied net capital gains of EUR 1,513 million realised in 2011 to other provisions.

In an environment that was once again complex in many markets where it operates, Santander continued to prove the robustness of its business model, which is adapted to the various markets and environments. Differentiated management enables Santander to generate high recurring profits, while improving, at the same time, the Group's positioning for the coming years.

The pillars of Santander's model are the focus on the customer and on commercial business, geographic diversification, the continuous striving to improve efficiency, prudence in risk and discipline in capital and liquidity. All of this enhanced by the Santander brand, which is recognised as one of the world's leading financial brands.

The key points in 2011 were:

1) **Solid generation of recurring profits**. In the last few years Grupo Santander has been able to keep on increasing its revenues which, as well as setting us apart from the sector, enabled net operating income (pre-provision profit) to continue to grow and reach EUR 24,373 million in 2011.

   This figure makes Santander one of the best banks in the world in these terms. It also shows an excellent evolution during the four years of the crisis, as profits before provisions amounted to EUR 90,000 million.

   This capacity to generate such results makes the income statement very solid and gives it a substantial cushion for absorbing provisions in the most demanding environments.

   The 2011 income statement continues to reflect the diversification and management focuses adapted to each market:

   – By areas, growth in net operating income in emerging markets (Latin America and, in local criteria, Poland). There was also an increase in the units of developed countries where the macroeconomic environment is still weak but the units are benefiting from the business moment (US and consumer business, ahead in the cycle). All of this is in stark contrast to the sharp fall in profits in markets such as Spain and Portugal, hard hit by intense deleveraging, as well as the lower level in the UK which was very affected by the cost of regulatory impacts.

   – By lines, of note was the growth in revenues (+5.3%). Net interest income and net fees increased at a good pace in a scenario of lower activity in developed markets, very low interest rates and upward pressure of funding costs. On the other hand, the negative impact of gains on financial transactions of the operating areas, especially in Global Banking and Markets.

– Total operating costs increased 9.3%, reflecting a differentiated management on the basis of markets and businesses. Most of the rise was due to capture growth in emerging markets. The efficiency ratio was 44.9%, the best among comparable banks.

2) **Effort in provisions to strengthen the balance sheet.** As well as the recurring profits, Grupo Santander decided to realise provisions net of taxes of EUR 3,183 million, of which EUR 1,513 million were drawn from capital gains and EUR 1,670 million from the fourth quarter profits.

The bank charged EUR 1,812 million pre-tax provisions against the fourth quarter earnings to cover real estate exposure in Spain and EUR 601 million in pre-tax provisions to amortise goodwill related to the businesses in Santander Totta.

Moreover, net capital gains of EUR 1,513 million generated in 2011 were also assigned to provisions, including charges against investment portfolios of EUR 620 million, and amortisation of intangibles and contributions to pensions and other contingencies of EUR 893 million.

The aforementioned provisions made for real estate risk pushed up coverage of foreclosed properties in Spain to 50%, while coverage of doubtful and substandard loans with a real estate purpose was also improved (33% and 16% respectively).

These increases in coverage anticipated part of the new requirements outlined in the Royal Decree 2/2012 which came into force on February 3, to increase provisions for real estate assets in the Spanish financial system.

In the case of Grupo Santander, such requirements amount to EUR 6,100 million, and will be entirely met in 2012, as follows:

- EUR 1,800 million already charged against 2011 results.
- EUR 2,000 million are a capital buffer required by the rules and already covered by the capital surplus held by the Group.
- The remaining EUR 2,300 million will be covered through capital gains which may be obtained during the year (including EUR 900 million from the capital gain obtained from the sale of Banco Santander Colombia) and through ordinary contributions to provisions during 2012.

3) **High level of credit quality**. Grupo Santander's risk management model, together with the capacity to assign profits to provisions, make the evolution of the credit quality ratios compare very well with those of other banks in the main countries where we operate.

This led to the Group's NPL ratio stabilising in the last two quarters. It ended 2011 at 3.89% and coverage was 61%.

4) **Strengthening the capital position**. Grupo Santander once again displayed its financial strength and flexibility by anticipating compliance with the European Banking Authority's capital requirement, which has to be reached by June 2012. The Group was able to carry out various measures to raise its core capital ratio from 7.53% to 9.01%, in accordance with the EBA's criteria.

At the same time, the increase in the last quarter meant that the core capital ratio, in accordance with the BIS II international standard, rose by 122 b.p. to 10.02% from 8.80% in December 2010. For the fifth year running, the Group improved its solvency.

5) **Solid funding structure and liquidity ratios**. After a year of tensions in the markets, particularly in the second half, Santander managed to maintain a solid liquidity position, thanks to its considerable capacity in the retail market via its branches, and its broad and diversified access to wholesale markets via its model of subsidiaries. Another factor at play in the current context is deleveraging in some markets.

The loan-to-deposit ratio ended 2011 at 117% compared to 150% at the beginning of the crisis in 2008.

Moreover, the Group maintained in 2011 a very conservative policy in medium- and long-term wholesale issues. The volume issued was higher than the maturities during the year.

6) **High shareholder return**. The total shareholder remuneration was EUR 0.60 per share, including the scrip dividend, thereby maintaining the remuneration for the last two years.

7) **Better positioning of the Group**. In the last few years, Santander has continued to combine organic growth initiatives in key countries with active management of the business portfolio, enabling it to end the year in a more diversified position and with greater future growth potential.

## Exchange rates: 1 euro / currency parity

| | 2011 | | 2010 | |
|---|---|---|---|---|
| | Year-end | Average | Year-end | Average |
| $ | 1.2939 | 1.3903 | 1.3362 | 1.3228 |
| Pound sterling | 0.8353 | 0.8675 | 0.8608 | 0.8570 |
| Brazilian real | 2.4159 | 2.3244 | 2.2177 | 2.3262 |
| New Mexican peso | 18.0512 | 17.2523 | 16.5475 | 16.6997 |
| Chilean peso | 671.3400 | 672.0923 | 625.2748 | 673.9214 |
| Argentine peso | 5.5686 | 5.7445 | 5.3074 | 5.1737 |
| Colombian peso | 2,509.5191 | 2,568.6527 | 2,565.5040 | 2,507.2221 |
| Uruguayan peso | 25.8133 | 26.7630 | 26.5904 | 26.4588 |
| Polish zloty | 4.4580 | 4.1105 | 3.9750 | 3.9931 |

During 2011, some of the pending agreements announced at the end of 2010 materialised and other operations were carried out to increase and restructure the Group's presence in emerging countries and developed with great potential for Santander.

As regards the Group's incorporations, the acquisition of the Polish bank BZ WBK was completed (it began to consolidate in the Group in the second quarter), as well as of the retail business of Skandinaviska Enskilda Banken (SEB Group) in Germany, which entered the Group in the first quarter.

The transaction with the insurer Zurich was also completed in order to reorganise bancassurance business in Latin America and new partners entered the capital of Santander Consumer USA, where the Group holds a 65% stake.

These operations together with the economic cycle in the various geographic areas, increased the contribution of emerging countries up to 54% of the operating areas attributable profit.

Lastly, agreement was reached to sell the subsidiary in Colombia, which will probably be completed during the first half of 2012. This sale will generate capital gains of around EUR 615 million, which will also be assigned to strengthening the balance sheet.

As regards the main segments (geographic), the main developments were:

- **Continental Europe**: attributable profit was 15.1% lower at EUR 2,849 million, hard hit by the low growth environment and deleveraging and low interest rates, as well as the negative impact of gains on financial transactions and fee income. Profits fell at the three commercial networks and at wholesale businesses, while Santander Consumer Finance performed well (+51.5% in attributable profit) and Poland's BZ WBK was incorporated to the Group in April.
- **United Kingdom**: attributable profit of EUR 1,145 million (£993 million), 41.0% less than in 2010 in local currency. The income statement was very affected by the environment of low activity, low interest rates, regulatory changes, higher funding costs and the PPI charge. On the other hand, costs were almost flat and fewer provisions were made, reflecting the good evolution of non-performing loans.
- **Latin America**: attributable profit of EUR 4,664 million, similar to 2010 without the impact of exchange rates, thanks to the dynamism of net interest income and fee income, which lifted gross income by 9.5%. This offset the higher costs from investments, the pressure of inflation on salaries and higher provisions.
- **Sovereign**: attributable profits of EUR 526 million ($732 million), 30.3% higher in local currency than in 2010. Revenues and provisions performed well and costs rose because of investments in technology and commercial structures.

## Rating agencies

The Group's access to wholesale finance markets, as well as the cost of issues, depend, to some extent, on the ratings given by rating agencies.

These agencies regularly review the Group's ratings. The long-term debt rating depends on a series of endogenous factors (solvency, business model, capacity to generate profits, ...) and other exogenous ones related to the general economic environment, the sector's situation and the sovereign risk of the countries in which it does business.

Since autumn the difficulties in resolving the problems of European countries, which have required financial assistance, together with worsening of the euro zone's growth expectations, have produced a fall in confidence and a rise in tensions on European sovereign debt. This situation led to a widespread and significant downgrading of the sovereign ratings of many European countries, which, in turn, resulted in actions on the rating of their banks.

Between October 2011 and February 2012, the Kingdom of Spain's credit rating was cut one notch by DBRS from AA to AA (low), three by Standard & Poor's (from AA to A) and four in the case of Moody's (from Aa2 to A3) and Fitch (from AA+ to A), maintaining the negative outlook in all of them.

These movements led to a review of Banco Santander's ratings, which in February 2012 were as follows:

### Rating Agencies

| | Long term | Short term | Stand-alone | Outlook |
|---|---|---|---|---|
| Standard & Poor's | A+ | A-1 | a | Negative |
| Fitch Ratings | A | F1 | a | Negative |
| Moody's | Aa3 | P1 | B- | Negative |
| DBRS | AA (low) | R1(medium) | | Negative |

Lastly, after its latest review, Standard & Poor's put Banco Santander's long-term rating one notch above the Spanish sovereign credit rating. Fitch and DBRS give the Bank the same rating as the Kingdom of Spain, and following the recent downgrading by Moody's of Spanish sovereign debt the Bank's rating is three notches above that of the Kingdom of Spain. At the date of publication of this report, Moody's was reviewing Banco Santander's rating.

## Grupo Santander. Results

- Solid profit generation: the Group generated over EUR 24,000 million in net operating income for the first time ever (pre-provision profit), improving for the ninth year running.
- Big effort to strengthen the balance sheet: extraordinary provisions of EUR 3,183 million net of tax, of which EUR 1,513 were capital gains and EUR 1,670 million fourth quarter profits.
- Recurring profit amounted to EUR 7,021 million, 14.2% less than in 2010:
  - Gross income rose 5.3% reaching historic highs, withstanding the cycle in mature markets and recovering in emerging ones.
  - Differentiated management of costs by unit.
  - Loan-loss provisions increased 3.0% due to the lower release of generic ones, as specific provisions were 9.8% lower.

Grupo Santander generated an attributable profit of EUR 5,351 million, 34.6% less than the EUR 8,181 million posted in 2010. Earnings per share (EPS) were EUR 0.6018 (-36.1%).

The following factors need to be taken into account in order to interpret the results appropriately.

- In the second half of the year, the economic environment deteriorated considerably, which is leading to lower global growth.
- In the fourth quarter the bank made provisions for EUR 3,183 million net of tax, of which EUR 1,513 million came from capital gains and EUR 1,670 million from fourth quarter profits (EUR 1,812 million gross) to be assigned to real estate provisions in Spain, and EUR 601 million for the amortisation of Santander Totta's goodwill.
- In addition, the profit reflects a one-off charge in the second quarter of EUR 620 million (£538 million) net of tax from a provision made in the second quarter related to Payment Protection Insurance (PPI) remediation in the UK.

## Income statement

*Million euros*

| | 2011 | 2010 | Variation amount | % | 2009 |
|---|---|---|---|---|---|
| **Net interest income** | **30,821** | **29,224** | **1,597** | **5.5** | **26,299** |
| Dividends | 394 | 362 | 32 | 8.9 | 436 |
| Income from equity-accounted method | 57 | 17 | 40 | 235.1 | (1) |
| Net fees | 10,471 | 9,734 | 737 | 7.6 | 9,080 |
| Gains (losses) on financial transactions | 2,500 | 2,606 | (106) | (4.1) | 3,423 |
| Other operating income/expenses | 18 | 106 | (88) | (82.8) | 144 |
| **Gross income** | **44,262** | **42,049** | **2,213** | **5.3** | **39,381** |
| Operating expenses | (19,889) | (18,196) | (1,694) | 9.3 | (16,421) |
| General administrative expenses | (17,781) | (16,256) | (1,525) | 9.4 | (14,825) |
| *Personnel* | *(10,326)* | *(9,330)* | *(996)* | *10.7* | *(8,450)* |
| *Other general administrative expenses* | *(7,455)* | *(6,926)* | *(528)* | *7.6* | *(6,374)* |
| Depreciation and amortisation | (2,109) | (1,940) | (169) | 8.7 | (1,596) |
| **Net operating income** | **24,373** | **23,853** | **519** | **2.2** | **22,960** |
| Net loan-loss provisions | (10,562) | (10,258) | (304) | 3.0 | (9,484) |
| Impairment losses on other assets | (173) | (471) | 298 | (63.4) | (402) |
| Other income | (2,822) | (1,072) | (1,749) | 163.1 | (1,311) |
| **Profit before taxes (w/o capital gains)** | **10,817** | **12,052** | **(1,235)** | **(10.2)** | **11,764** |
| Tax on profit | (2,936) | (2,923) | (12) | 0.4 | (2,336) |
| **Profit from continuing operations (w/o capital gains)** | **7,881** | **9,129** | **(1,248)** | **(13.7)** | **9,427** |
| Net profit from discontinued operations | (24) | (27) | 3 | (9.3) | 31 |
| **Consolidated profit (w/o capital gains)** | **7,857** | **9,102** | **(1,245)** | **(13.7)** | **9,458** |
| Minority interests | 836 | 921 | (85) | (9.2) | 516 |
| **Attributable profit to the Group (w/o capital gains)** | **7,021** | **8,181** | **(1,160)** | **(14.2)** | **8,943** |
| Net extraordinary capital gains and provisions (1) | (1,670) | — | (1,670) | — | — |
| **Attributable profit to the Group** | **5,351** | **8,181** | **(2,830)** | **(34.6)** | **8,943** |
| | | | | | |
| **EPS (euros)** | **0.6018** | **0.9418** | **(0.3400)** | **(36.1)** | **1.0454** |
| **Diluted EPS (euros)** | **0.5974** | **0.9356** | **(0.3382)** | **(36.1)** | **1.0382** |
| | | | | | |
| Pro memoria: | | | | | |
| Average total assets | 1,228,382 | 1,190,361 | 38,021 | 3.2 | 1,099,018 |
| Average shareholders' equity | 74,901 | 69,334 | 5,567 | 8.0 | 64,335 |

(1) In 2009 extraordinary capital gains and extraordinary provisions for the same amount are included, and thus the net amount is zero.

- The impact of the exchange rates of various currencies against the euro was not very significant at around one percentage point negative in comparing revenues and costs with 2011. In the UK and Latin America, the impact was one percentage point negative and in Sovereign five percentage points negative.

- Lastly, there is a positive impact of around three or four points in revenues and costs from the change in perimeter. This impact is the net effect of the entry into consolidation of Bank Zachodni WBK, AIG in Poland and SEB in Germany (Santander Retail) and lower revenues from insurance business, as the operation with Zurich Financial Services was closed in the fourth quarter.

The performance of the income statement and comparisons with 2010 was as follows:

**Basic revenues** (net interest income, fee income and insurance results) amounted to EUR 41,685 million, 6.0% more than in 2010 (+4.8% excluding the perimeter and exchange rate effects).

- **Net interest income** rose 5.5% to EUR 30,821 million. This was due to the net impact of several factors.

  – There was a positive effect from the moderate increase in volumes and the improvement in the spreads on loans for the whole Group (from 3.64% to 3.89%).

  – Spreads on deposits which compared negatively in the first half of the year, are already at the same levels (0.28% in 2010 and 0.29% in 2011).

  – Negative impact from the higher cost of wholesale funding and the greater regulatory requirements for liquidity in some countries, mainly the UK.

- **Net fee** income increased 7.6%, with a favourable performance of those from insurance and services. The latter showed rises in almost all lines: cards, demand deposits, etc. On the other hand, income from securities and custody was lower and virtually unchanged from mutual and pension funds.

## Quarterly

*Million euros*

| | 2010 | | | | 2011 | | | |
|---|---|---|---|---|---|---|---|---|
| | Q1 | Q2 | Q3 | Q4 | Q1 | Q2 | Q3 | Q4 |
| **Net interest income** | **7,122** | **7,378** | **7,396** | **7,329** | **7,514** | **7,638** | **7,700** | **7,969** |
| Dividends | 47 | 144 | 60 | 111 | 40 | 193 | 60 | 101 |
| Income from equity-accounted method | 3 | 5 | 5 | 4 | 5 | 5 | 6 | 40 |
| Net fees | 2,326 | 2,483 | 2,481 | 2,445 | 2,595 | 2,729 | 2,694 | 2,454 |
| Gains (losses) on financial transactions | 724 | 567 | 599 | 715 | 657 | 722 | 639 | 482 |
| Other operating income/expenses | 38 | 38 | 22 | 9 | 41 | (2) | 18 | (38) |
| **Gross income** | **10,260** | **10,614** | **10,563** | **10,613** | **10,852** | **11,285** | **11,117** | **11,008** |
| Operating expenses | (4,263) | (4,548) | (4,687) | (4,698) | (4,824) | (4,908) | (4,994) | (5,164) |
| General administrative expenses | (3,812) | (4,070) | (4,206) | (4,168) | (4,314) | (4,380) | (4,456) | (4,631) |
| *Personnel* | *(2,182)* | *(2,317)* | *(2,408)* | *(2,421)* | *(2,521)* | *(2,550)* | *(2,611)* | *(2,644)* |
| *Other general administrative expenses* | *(1,629)* | *(1,753)* | *(1,798)* | *(1,746)* | *(1,792)* | *(1,830)* | *(1,845)* | *(1,987)* |
| Depreciation and amortisation | (451) | (478) | (481) | (531) | (510) | (528) | (538) | (534) |
| **Net operating income** | **5,997** | **6,066** | **5,876** | **5,915** | **6,029** | **6,377** | **6,123** | **5,843** |
| Net loan-loss provisions | (2,436) | (2,483) | (2,935) | (2,404) | (2,188) | (2,684) | (2,906) | (2,785) |
| Impairment losses on other assets | (57) | (63) | (41) | (310) | (48) | (52) | (84) | 11 |
| Other income | (331) | (362) | (364) | (16) | (550) | (1,379) | (361) | (531) |
| **Profit before taxes (w/o capital gains)** | **3,173** | **3,158** | **2,535** | **3,186** | **3,243** | **2,262** | **2,773** | **2,538** |
| Tax on profit | (734) | (680) | (634) | (874) | (888) | (636) | (778) | (634) |
| **Profit from continuing operations (w/o capital gains)** | **2,439** | **2,477** | **1,901** | **2,311** | **2,355** | **1,627** | **1,995** | **1,904** |
| Net profit from discontinued operations | (12) | (1) | (4) | (10) | (6) | (0) | (15) | (3) |
| **Consolidated profit (w/o capital gains)** | **2,427** | **2,476** | **1,897** | **2,301** | **2,349** | **1,626** | **1,980** | **1,901** |
| Minority interests | 212 | 246 | 262 | 201 | 241 | 234 | 177 | 184 |
| **Attributable profit to the Group (w/o capital gains)** | **2,215** | **2,230** | **1,635** | **2,101** | **2,108** | **1,393** | **1,803** | **1,717** |
| Net extraordinary capital gains and provisions | — | — | — | — | — | — | — | (1,670) |
| **Attributable profit to the Group** | **2,215** | **2,230** | **1,635** | **2,101** | **2,108** | **1,393** | **1,803** | **47** |
| | | | | | | | | |
| **EPS (euros)** | **0.2553** | **0.2574** | **0.1884** | **0.2408** | **0.2382** | **0.1569** | **0.2030** | **0.0037** |
| **Diluted EPS (euros)** | **0.2537** | **0.2558** | **0.1854** | **0.2406** | **0.2364** | **0.1558** | **0.2007** | **0.0045** |

## Net interest income
*Million euros*

+5.5% 2011-2010

## Net fees
*Million euros*

+7.6% 2011-2010

- Results from **insurance activity** were 3.9% higher at EUR 393 million (EUR 378 million in 2010) and were affected by the completion of the operation with Zurich Financial Services, which meant reduced revenues in the fourth quarter.

**Gains on financial transactions** dropped 4.1%, due to the net impact of two factors. On the one hand, the reduced revenues from the operating areas, mostly GBM (Global Banking and Markets), which were weak in the last three quarters of 2011, very affected by the environment, compared to strong results in 2010, mainly in the first half of the year. On the other hand, Corporate Activities registered profits in hedging of exchange rates in 2011 as against losses in 2010.

Gains on financial transactions as a proportion of total revenues dropped from 6.2% in 2010 to 5.6% in 2011.

As regards the **rest of revenues**, dividends collected amounted to EUR 394 million (EUR 362 million in 2010), while income accounted for by the equity method was EUR 57 million, up from EUR 17 million in 2010. This increase benefited from the recording in the fourth quarter of insurance business in Latin America.

**Total gross income** was EUR 44,262 million (EUR 42,049 million in 2010), 5.3% more than in 2010 (+4.0% excluding the perimeter and exchange rate effects).

**Operating expenses** rose 9.3% and 6.8% excluding the perimeter and exchange rate effects. The year-on-year performance varied throughout the Group, depending on the environment and strategy followed in each unit.

In Europe, both the large retail units (Santander Branch Network, Banesto and Portugal) as well as the UK recorded falls in expenses in real terms. Of note were the reductions of 2.5% at Banesto, 2.1% in Portugal and 1.2% in the Santander Branch Network.

The global units (GBM and Asset Management and Insurance) registered higher growth in expenses (+4.1%) because of investments in equipment and technology with the double purpose of strengthening the positions attained in key markets and businesses in previous years, and developing new initiatives.

Moreover, there is also an increase in expenses resulting from the incorporation of new entities, mainly Bank Zachodni WBK in Poland and SEB in Germany.

In Latin America, costs also rose due to the drive in new commercial projects, the increase in installed capacity, the restructuring of points of attention, particularly in Brazil, and the revision of collective bargaining agreements in an environment of higher inflation. Sovereign also registered single digit growth in costs.

**Net operating income** (pre-provision profit) was EUR 24,373 million, 2.2% more than the EUR 23,853 million registered in 2010.

Net operating income was particularly noteworthy as it set a new record. It rose for the ninth year running and exceeded EUR 24,000 million for the first time, placing Santander among the best banks in the world for its profit generation capacity.

The efficiency ratio was 44.9% with amortisations and 40.2% without amortisations (43.3% and 38.7%, respectively, in 2010).

## Net fees
*Million euros*

| | 2011 | 2010 | Variation amount | % | 2009 |
|---|---|---|---|---|---|
| Fees from services | 6,171 | 5,632 | 538 | 9.6 | 5,267 |
| Mutual & pension funds | 1,236 | 1,267 | (31) | (2.4) | 1,178 |
| Securities and custody | 668 | 784 | (117) | (14.9) | 774 |
| Insurance | 2,397 | 2,051 | 346 | 16.9 | 1,861 |
| **Net fee income** | **10,471** | **9,734** | **737** | **7.6** | **9,080** |

This performance showed the Group's capacity to continue to generate revenues in a difficult context and comfortably absorb the **provisions made for loan losses**, which at EUR 10,562 million were 3.0% more than in 2010. This increase was due to the reduced release of generic provisions, as based on just specific ones there was a decline of 9.8%.

Similar comments can be made for Spain, where total provisions rose 13.6% and specific ones dropped 32.0%. There were significant reductions in provisions in the UK, Sovereign and Santander Consumer Finance (even with the incorporation of new units). Provisions in Latin America excluding Brazil also dropped. However, they rose strongly in Portugal, reflecting the economic difficulties, and in Brazil because of the greater growth in lending of around 20% and an increase in the sector's NPLs in previous quarters.

**Net operating income after provisions** was EUR 13,811 million, 1.6% more than in 2010 (+1.1% excluding the perimeter and exchange-rate impacts).

There were notable rises in these results in Santander Consumer Finance (+46.8%), Sovereign (+33.6%) and almost all Latin American units such as Brazil (+2.9%), Mexico (+12.4%), Argentina (+8.2%), Puerto Rico (+42.4%) and Colombia (+43.1%). On the other hand there were declines in the UK (-8.4%), after absorbing the significant effects of the regulatory changes, as commented on in greater detail in the relevant section. There were larger falls in Spain (-30.4%) and Portugal (-56.2%).

**Asset impairment losses and other results** were EUR 2,995 million negative compared to EUR 1,543 million, also negative, in 2010, largely due to the charge made in the second quarter for EUR 842 million gross for payment protection insurance (PPI) remediation in the UK.

**Profit before tax** was 10.2% lower at EUR 10,817 million (excluding the perimeter and exchange rate effects: -10.6% ). The tax charge of EUR 2,936 million was almost the same as in 2010, mainly due to a higher rate in Brazil, Sovereign and Corporate Activities.

## Gross income and expenses

*Billion euros*

## Net operating income

*Billion euros*

+2.2% 2011-2010

After deducting the tax charge **profit from continued operations** was EUR 7,881 million (-13.7%). **Recurring attributable profit,** after incorporating discontinued operations and minority interests, was EUR 7,021 million (-14.2%).

## Operating expenses

*Million euros*

| | 2011 | 2010 | Variation amount | % | 2009 |
|---|---|---|---|---|---|
| Personnel expenses | 10,326 | 9,330 | 996 | 10.7 | 8,450 |
| General expenses | 7,455 | 6,926 | 528 | 7.6 | 6,374 |
| Information technology | 875 | 798 | 77 | 9.7 | 786 |
| Communications | 659 | 670 | (12) | (1.7) | 632 |
| Advertising | 695 | 634 | 62 | 9.7 | 594 |
| Buildings and premises | 1,667 | 1,553 | 114 | 7.4 | 1,405 |
| Printed and office material | 178 | 178 | (0) | (0.2) | 209 |
| Taxes (other than profit tax) | 401 | 376 | 25 | 6.5 | 313 |
| Other expenses | 2,980 | 2,718 | 263 | 9.7 | 2,436 |
| **Personnel and general expenses** | **17,781** | **16,256** | **1,525** | **9.4** | **14,825** |
| Depreciation and amortisation | 2,109 | 1,940 | 169 | 8.7 | 1,596 |
| **Total operating expenses** | **19,889** | **18,196** | **1,694** | **9.3** | **16,421** |

## Net loan-loss provisions
*Million euros*

| | 2011 | 2010 | Variation amount | % | 2009 |
|---|---|---|---|---|---|
| Non performing loans | 12,368 | 11,457 | 911 | 7.9 | 10,516 |
| Country-risk | (7) | 2 | (9) | — | (117) |
| Recovery of written-off assets | (1,800) | (1,201) | (598) | 49.8 | (915) |
| **Total** | **10,562** | **10,258** | **304** | **3.0** | **9,484** |

## Profit before tax
*Million euros*

-10.2% 2011-2010

Moreover, and as it was already commented on, the bank made provisions for EUR 3,183 million net of tax, of which EUR 1,513 million came from capital gains and EUR 1,670 million from fourth quarter profits. After these impacts, **attributable profit** was EUR 5,351 million.

**Earnings per share** were EUR 0.6018, 36.1% less than in 2010 and slightly affected by the capital increases in 2011 to convert Valores Santander (convertible bonds) and tend to the remuneration in shares for those shareholders that chose this option, as no adjustment was made retroactively to the number of shares of previous periods.

The Group's **ROE** was 7.14% and **ROTE** (measured as attributable profit / shareholders equity less goodwill) was 10.81% (9.37% and 14.18%, respectively, on the basis of recurring attributable profit).

## Attributable profit to the Group
*Million euros*

-34.6% 2011-2010

## Extraordinary capital gains and provisions (net of tax) *Million euros*

(*) Not including capital gains from agreement to sell the bank in Colombia, which are to be registered in 2012

## Balance sheet

*Million euros*

| | 2011 | 2010 | Variation amount | % | 2009 |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Cash on hand and deposits at central banks | 96,524 | 77,785 | 18,739 | 24.1 | 34,889 |
| Trading portfolio | 172,637 | 156,762 | 15,875 | 10.1 | 135,054 |
| *Debt securities* | *52,704* | *57,871* | *(5,168)* | *(8.9)* | *49,921* |
| *Customer loans* | *8,056* | *755* | *7,301* | *966.7* | *10,076* |
| *Equities* | *4,744* | *8,850* | *(4,107)* | *(46.4)* | *9,248* |
| *Trading derivatives* | *102,498* | *73,069* | *29,429* | *40.3* | *59,856* |
| *Deposits from credit institutions* | *4,636* | *16,216* | *(11,581)* | *(71.4)* | *5,953* |
| Other financial assets at fair value | 19,563 | 39,480 | (19,917) | (50.4) | 37,814 |
| *Customer loans* | *11,748* | *7,777* | *3,971* | *51.1* | *8,329* |
| *Other (deposits at credit institutions, debt securities and equities)* | *7,815* | *31,703* | *(23,888)* | *(75.4)* | *29,485* |
| Available-for-sale financial assets | 86,612 | 86,235 | 378 | 0.4 | 86,621 |
| *Debt securities* | *81,589* | *79,689* | *1,900* | *2.4* | *79,289* |
| *Equities* | *5,024* | *6,546* | *(1,522)* | *(23.3)* | *7,331* |
| Loans | 779,525 | 768,858 | 10,667 | 1.4 | 736,746 |
| *Deposits at credit institutions* | *42,389* | *44,808* | *(2,419)* | *(5.4)* | *57,641* |
| *Customer loans* | *730,296* | *715,621* | *14,675* | *2.1* | *664,146* |
| *Debt securities* | *6,840* | *8,429* | *(1,589)* | *(18.9)* | *14,959* |
| Investments | 4,154 | 273 | 3,881 | — | 164 |
| Intangible assets and property and equipment | 16,840 | 14,584 | 2,257 | 15.5 | 11,774 |
| Goodwill | 25,089 | 24,622 | 466 | 1.9 | 22,865 |
| Other | 50,580 | 48,901 | 1,679 | 3.4 | 44,602 |
| **Total assets** | **1,251,525** | **1,217,501** | **34,024** | **2.8** | **1,110,529** |
| **Liabilities and shareholders' equity** | | | | | |
| Trading portfolio | 146,949 | 136,772 | 10,177 | 7.4 | 115,516 |
| *Customer deposits* | *16,574* | *7,849* | *8,725* | *111.2* | *4,658* |
| *Marketable debt securities* | *77* | *365* | *(288)* | *(78.8)* | *586* |
| *Trading derivatives* | *103,083* | *75,279* | *27,804* | *36.9* | *58,713* |
| *Other* | *27,214* | *53,279* | *(26,064)* | *(48.9)* | *51,559* |
| Other financial liabilities at fair value | 44,908 | 51,020 | (6,111) | (12.0) | 42,371 |
| *Customer deposits* | *26,982* | *27,142* | *(160)* | *(0.6)* | *14,636* |
| *Marketable debt securities* | *8,185* | *4,278* | *3,907* | *91.3* | *4,887* |
| *Due to central banks and credit institutions* | *9,741* | *19,600* | *(9,859)* | *(50.3)* | *22,848* |
| Financial liabilities at amortized cost | 935,669 | 898,969 | 36,700 | 4.1 | 823,403 |
| *Due to central banks and credit institutions* | *116,368* | *79,537* | *36,832* | *46.3* | *73,126* |
| *Customer deposits* | *588,977* | *581,385* | *7,593* | *1.3* | *487,681* |
| *Marketable debt securities* | *189,110* | *188,229* | *880* | *0.5* | *206,490* |
| *Subordinated debt* | *22,992* | *30,475* | *(7,482)* | *(24.6)* | *36,805* |
| *Other financial liabilities* | *18,221* | *19,343* | *(1,122)* | *(5.8)* | *19,300* |
| Insurance liabilities | 517 | 10,449 | (9,932) | (95.1) | 16,916 |
| Provisions | 15,571 | 15,660 | (89) | (0.6) | 17,533 |
| Other liability accounts | 25,052 | 23,717 | 1,335 | 5.6 | 20,919 |
| **Total liabilities** | **1,168,666** | **1,136,586** | **32,080** | **2.8** | **1,036,659** |
| Shareholders' equity | 80,895 | 77,334 | 3,562 | 4.6 | 71,832 |
| *Capital stock* | *4,455* | *4,165* | *290* | *7.0* | *4,114* |
| *Reserves* | *72,660* | *66,258* | *6,402* | *9.7* | *61,071* |
| *Attributable profit to the Group* | *5,351* | *8,181* | *(2,830)* | *(34.6)* | *8,943* |
| *Less: dividends* | *(1,570)* | *(1,270)* | *(300)* | *23.6* | *(2,297)* |
| Equity adjustments by valuation | (4,482) | (2,315) | (2,166) | 93.6 | (3,165) |
| Minority interests | 6,445 | 5,896 | 549 | 9.3 | 5,204 |
| **Total equity** | **82,859** | **80,914** | **1,944** | **2.4** | **73,871** |
| **Total liabilities and equity** | **1,251,525** | **1,217,501** | **34,024** | **2.8** | **1,110,529** |

## Grupo Santander. Balance sheet

- Activity continued to reflect the market context:
  - Lower demand for loans in Europe, especially in Spain and Portugal, and double-digit growth in Latin America.
  - In funds, preference for deposits and conservative policy in issues.
  - Loan-to-deposit ratio of 117% (150% at the start of the crisis).
- Core capital ratio (BIS II) of 10.02%, after rising for the fifth year running.
- The European Banking Authority's target has already been reached: core capital ratio of 9.01%.
- Shareholders' equity per share increased again to EUR 8.62.

### Distribution of total assets by geographic segment

*December 2011*

Total managed funds at the end of 2011 amounted to EUR 1,382,980 million, of which 90%, EUR 1,251,525 million, were on-balance sheet and the rest off-balance sheet mutual and pension funds and managed portfolios.

Two factors need to be taken into account in the year-on-year comparisons:

- A slightly positive perimeter impact from the net effect of the following changes in the Group's composition:
  - Positive impact from the consolidation of Banco Zachodni WBK in Poland, the incorporation to the Group in 2011 of SEB's retail banking business in Germany (Santander Retail) into Santander Consumer Finance and the acquisition of GE Capital Corporation's mortgage portfolio in Mexico and of Creditel in Uruguay.
  - Negative impact from Santander Consumer USA, which in December stopped consolidating by global integration and moved to consolidation by the equity accounted method, and Latinoamerica's bancassurance business.
- The second effect came from the appreciation/depreciation of various currencies against the euro (end of period rates). Both the dollar and sterling appreciated by 3%, while the main Latin American currencies depreciated: Brazilian real and Mexican peso (8%); Chilean peso (7%) and the Argentine peso (5%). The net impact of both is virtually zero.

The joint impact of the two effects on changes in customer balances was minimal (less than one percentage point positive), both on lending as well as managed customer funds.

### Lending

The Group's customer loans amounted to EUR 769,036 million, 3.4% higher than in 2010. Eliminating the exchange rate and perimeter effects it was 3.0% higher.

The geographic distribution (principal segments) was also very different by markets.

### Customer loans

*Million euros*

| | 2011 | 2010 | Variation amount | % | 2009 |
|---|---|---|---|---|---|
| Public sector | 12,147 | 12,137 | 10 | 0.1 | 9,803 |
| Other residents | 202,411 | 217,497 | (15,086) | (6.9) | 222,355 |
| Commercial bills | 9,679 | 11,146 | (1,466) | (13.2) | 11,134 |
| Secured loans | 117,946 | 127,472 | (9,526) | (7.5) | 125,397 |
| Other loans | 74,785 | 78,879 | (4,094) | (5.2) | 85,824 |
| Non-resident sector | 554,478 | 514,217 | 40,262 | 7.8 | 468,267 |
| Secured loans | 342,676 | 311,048 | 31,627 | 10.2 | 286,381 |
| Other loans | 211,802 | 203,168 | 8,634 | 4.2 | 181,886 |
| **Gross customer loans** | **769,036** | **743,851** | **25,185** | **3.4** | **700,424** |
| Loan-loss allowances | 18,936 | 19,697 | (761) | (3.9) | 17,873 |
| **Net customer loans** | **750,100** | **724,154** | **25,946** | **3.6** | **682,551** |
| Pro memoria: Doubtful loans | 31,287 | 27,908 | 3,379 | 12.1 | 24,027 |
| Public sector | 102 | 42 | 60 | 142.0 | 18 |
| Other residents | 14,745 | 12,106 | 2,639 | 21.8 | 9,898 |
| Non-resident sector | 16,439 | 15,759 | 680 | 4.3 | 14,111 |

In **Continental Europe**, Spain and Portugal's lending fell by 4.6% and 5.6%, respectively, due to deleveraging. Santander Consumer Finance's lending dropped 4.8%, due to the impact of the consolidation by the equity accounted method of Santander Consumer USA in December 2011 (+16.1% before this impact). The incorporation of Bank Zachodni WBK increased the Group's net lending by EUR 8,479 million.

Gross customer loans in Spain amounted to EUR 225,288 million, with the following structure:

- Loans to the public sector amounted to EUR 12,147 million, (+0.1%).
- Lending to individuals amounted to EUR 84,816 million, of which EUR 58,535 million were mortgages for homes. These are the healthiest part and with the least risk of further deterioration of the portfolio in Spain because of the different features of this product compared to similar ones in other countries. For example, the principle is amortised as of the first day, the borrowers' responsibility extends to all their assets and almost all loans are for residences in ownership, with a very low expected loss.

  In the specific case of Grupo Santander, the portfolio is mostly composed of mortgages that are for the first residence, with large concentration of loans in the lowest tranches of loan-to-value (88% with an LTV lower than 80%) and the NPL ratio is very low (2.7%).
- Loans to SMEs and companies without real estate purpose, the most relevant part of the lending portfolio, amounted to EUR 104,883 million and accounted for 47% of the total. Of note was the stability shown during the year (-0.4%) within an environment of widespread reduction of lending in the whole system.
- Loans for real estate purposes (with the greatest risk) stood at EUR 23,442 million, after falling in every quarter of 2011. The total reduction for the year was EUR 3,892 million (-14.2%).

  The Group maintained in the year the strategy of previous years to reduce exposure to this segment of greater risk. The total reduction in the last three years amounts to EUR 14,246 million (-37.8%).

In Portugal, the fall in lending (5.6%) came from all segments: -11.8% to SMEs, -13.9% to companies and -3.1% to individuals. In addition, balances in construction and real estate, which represent only 3.6% of lending in the country, declined 12.1% in 2011.

Santander Consumer Finance's lending, after the operation at Santander Consumer USA, dropped 4.8%. Excluding this impact, growth was 16.1% due to organic growth plus SEB's integration in Germany. New lending rose 11.1%.

## Gross customer loans

*Billion euros*

+3.4%* 2011-2010

* Excluding exchange rate impact: +3.8%

## Gross customer loans

*% o/ operating areas. December 2011*

## Loan portfolio in Spain

*Billion euros*

## Credit risk management*

*Million euros*

| | 2011 | 2010 | Variation amount | % | 2009 |
|---|---|---|---|---|---|
| Non-performing loans | 32,036 | 28,522 | 3,514 | 12.3 | 24,554 |
| NPL ratio (%) | 3.89 | 3.55 | 0.34 p. | | 3.24 |
| Loan-loss allowances | 19,661 | 20,748 | (1,087) | (5.2) | 18,497 |
| Specific | 15,474 | 14,901 | 572 | 3.8 | 11,770 |
| Generic | 4,187 | 5,846 | (1,659) | (28.4) | 6,727 |
| NPL coverage (%) | 61 | 73 | (11 p.) | | 75 |
| Credit cost (%) ** | 1.41 | 1.56 | (0.15 p.) | | 1.57 |
| Ordinary non-performing and doubtful loans *** | 18,318 | 18,061 | 257 | 1.4 | 17,641 |
| NPL ratio (%) *** | 2.26 | 2.28 | (0.02 p.) | | 2.35 |
| NPL coverage (%) *** | 107 | 115 | (8 p.) | | 105 |

* Excluding country-risk
** Net specific allowance / computable assets
*** Excluding mortgage guarantees

Note: NPL ratio: Non-performing loans / computable assets

In the **United Kingdom**, the balance of customer loans was 4.6% higher. In local criteria, the stock of residential mortgages, in a still depressed market, were very stable, while loans to SMEs increased 25.4%, gaining further market share. Personal loans, reflecting the policy in the last few years of reducing them, declined 12.7%.

Lending in **Latin America** increased 17.9% excluding the exchange rate impact, due to organic growth and the incorporation of GE Capital Corporation's mortgage portfolio in Mexico and of Creditel in Uruguay. Loans in local currency rose 20.3% in Brazil, 7.3% in Chile and 30.9% in Mexico (+22.4% excluding the perimeter impact).

**Sovereign's** loans rose 6.0% in dollars, due to the 4.5% increase in the most attractive mortgage segments (residential and multifamily), and the acquisition of a consumer credit portfolio from GE. Both effects comfortably offset the exit from higher risk segments and from those not considered strategic for the Group.

Continental Europe accounted for 42% of the Group's total lending (29% Spain), the UK 34%, Latin America 19% (11% Brazil) and Sovereign 5%. These percentages in 2010 were 45% for Continental Europe (32% Spain), 32% the UK, 18% Latin America (10% Brazil) and 5% (Sovereign).

### Risks

The still weak scenario in some markets continued to push up non-performing loans, linked both to the rise in bad and doubtful loans (the numerator) as well as the slower growth in lending (denominator), which in some cases were declines.

Despite this, the active management of risk is reflected in a slower pace of growth in the Group's NPLs in the last few quarters.

The Group's annual risk premium was 1.67% at December 2011, well below the maximum of 2.47% reached in the third quarter of 2009.

Bad and doubtful loans amounted to EUR 32,036 million, 12.3% more than in 2010.

The Group's NPL ratio was 3.89% at the end of 2011 (+34 b.p.), but it only rose by 11 b.p. in the second half of the year (+3 b.p. in the fourth quarter).

In order to cover these loans, total loan-loss provisions amounted to EUR 19,661 million, of which 21% (EUR 4,187 million) were generic provisions.

Since the end of 2008, total loan-loss provisions have increased by EUR 6,800 million (+53%), reflecting the efforts made in the last three years. The Group's NPL coverage is 61%, negatively affected by some 3 percentage points because of the operation at Santander Consumer USA.

The NPL ratios by units and countries are set out below:

- The NPL ratio in Spain is 5.49%, well below the sector's average, and coverage 45% (4.24% and 58%, respectively, in 2010).

## Loan-loss allowances

*Million euros*

-5.2% 2011-2010

Around 90% of the portfolio (including mortgages and companies) has an NPL ratio of 3.3%. The ratio for mortgages to buy homes is 2.7% and 3.5% for the rest of the portfolio (public sector, individual customers and companies without real estate purposes). In both cases, NPLs increased moderately.

The rise in the total ratio was thus due to loans with a real estate purpose (ratio of 28.6%). This ratio reflects, on the one hand, the greater NPLs in this segment and, on the other, the Group's anticipative policy to sharply reduce balances in this segment.

Doubtful loans with a real estate purpose amounted to EUR 6,772 million. Their coverage rose by 4.p.p. to 33%.

Another EUR 3,916 million was recorded as substandard, all of which is up-to-date with payments. These balances are 16% covered (+ 4 p.p.).

The gross balance of foreclosed properties at the end of 2011 was EUR 8,552 million, and after the provisions made in the fourth quarter of the year coverage rose to 50% from 31% in 2010.

These coverage levels signify that Santander has already anticipated a significant part of the new requirements outlined in the Royal Decree 2/2012, which came into force on February 3, 2012 and will be entirely met during the year, through the existing capital buffer, ordinary contributions to provisions and applying the capital gains which may be obtained during the year (including EUR 900 million from the capital gain obtained from the sale of Banco Santander Colombia).

- Portugal's NPL ratio rose 116 b.p. to 4.06%, using the Group's criteria, while coverage was 55%, 5 p.p. less than in 2010. In local criteria, Santander Totta has a lower NPL ratio than its competitors.
- Santander Consumer Finance reduced its NPL ratio for the sixth quarter running to 3.77%, with coverage of 113%. The evolution during the year was determined by the consolidation in December of Santander Consumer USA by the equity accounted method as, without this effect, coverage was 9 p.p. higher.
- In the UK the NPL ratio was 1.86%, slightly higher than in 2010 (+10 b.p.), while coverage was 38% (46% in 2010).

  Because of its importance in the Group's overall lending, the NPL ratio of mortgages was 1.46% (1.41% in 2010), while the average loan-to-value was 53%.

  Another indicator of this portfolio's good performance is the small volume of foreclosed homes (EUR 160 million, or only 0.07% of total mortgage lending portfolio). Efficient management of these cases and a dynamic market for this kind of housing enable sales to be made in a short period, contributing to the good results.

## Non-performing loans

*Million euros*

| | 2011 | 2010 | 2009 |
|---|---|---|---|
| Balance at beginning of period | 28,522 | 24,554 | 14,191 |
| Net additions | 15,381 | 13,478 | 18,234 |
| Increase in scope of consolidation | 925 | 257 | 1,033 |
| Exchange differences | (362) | 1,147 | 890 |
| Write-offs | (12,430) | (10,913) | (9,795) |
| **Balance at period-end** | **32,036** | **28,522** | **24,554** |

## NPL ratio

*%*

## NPL ratio in Spain

*%*

- Brazil's NPL ratio was 5.38% (+47 b.p.). This increase was due to the small rise in the sector and to higher growth in lending to individuals, basically consumer credit and cards. Santander Brazil's performance was better than that of the country's other private sector banks, the most comparable collective. Coverage was 95%.
- The NPL ratio of Latin America ex-Brazil was 2.89% and coverage an excellent 102%. Its comparison is affected by the incorporation in the second quarter of GE Capital Corporation's mortgage portfolio in Mexico. Excluding it, the ratio improved in every quarter of 2011 (-25 b.p. for the whole year), while coverage was 104% (-6 p.p.).
- Sovereign's NPL ratio, after declining in the last eight quarters, was 2.85%, much better than the 4.61% in 2010 (-176 b.p.). Coverage was 96% (+21 p.p.).

Lastly, specific loan-loss provisions for the whole Group, after deducting write-offs recovered, amounted to EUR 11,137 million (1.41% of average credit risk in the last 12 months), down from EUR 12,342 million in 2010 (1.56%).

Net provisions represented 1.4% of loans, well below the 3.3% represented by net operating income/lending.

Further information on the evolution of credit risk, particularly real estate risk in Spain, control and monitoring systems and internal risk models to calculate provisions is included in the section on Risk Management in this annual report.

**Customer funds under management**

Total managed funds amounted to EUR 984,353 million, almost the same as in 2010 (-0.1%). After deducting the perimeter and forex effects, which had a marginal impact, the reduction was 0.8%.

Customer deposits rose 2.6% and 4.5% including retail commercial paper in Spain and Brazil's *letras financeiras*. Mutual and pension funds declined 9.8%, affected by the greater focus on capturing on-balance sheet funds.

Deposits in **Continental Europe** were very similar to 2010 at EUR 49,400 million (-0.1%) and 25.0% higher than at the end of 2009. This reflected the strong campaign in 2010, a large part of which was retained in 2011. To this is added the favourable impact of the entities incorporated to the Group.

- In Spain, the strategy followed in the renewal of funds captured in the 2010 campaign was to give priority to improved costs over volumes. As a result, deposits fell 7.2%. However, if one compares the balances at the start of the campaign with those at the end of 2011, growth was more than EUR 18,800 million (+12.1%). To this is added, the retail commercial paper sold during the year, which made the changes -4.0% for 2011 and +16.0% for the last two years. This policy of emphasis on balance sheet funds was reflected in a fall in mutual funds.

## Customer funds under management

*Million euros*

| | 2011 | 2010 | Variation amount | % | 2009 |
|---|---|---|---|---|---|
| Public sector | 6,528 | 9,655 | (3,127) | (32.4) | 13,293 |
| Other residents | 165,095 | 161,096 | 3,999 | 2.5 | 126,189 |
| Demand deposits | 68,389 | 67,077 | 1,312 | 2.0 | 61,000 |
| Time deposits | 61,185 | 81,145 | (19,960) | (24.6) | 49,177 |
| REPOs | 35,520 | 12,873 | 22,647 | 175.9 | 16,012 |
| Non-resident sector | 460,911 | 445,625 | 15,286 | 3.4 | 367,495 |
| Demand deposits | 220,299 | 210,490 | 9,808 | 4.7 | 195,823 |
| Time deposits | 197,249 | 197,590 | (341) | (0.2) | 148,485 |
| REPOs | 33,275 | 30,623 | 2,652 | 8.7 | 18,403 |
| Public Sector | 10,089 | 6,922 | 3,167 | 45.7 | 4,784 |
| **Customer deposits** | **632,533** | **616,376** | **16,158** | **2.6** | **506,976** |
| Debt securities | 197,372 | 192,872 | 4,499 | 2.3 | 211,963 |
| Subordinated debt | 22,992 | 30,475 | (7,482) | (24.6) | 36,805 |
| **On-balance-sheet customer funds** | **852,898** | **839,723** | **13,175** | **1.6** | **755,744** |
| Mutual funds | 102,611 | 113,510 | (10,898) | (9.6) | 105,216 |
| Pension funds | 9,645 | 10,965 | (1,320) | (12.0) | 11,310 |
| Managed portfolios | 19,199 | 20,314 | (1,115) | (5.5) | 18,364 |
| Savings-insurance policies | — | 758 | (758) | (100.0) | 9,422 |
| **Other customer funds under management** | **131,456** | **145,547** | **(14,091)** | **(9.7)** | **144,313** |
| **Customer funds under management** | **984,353** | **985,269** | **(916)** | **(0.1)** | **900,057** |

- Santander Consumer Finance's deposits increased 27.9% due to organic growth and the entry of Santander Retail in Germany which, with its welcome campaign, increased its balances by EUR 2,500 million.
- Portugal increased its customer deposits by 8.0% and significantly improved its liquidity position for the second year running and surpassed its commercial gap reduction target for the year.
- The incorporation of Bank Zachodni WBK contributed EUR 12,383 million of customer funds to the Group, of which EUR 10,359 million were deposits.

In the **UK**, customer deposits increased 2.2% in sterling and mutual funds rose 6.3% in 2011.

In **Latin America** (excluding the balances in the New York branch, which are more volatile), deposits without repos increased 9.1% excluding the exchange rate impact. Good evolution of the three main countries: Brazil (+16.4%, including the *letras financeiras*), Mexico (+10.4%) and Chile (+18.5%), with increases in both time and demand deposits except for Brazil in demand deposits. Mutual funds dropped 2.3% in Brazil, 10.4% in Chile and rose 2.8% in Mexico. The overall reduction for the whole region was 1.7%.

Lastly, **Sovereign's** deposits increased 11.6% in dollars.

Continental Europe accounted at the end of 2011 for 37% of managed customer funds (28% Spain), the UK 32%, Latin America 26% (Brazil 15%) and Sovereign 5%. These percentages in 2010 were 39% for Continental Europe (30% Spain), 31% for the UK, 26% for Latin America (15% Brazil) and 4% for Sovereign.

As well as capturing large volumes of funds in the last two years, the Group, for strategic reasons, maintained an active policy of issuing securities in the international fixed income markets.

The Group issued in 2011 EUR 40,390 million of medium- and long-term issues, as follows: EUR 26,464 million of senior debt; EUR 13,664 million of covered and territorial bonds and EUR 262 million of subordinated debt.

## Customer funds under management

*Billion euros*

-0.1%* 2011-2010

* Excluding exchange rate impact: +0.5%

## Customer funds under management

*% o/ operating areas. December 2011*

## Mutual funds

*Million euros*

| | 2011 | 2010 | Variation amount | % | 2009 |
|---|---|---|---|---|---|
| Spain | 27,425 | 34,310 | (6,885) | (20.1) | 40,616 |
| Portugal | 1,866 | 3,209 | (1,343) | (41.8) | 3,982 |
| Poland | 1,747 | | 1,747 | | |
| United Kingdom | 15,744 | 14,369 | 1,375 | 9.6 | 10,937 |
| Latin America | 55,829 | 61,621 | (5,792) | (9.4) | 49,681 |
| **Total** | **102,611** | **113,510** | **(10,898)** | **(9.6)** | **105,216** |

## Pension funds
*Million euros*

| | 2011 | 2010 | Variation amount | % | 2009 |
|---|---|---|---|---|---|
| Spain | 8,884 | 9,650 | (765) | (7.9) | 9,912 |
| Individuals | 7,670 | 8,161 | (491) | (6.0) | 8,429 |
| Collective plans | 249 | 262 | (13) | (5.0) | 266 |
| Group employee plans | 965 | 1,227 | (262) | (21.4) | 1,217 |
| Portugal | 760 | 1,315 | (555) | (42.2) | 1,398 |
| **Total** | **9,645** | **10,965** | **(1,320)** | **(12.0)** | **11,310** |

This issuing activity underscores the Group's capacity to access the different institutional markets via its more than ten units with issuing capacity, including the parent bank, Banco Santander, and its main subsidiaries in the countries where it operates: Banesto, Santander Totta, Santander UK/Chile/Brazil/Mexico, Sovereign and the units of Santander Consumer Finance. These issues were made at higher prices than in 2010 because of the greater tensions and volatility in markets.

As regards securitisations, the Group's subsidiaries placed in the market in 2011 a total of EUR 24,831 million, mainly in the UK.

Maturities of medium and long-term debt amounted to EUR 32,497 million, of which EUR 18,006 million was senior debt, EUR 7,439 million covered bonds, EUR 5,109 million subordinated debt and EUR 1,943 million preferred shares.

This capturing of stable funds, via deposits, retail commercial paper and issues, combined with the trend of moderate growth in lending, kept the loan-to-deposit ratio at 117% (the same as in 2010), and put the ratio of deposits plus medium and long-term funding to the Group's loans at 113%, underscoring the appropriate structure of funding the Group's lending.

## Loans / deposits*. Total Group
*%*

* Including retail commercial paper

More information on the management of financing in the markets, the framework for managing liquidity and the structural position of the Group's liquidity can be found in the Risk Management section of this annual report ("Management of funding and liquidity risk").

### Other items of the balance sheet

Total goodwill was EUR 25,089 million, EUR 466 million more than in 2010, due to the net impact between the increase from the incorporations of BZ WBK, Santander Retail in Germany, GE Capital Corporation's mortgage portfolio in Mexico and Creditel in Uruguay and the reductions resulting from the amortisation of EUR 601 million of goodwill in Santander Totta, the Santander Consumer USA consolidation by the equity accounted method and exchange rates.

Trading derivatives rose strongly, both in assets and liabilities (+EUR 29,429 million and +EUR 27,804 million, respectively), due to the evolution of the market value, mainly interest rate swaps. The balance at the end of 2011 was EUR 102,498 million in assets and EUR 103,083 million in liabilities.

Equity stakes increased from EUR 273 million to EUR 4,154 million, largely due to consolidation by the equity accounted method at Santander Consumer USA and the insurance operation in Latin America.

Balances with central banks have increased for both deposits and assets, after the liquidity injections by central banks in the countries where we operate, mainly the euro zone. The European Central Bank adopted extraordinary measures on monetary policies, including the expansion of collateral and liquidity auctions at three years.

The Group continued to go to these auctions and deposit in the ECB most of the funds captured, significantly increasing the liquidity buffer and improving its structure by replacing short-term maturities by longer term funding. The only Group entity that has a net structural borrowing position from the ECB is Santander Totta (close to EUR 4 billion).

The balance of financial assets available for sale rose 0.4% from EUR 86,235 in 2010 to EUR 86,612 million in 2011.

## Total equity and capital with the nature of financial liabilities

*Million euros*

| | 2011 | 2010 | Variation amount | % | 2009 |
|---|---|---|---|---|---|
| Capital stock | 4,455 | 4,165 | 290 | 7.0 | 4,114 |
| Additional paid-in surplus | 31,223 | 29,457 | 1,765 | 6.0 | 29,305 |
| Reserves | 41,688 | 36,993 | 4,695 | 12.7 | 31,796 |
| Treasury stock | (251) | (192) | (58) | 30.3 | (30) |
| **Shareholders' equity (before profit and dividends)** | **77,115** | **70,423** | **6,692** | **9.5** | **65,186** |
| Attributable profit | 5,351 | 8,181 | (2,830) | (34.6) | 8,943 |
| Interim dividend distributed | (1,429) | (1,270) | (159) | 12.5 | (1,285) |
| Interim dividend not distributed (1) | (408) | (2,060) | 1,652 | (80.2) | (2,837) |
| **Shareholders' equity (after retained profit)** | **80,629** | **75,273** | **5,356** | **7.1** | **70,006** |
| Valuation adjustments | (4,482) | (2,315) | (2,166) | 93.6 | (3,165) |
| Minority interests | 6,445 | 5,896 | 549 | 9.3 | 5,204 |
| **Total equity (after retained profit)** | **82,592** | **78,854** | **3,738** | **4.7** | **72,045** |
| Preferred shares and securities in subordinated debt | 5,896 | 7,352 | (1,456) | (19.8) | 7,745 |
| **Total equity and capital with the nature of financial liabilities** | **88,488** | **86,207** | **2,282** | **2.6** | **79,791** |

(1) In 2011, estimated data of May 2012 scrip dividend.

### Shareholders' equity and solvency ratios

Total shareholders' equity, after retained profits, increased EUR 5,356 million (+7.1%) to EUR 80,629 million, due to reserves.

Shareholders' equity per share at the end of 2011 stood at EUR 8.62 (+EUR 0.04). This was the fifth year of increase.

A total of 579,921,105 shares were issued in 2011, as follows:

- In February, 111,152,906 shares were issued for the scrip dividend that month when 86.7% of capital opted to receive the amount equivalent to the third interim dividend charged to 2010's earnings in shares.
- In October, 1,223,457 shares were issued to meet the exchange of 3,458 Valores Santander.
- In November, 125,742,571 shares for that month's scrip dividend were issued when 73.0% of capital opted to receive the amount equivalent to the second interim dividend charged to 2011's earnings in shares.
- In December, 341,802,171 shares were issued to tend to the repurchase of 77,743,969 preferred shares.

Shareholders' equity and capital with the nature of financial liabilities amounted to EUR 88,488 million at the end of 2011 (+EUR 2,282 million), after incorporating minority interests, preferred shares and valuation adjustments. Of note in the fall in valuation adjustments (EUR 2,166 million) was the negative impact on the value of stakes in foreign subsidiaries of exchange rates (partly covered by hedging).

In addition, it includes the negative impact of exchange rates on goodwill, neutral for the purposes of the capital ratios, as it occurred in the same way in their recording in assets.

## Capital ratios (BIS II)

*%*

## Computable capital and BIS II ratio

*Million euros*

| | 2011 | 2010 | 2009 |
|---|---|---|---|
| Core capital | 56,694 | 53,205 | 48,366 |
| Basic capital | 62,294 | 60,617 | 56,615 |
| Supplementary capital | 15,568 | 20,670 | 24,309 |
| Deductions | (1,090) | (2,011) | (1,221) |
| **Computable capital** | **76,772** | **79,276** | **79,704** |
| Risk-weighted assets | 565,958 | 604,885 | 561,684 |
| **BIS II ratio** | **13.56** | **13.11** | **14.19** |
| **Tier I** (before deductions) | **11.01** | **10.02** | **10.08** |
| **Core capital** | **10.02** | **8.80** | **8.61** |
| **Shareholders' equity surplus (BIS II)** | **31,495** | **30,885** | **34,769** |

Grupo Santander's equity eligible for applying the BIS II criteria amounted to EUR 76,772 million, EUR 31,495 million above the minimum requirement (+70%).

The core capital ratio was 10.02% (+60 b.p. in the fourth quarter) and 122 b.p. higher during the year after absorbing the impact of the incorporation of BZ WBK and the charge in the UK for PPI, registered in the second quarter. This was the fifth consecutive annual improvement in the Group's solvency.

The core capital is of very high quality, very solid and adjusted to the business model, the balance sheet structure and the Group's risk profile.

The Tier 1 ratio was 11.01% and the BIS ratio 13.56%.

This improvement in the ratios benefited from the strengthening of capital, in accordance with the new requirements of the European Banking Authority (EBA). They form part of a series of measures adopted by the European Council in the second half of 2011, which aim to restore stability and confidence to the European markets. These capital requirements are expected to be exceptional and temporary.

The selected banks must have by June 30, 2012 a core capital Tier 1 ratio of at least 9%, in accordance with the EBA's rules. Each bank was required to present by January 20, 2012 their capitalisation plan to reach the requirement at June 30, 2012.

In this regard, Grupo Santander has carried out a series of measures in the latter part of 2011 regarding capital, allowing it to achieve a core capital ratio of 9% ahead of the deadline set by the EBA.

The EBA's estimated additional capital needs for Grupo Santander amounted to EUR 15,302 million. This amount has been obtained as follows:

- EUR 6,829 million through Valores Santander, which have to compulsorily be converted into shares before the end of October 2012.
- EUR 1,943 million through the exchange of preferred shares for ordinary new shares.
- EUR 1,660 million through the application of the Santander Dividendo Elección programme (scrip dividend) at the time of the final dividend corresponding to fiscal year 2011.
- EUR 4,890 million through organic capital generation, provisions and the transfer of minority stakes, mainly in Chile and Brazil.

Regarding the latter, Santander reached in December 2011 an agreement (closed during the first week of 2012) to transfer 4.41% of Santander Brazil to a major international financial institution, which will deliver such shares to holders of convertible bonds issued in October 2010 by Banco Santander, when these mature, pursuant to the terms of said convertible bonds.

This means that Santander met the EBA's core capital requirement of 9% six months in advance, underscoring the Group's financial strength and high degree of flexibility.

## Core capital evolution

*EBA criteria*

## Description of the segments

Grupo Santander maintained in 2011 the general criteria used in 2010, with the following exceptions:

- The system for calculating the internal transfer rate (ITR) was changed. Until now Grupo Santander's management model applied an ITR to each operation on the basis of its maturity and regardless of whether it was an operation for assets or liabilities. After three years of financial and liquidity crisis, the real cost of the liquidity of institutions has been shown to differ from the reference yield curve significantly and constantly.

  As a result, the Group decided to revise the system for measuring the spread by changing the ITR applied by the corporate centre to the units. The new ITR consists of the depo/swap curve (the same as the previous system) plus the "liquidity spread" relative to the period of "duration" of each operation. In other words, it reflects the average cost of Santander's financing corresponding to the "duration" of each operation.

  This change makes the model more in line with the requirements of regulators, ensures a better pricing of operations and enables the market to better assess the profitability of businesses.

- Change of perimeter in the UK. For the past few years, the Group has been developing a cards platform for the UK, which once operational was integrated into the juridical structure of this unit (with counterparty in the rest of Europe).

- The annual adjustment was made to the Global Customer Relation Model and resulted in a net increase of 94 new clients. This does not mean any changes in the principal (geographic) segments, but it does affect the figures for Retail Banking and Global Wholesale Banking.

None of these changes was significant for the Group and do not alter its figures. The figures for 2010 were restated and include the changes in the affected areas.

The financial statements of each business segment are drawn up by aggregating the Group's basic operating units. The information relates to both the accounting data of the companies in each area as well as that provided by the management information systems. In all cases, the same general principles as those used in the Group are applied.

In accordance with the IFRS, the business areas are structured into two levels:

Principal level (or geographic). The activity of the Group's operating units is segmented by geographic areas. This coincides with the Group's first level of management and reflects our positioning in the world's three main currency areas (euro, dollar and sterling). The segments reported on are:

- **Continental Europe**. This covers all retail banking business (including Banif, the specialised private bank), wholesale banking and asset management and insurance conducted in Europe with the exception of the United Kingdom. Given the importance of some of these units, the financial information of the Santander Branch Network, Banesto, Santander Consumer Finance and Portugal are set out and from the second quarter Bank Zachodni WBK after its incorporation to the Group.

- **United Kingdom**. This includes retail and wholesale banking, asset management and insurance conducted by the various units and branches of the Group in the country.

- **Latin America**. This embraces all the Group's financial activities conducted via its subsidiary banks and subsidiaries. It also includes the specialised units of Santander Private Banking, as an independent and globally managed unit, and New York's business. Because of their specific importance, the financial statements of Brazil, Mexico and Chile are also provided.

In addition, Sovereign's figures are recorded on their own.

Secondary level (or business). This segments the activity of the operating units by the type of business. The reported segments are:

- **Retail Banking**. This covers all customer banking businesses (except those of Corporate Banking, managed through the Global Customer Relationship Model). Because of their relative importance details are provided by the main geographic areas (Continental Europe, United Kingdom and Latin America) and Sovereign, as well as by the main countries. The results of the hedging positions in each country are also included, conducted within the sphere of each one's Assets and Liabilities Committee.

- **Global Wholesale Banking (GBM)**. This business reflects the revenues from global corporate banking, investment banking and markets worldwide including all treasuries managed globally, both trading and distribution to customers (always after the appropriate distribution with Retail Banking customers), as well as equities business.

- **Asset Management and Insurance**. This includes the contribution of the various units to the Group in the design and management of mutual and pension funds and insurance. The Group uses, and remunerates through agreements, the retail networks that place these products. This means that the result recorded in this business is net (i.e. deducting the distribution cost from gross income).

As well as these operating units, which cover everything by geographic area and by businesses, the Group continues to maintain the area of Corporate Activities. This area incorporates the centralised activities relating to equity stakes in industrial and financial companies, financial management of the structural exchange rate position and of the parent bank's structural interest rate risk, as well as management of liquidity and of shareholders' equity through issues and securitisations.

As the Group's holding entity, this area manages all capital and reserves and allocations of capital and liquidity. It also incorporates amortisation of goodwill but not the costs related to the Group's central services except for corporate and institutional expenses related to the Group's functioning.

The figures of the various units of the Group listed below have been prepared in accordance with these criteria and therefore do not match those published by each institution individually.

# 1. Principal segments or geographic

## Income statement

*Million euros*

| | Net operating income | | | | Attributable profit to the Group | | | |
|---|---|---|---|---|---|---|---|---|
| | **2011** | 2010 | Amount | **%** | **2011** | 2010 | Amount | **%** |
| **Continental Europe** | **8,735** | **8,875** | **(141)** | **(1.6)** | **2,849** | **3,355** | **(506)** | **(15.1)** |
| o/w: Santander Branch Network | 2,353 | 2,227 | 126 | 5.7 | 660 | 847 | (187) | (22.1) |
| Banesto | 1,112 | 1,376 | (264) | (19.2) | 130 | 419 | (289) | (68.9) |
| Santander Consumer Finance | 3,604 | 3,361 | 243 | 7.2 | 1,228 | 811 | 418 | 51.5 |
| Portugal | 443 | 650 | (207) | (31.9) | 174 | 456 | (282) | (61.8) |
| Retail Poland (BZ WBK) | 366 | | 366 | | 232 | | 232 | |
| **United Kingdom** | **3,123** | **3,735** | **(612)** | **(16.4)** | **1,145** | **1,965** | **(820)** | **(41.7)** |
| **Latin America** | **13,533** | **12,705** | **828** | **6.5** | **4,664** | **4,728** | **(64)** | **(1.4)** |
| o/w: Brazil | 9,963 | 9,007 | 956 | 10.6 | 2,610 | 2,814 | (204) | (7.2) |
| Mexico | 1,387 | 1,434 | (47) | (3.3) | 936 | 664 | 272 | 40.9 |
| Chile | 1,264 | 1,296 | (32) | (2.5) | 611 | 671 | (61) | (9.0) |
| **Sovereign** | **1,212** | **1,169** | **43** | **3.7** | **526** | **424** | **102** | **24.0** |
| **Operating areas** | **26,603** | **26,485** | **118** | **0.4** | **9,184** | **10,472** | **(1,289)** | **(12.3)** |
| Corporate Activities* | (2,230) | (2,632) | 401 | (15.2) | (2,163) | (2,291) | 128 | (5.6) |
| **Total Group*** | **24,373** | **23,853** | **519** | **2.2** | **7,021** | **8,181** | **(1,160)** | **(14.2)** |
| Net extraordinary capital gains and provisions | | | | | (1,670) | — | (1,670) | — |
| **Total Group** | **24,373** | **23,853** | **519** | **2.2** | **5,351** | **8,181** | **(2,830)** | **(34.6)** |

(*).- Excluding net extraordinary capital gains and provisions

## Ratios

*%*

| | Efficiency ratio[1] | | ROE | | NPL ratio* | | NPL coverage* | |
|---|---|---|---|---|---|---|---|---|
| | **2011** | 2010 | **2011** | 2010 | **2011** | 2010 | **2011** | 2010 |
| **Continental Europe** | **43.1** | **40.0** | **9.34** | **12.45** | **5.20** | **4.34** | **55** | **71** |
| o/w: Santander Branch Network * | 46.5 | 48.2 | 9.63 | 11.85 | 8.47 | 5.52 | 40 | 52 |
| Banesto | 47.4 | 42.8 | 2.78 | 9.43 | 5.01 | 4.11 | 53 | 54 |
| Santander Consumer Finance | 31.8 | 27.5 | 12.34 | 10.31 | 3.77 | 4.95 | 113 | 128 |
| Portugal | 54.4 | 45.4 | 7.00 | 20.34 | 4.06 | 2.90 | 55 | 60 |
| Retail Poland (BZ WBK) | 47.0 | | 17.93 | | 4.89 | | 65 | |
| **United Kingdom** | **45.0** | **40.6** | **9.15** | **21.25** | **1.86** | **1.76** | **38** | **46** |
| **Latin America** | **39.7** | **38.6** | **21.78** | **22.30** | **4.32** | **4.11** | **97** | **104** |
| o/w: Brazil | 37.5 | 37.1 | 23.26 | 22.93 | 5.38 | 4.91 | 95 | 101 |
| Mexico | 41.8 | 39.1 | 21.16 | 19.00 | 1.82 | 1.84 | 176 | 215 |
| Chile | 39.2 | 36.2 | 25.43 | 30.01 | 3.85 | 3.74 | 73 | 89 |
| **Sovereign** | **44.6** | **44.5** | **12.96** | **14.87** | **2.85** | **4.61** | **96** | **75** |
| **Operating areas** | **41.7** | **39.6** | **13.41** | **17.38** | **3.87** | **3.53** | **63** | **75** |
| **Total Group** | **44.9** | **43.3** | **7.14** | **11.80** | **3.89** | **3.55** | **61** | **73** |

(1) With amortisations

* Santander Branch Network is the retail banking unit of Banco Santander S.A. The NPL ratio of Banco Santander S.A. at the end of December 2011 stood at 5.99% (4.24% in December 2010) and NPL coverage was 39% (54% in December 2010)

## Operating means

*Million euros*

| | Employees | | Branches | |
|---|---|---|---|---|
| | **2011** | 2010 | **2011** | 2010 |
| **Continental Europe** | **63,866** | **54,518** | **6,608** | **6,063** |
| o/w: Santander Branch Network | 18,704 | 18,893 | 2,915 | 2,931 |
| Banesto | 9,548 | 9,742 | 1,714 | 1,762 |
| Santander Consumer Finance | 15,610 | 13,852 | 647 | 519 |
| Portugal | 6,091 | 6,214 | 716 | 759 |
| Retail Poland (BZ WBK) | 9,383 | | 526 | |
| **United Kingdom** | **26,295** | **23,649** | **1,379** | **1,416** |
| **Latin America** | **91,887** | **89,526** | **6,046** | **5,882** |
| o/w: Brazil | 54,265 | 53,900 | 3,775 | 3,702 |
| Mexico | 13,162 | 12,500 | 1,125 | 1,100 |
| Chile | 12,089 | 11,595 | 499 | 504 |
| **Sovereign** | **8,968** | **8,647** | **723** | **721** |
| **Operating areas** | **191,016** | **176,340** | **14,756** | **14,082** |
| Corporate Activities | 2,333 | 2,529 | | |
| **Total Group** | **193,349** | **178,869** | **14,756** | **14,082** |

## Continental Europe

*Million euros*

| | 2011 | 2010 | Variation amount | % |
|---|---|---|---|---|
| **Income statement** | | | | |
| **Net interest income** | **10,666** | **9,872** | **794** | **8.0** |
| Net fees | 4,050 | 3,679 | 371 | 10.1 |
| Gains (losses) on financial transactions | 233 | 846 | (612) | (72.4) |
| Other operating income [1] | 397 | 396 | 1 | 0.3 |
| **Gross income** | **15,347** | **14,793** | **554** | **3.7** |
| Operating expenses | (6,612) | (5,917) | (695) | 11.7 |
| General administrative expenses | (5,998) | (5,301) | (697) | 13.1 |
| *Personnel* | *(3,725)* | *(3,343)* | *(382)* | *11.4* |
| *Other general administrative expenses* | *(2,273)* | *(1,958)* | *(315)* | *16.1* |
| Depreciation and amortisation | (614) | (616) | 2 | (0.3) |
| **Net operating income** | **8,735** | **8,875** | **(141)** | **(1.6)** |
| Net loan-loss provisions | (4,192) | (4,019) | (173) | 4.3 |
| Other income | (503) | (172) | (331) | 193.0 |
| **Profit before taxes** | **4,039** | **4,684** | **(645)** | **(13.8)** |
| Tax on profit | (1,049) | (1,220) | 170 | (14.0) |
| **Profit from continuing operations** | **2,990** | **3,465** | **(475)** | **(13.7)** |
| Net profit from discontinued operations | (24) | (14) | (11) | 77.7 |
| **Consolidated profit** | **2,966** | **3,451** | **(486)** | **(14.1)** |
| Minority interests | 117 | 96 | 21 | 21.7 |
| **Attributable profit to the Group** | **2,849** | **3,355** | **(506)** | **(15.1)** |
| **Balance sheet** | | | | |
| Customer loans [2] | 315,081 | 323,660 | (8,579) | (2.7) |
| Trading portfolio (w/o loans) | 78,802 | 57,690 | 21,112 | 36.6 |
| Available-for-sale financial assets | 24,640 | 23,843 | 797 | 3.3 |
| Due from credit institutions [2] | 51,638 | 66,925 | (15,287) | (22.8) |
| Intangible assets and property and equipment | 5,045 | 4,965 | 80 | 1.6 |
| Other assets | 28,586 | 22,160 | 6,427 | 29.0 |
| **Total assets/liabilities & shareholders' equity** | **503,793** | **499,243** | **4,549** | **0.9** |
| Customer deposits [2] | 247,582 | 247,715 | (133) | (0.1) |
| Marketable debt securities [2] | 39,708 | 48,413 | (8,705) | (18.0) |
| Subordinated debt [2] | 965 | 1,740 | (774) | (44.5) |
| Insurance liabilities | 517 | 933 | (416) | (44.6) |
| Due to credit institutions [2] | 88,143 | 77,059 | 11,084 | 14.4 |
| Other liabilities | 96,088 | 95,963 | 126 | 0.1 |
| Shareholders' equity [3] | 30,789 | 27,420 | 3,369 | 12.3 |
| **Other customer funds under management** | **45,809** | **53,968** | **(8,159)** | **(15.1)** |
| Mutual funds | 31,038 | 37,519 | (6,481) | (17.3) |
| Pension funds | 9,645 | 10,965 | (1,320) | (12.0) |
| Managed portfolios | 5,126 | 5,484 | (358) | (6.5) |
| Savings-insurance policies | — | — | — | — |
| **Customer funds under management** | **334,064** | **351,836** | **(17,772)** | **(5.1)** |

(1).- Including dividends, income from equity-accounted method and other operating income/expenses
(2).- Including all on-balance sheet sheet balance sheets for this item
(3).- Not including profit of the year

**Loans**
*% annual variation*

**Deposits***
*% annual variation*

(*) Including retail commercial paper

**Loans / deposits***
*%*

(*) Including retail commercial paper

## Continental Europe

- Basic revenues increased 8.4% due to the improvement in net interest income and fee income in the commercial units and consolidation of Bank Zachodni WBK.
- Controlled expenses: flat on a like-for-like basis (+0.6%).
- Attributable profit hit by lower gains on financial transactions and reduced release of generic provisions.
- Growth strategy: preference for liquidity against a background of low demand for loans.
- Best bank in Western Europe prize from The Banker.

Continental Europe includes all activities carried out in this geographic area: retail banking, global wholesale banking, asset management and insurance.

Attributable profit was EUR 2,849 million, 15.1% lower than in 2010.

The results reflect the perimeter effect of incorporating Bank Zachodni WBK and SEB's branches in Germany. Overall, the positive impact was around 6 percentage points in the profit.

**Strategy**
In a still weak environment and with low interest rates, the Group maintained the same strategic lines, aimed at:

- defending spreads on loans (those on new ones continued to improve) and on deposits, which reflect a lower cost thanks to the strategy of renewing the balances captured in the 2010 campaign, where priority was given to costs over volumes;
- control of expenses
- and risk management very centred on recoveries.

Preference was given in volumes to liquidity and deposits in a context of low demand for loans.

**Activity**
Lending dropped 3% due to lower demand in Spain and Portugal, and the consolidation by the equity accounted method of Santander Consumer USA, which was partly offset by the incorporation of Bank Zachodni WBK.

Deposits remained virtually unchanged because of the incorporation of new institutions and Portugal's evolution, offsetting the lower balances in Spain, which were affected by the strategy in renewing maturities of deposits captured in the 2010 campaign. The increase including the commercial paper placed by the retail networks in Spain was 2% The rise since December 2009, before the launch of the campaign, was EUR 49,400 million (+25%).

Growth in mutual funds and pension funds was affected by the strategy of greater preference for deposits

**Results**
Basic revenues grew 8.4%, driven by Santander Consumer Finance (partially favoured by the SEB incorporation in Germany), the entry of BZ WBK and the recovery in net interest income at the Santander Branch Network and Banesto.

Net interest income rose 8.0% and fee income 10.1%. Deducting the perimeter impact, net interest income and fee income increased 1.1%.

Operating expenses increased 11.7%, due to the perimeter effect as on a like-for-like basis they were flat (+ 0.6%). The Santander Branch Network, Banesto and Portugal reduced their costs.

Provisions for loan losses were 4.3% higher (+1.8% deducting the perimeter impact). This was due to various factors:

- On the one hand, it reflected the effort being made in risk management, which led to lower specific provisions.
- On the other, the ending of the regulating effect from the release of generic provisions in the commercial units in Spain. Releases amounted to EUR 379 million, down from EUR 1,949 million in 2010.

Attributable profit, after the rest of results and provisions, particularly for real estate, and taxes was EUR 2,849 million.

**Net operating income**
*Million euros*

-1.6% 2011-2010

**Attributable profit**
*Million euros*

-15.1% 2011-2010

**NPL ratio**
*%*

**NPL coverage**
*%*

## Continental Europe. Main units

*Million euros*

| | Santander Branch Network | | Banesto | | Santander Consumer Finance | | Portugal | | BZ WBK |
|---|---|---|---|---|---|---|---|---|---|
| | 2011 | Var (%) | 2011 | Var (%) | 2011* | Var (%) | 2011 | Var (%) | 2011 |
| **Income statement** | | | | | | | | | |
| **Net interest income** | **3,235** | **3.0** | **1,351** | **(11.1)** | **4,162** | **13.6** | **592** | **(18.2)** | **371** |
| Net fees | 1,099 | 1.7 | 616 | (0.2) | 1,128 | 18.0 | 345 | (3.5) | 248 |
| Gains (losses) on financial transactions | 108 | (1.6) | 98 | (49.9) | (12) | 84.6 | 14 | (78.8) | 58 |
| Other operating income [1] | (41) | 32.4 | 47 | (31.3) | 3 | (86.4) | 21 | (49.8) | 13 |
| **Gross income** | **4,400** | **2.4** | **2,113** | **(12.1)** | **5,282** | **14.0** | **972** | **(18.3)** | **690** |
| Operating expenses | (2,047) | (1.2) | (1,001) | (2.5) | (1,678) | 31.8 | (529) | (2.1) | (324) |
| General administrative expenses | (1,895) | (0.8) | (878) | (2.8) | (1,542) | 33.3 | (460) | (1.6) | (298) |
| *Personnel* | *(1,233)* | *(0.2)* | *(636)* | *(4.6)* | *(783)* | *31.6* | *(317)* | *(1.4)* | *(179)* |
| *Other general administrative expenses* | *(662)* | *(2.1)* | *(242)* | *2.0* | *(758)* | *35.2* | *(143)* | *(2.1)* | *(119)* |
| Depreciation and amortisation | (153) | (5.3) | (123) | (0.5) | (136) | 16.6 | (69) | (4.8) | (26) |
| **Net operating income** | **2,353** | **5.7** | **1,112** | **(19.2)** | **3,604** | **7.2** | **443** | **(31.9)** | **366** |
| Net loan-loss provisions | (1,437) | 31.7 | (661) | (6.8) | (1,632) | (19.1) | (206) | 87.7 | (60) |
| Other income | (11) | — | (251) | 756.5 | (135) | (5.8) | (50) | — | (3) |
| **Profit before taxes** | **905** | **(22.0)** | **200** | **(68.6)** | **1,837** | **53.1** | **187** | **(66.7)** | **303** |
| Tax on profit | (244) | (22.0) | (46) | (71.4) | (506) | 49.0 | (13) | (87.8) | (63) |
| **Profit from continuing operations** | **660** | **(22.0)** | **154** | **(67.6)** | **1,332** | **54.6** | **174** | **(61.9)** | **240** |
| Net profit from discontinued operations | — | — | — | — | (24) | 77.7 | — | — | — |
| **Consolidated profit** | **660** | **(22.0)** | **154** | **(67.6)** | **1,307** | **54.3** | **174** | **(61.9)** | **240** |
| Minority interests | 1 | 80.6 | 24 | (58.0) | 79 | 115.0 | 0 | (99.3) | 8 |
| **Attributable profit to the Group** | **660** | **(22.1)** | **130** | **(68.9)** | **1,228** | **51.5** | **174** | **(61.8)** | **232** |
| **Balance sheet** | | | | | | | | | |
| Customer loans [2] | 102,643 | (7.8) | 68,850 | (9.0) | 60,276 | (4.8) | 28,403 | (5.6) | 8,479 |
| Trading portfolio (w/o loans) | — | — | 7,869 | 19.7 | 1,335 | 16.4 | 1,617 | (7.1) | 1,304 |
| Available-for-sale financial assets | — | — | 8,333 | (7.7) | 205 | (63.3) | 4,496 | (30.4) | 2,617 |
| Due from credit institutions [2] | 104 | (51.2) | 9,637 | (43.7) | 11,011 | 37.4 | 2,467 | (27.4) | 309 |
| Intangible assets and property and equipment | 1,201 | — | 1,328 | (3.3) | 799 | (10.1) | 452 | (5.8) | 183 |
| Other assets | 1,829 | 279.8 | 10,215 | 35.8 | 4,984 | 72.3 | 7,120 | 0.4 | 645 |
| **Total assets/liabilities & shareholders' equity** | **105,776** | **(6.6)** | **106,232** | **(9.4)** | **78,610** | **2.3** | **44,555** | **(9.6)** | **13,536** |
| Customer deposits [2] | 78,864 | (7.9) | 50,755 | (15.0) | 33,198 | 27.9 | 23,465 | 8.0 | 10,359 |
| Marketable debt securities [2] | 4,965 | — | 22,531 | (18.6) | 5,729 | (51.1) | 5,037 | (33.2) | — |
| Subordinated debt [2] | — | — | 784 | (39.9) | 75 | (82.4) | — | — | 99 |
| Insurance liabilities | — | — | — | — | — | — | 70 | (11.1) | — |
| Due to credit institutions [2] | 543 | 18.9 | 16,591 | 23.6 | 23,565 | (8.9) | 13,395 | (20.4) | 1,163 |
| Other liabilities | 14,780 | (26.4) | 10,870 | 2.4 | 6,023 | 40.9 | 31 | (97.4) | 703 |
| Shareholders' equity [3] | 6,625 | (6.1) | 4,702 | 5.0 | 10,020 | 16.4 | 2,557 | 32.3 | 1,213 |
| **Other customer funds under management** | **23,640** | **(12.0)** | **8,375** | **(12.9)** | **6** | **(73.6)** | **2,686** | **(42.3)** | **1,926** |
| Mutual funds | 16,158 | (20.6) | 4,440 | (22.3) | 2 | (88.3) | 1,866 | (41.8) | 1,747 |
| Pension funds | 5,918 | (3.5) | 1,237 | (7.5) | 4 | (15.8) | 760 | (42.2) | — |
| Managed portfolios | — | — | 109 | (6.6) | — | — | 59 | (54.9) | 179 |
| Savings-insurance policies | 1,564 | 306.4 | 2,588 | 5.6 | — | — | — | — | — |
| **Customer funds under management** | **107,469** | **(4.5)** | **82,444** | **(16.2)** | **39,008** | **2.3** | **31,188** | **(8.1)** | **12,383** |

(1).- Including dividends, income from equity-accounted method and other operating income/expenses
(2).- Including all on-balance sheet sheet balance sheets for this item
(3).- Not including profit of the year

(*).- In December SC USA began to consolidate by the equity accounted method. Without impact on profits

## Santander Branch Network

- Improved underlying results:
  - Positive growth in gross income (+2.4%).
  - Operating expenses declined 1.2% by the second straight year.
  - Specific provisions declined 29.3%.
- The lower attributable profit was due to fewer releases of generic provisions.
- Activity reflected the scant demand for loans and a strategy in funding which combines cost reduction and volume retention.
- Best bank in Spain according to The Banker and Euromoney.

The Santander Network posted an attributable profit of EUR 660 million, 22.1% less than in 2010. This was mainly due to the smaller release of generic provisions, as net operating income rose 5.7%, after gradually improving during the year due to the better quarterly trend in gross income than in 2010 and control of costs.

These results were obtained in a still difficult environment, with insufficient signs of an economic recovery, strong competition for liquidity and low demand for loans.

**Strategy**
The Santander Branch Network maintained its strategic priorities: management of prices, control of costs and strengthening the balance sheet, with particular emphasis on capturing funds and control and early management of NPLs. We also continued to take advantage of opportunities to keep on capturing funds and boost customer linkage.

Santander remained very active in selling products and services, tailored to customers' needs and differentiated by segments.

The bank was particularly active with SMEs. Of note was the agreement with Google to support the digitisation of SMEs and businesses. We worked on different lines:

– EUR 100 gift for first time publicity in the leading search engine. Some 215,000 SMEs and self-employed people, who began to work with Santander or who increased their linkage, were rewarded.

– Incorporation to *Conecta tu Negocio* (creation of a web page and domain free for a year). In just nine months, 18,000 SMEs and self-employed created their web pages with this programme and the bank enabled them to have a 24-hour window throughout the world via Internet.

Also important in the sphere of companies were activities related to international business, in particular the *Plan Exporta* which aims to capture and link new customers whose commercial and industrial activity is related to exports. In 2011, 6,689 customers were captured.

There were also new multi channel projects, notably a new application for iPad and participation along with the Ministry of Industry, Tourism and Commerce in an initiative to foster the use of electronic DNIs.

Lastly, many customers continued to be captured under the *We want to be your Bank* plan. Close to 500,000 customers were captured during 2011, a similar number to 2010 after discounting the impact of the campaign to capture deposits.

**Activity**
There were two different periods for deposits. In the first half, Santander managed the maturity of the deposits captured in the 2010 campaign when priority was given to reducing the cost, reflecting a decline of 0.56 p.p. in that of time deposits.

This policy was combined with a high retention level of more than 60%. A key factor here were the funds captured by various products with different periods of renewal: the *Depósito Avanzado* (time), the *Cuenta Inversión* (demand), structured products (medium term) and *Seguros de Rentas* (for a more specialised segment of customers).

The second half of the year was characterised by the capturing of retail savings via commercial paper, as an alternative to traditional deposits. EUR 5,000 million was captured in the last three months.

**Activity**
*Annual variation in billion euros*

(*) Including retail commercial paper

**Loans / deposits***
%

(*) Including retail commercial paper

**Return / cost**
%

**Net interest inc. / ATAs**
%

All in all, total funds on the balance sheet declined by EUR 1,800 million (-2%), but were EUR 11,400 million (+16%) more than at the end of 2009 (i.e. before the start of the campaign). As a result, there was a gain of more than 100 b.p. in market share.

Lending in a weak market declined 8%. In this context, 227,000 loans were granted for a total of EUR 25,000 million.

We continued to be the leader in facilities credit lines, among which are the ICO lines. Some 50,000 loans were granted for a total of EUR 3,640 million, with a market share of around 20%, 6 p.p. more than the following competitor.

As regards liquidity, there was a sharp fall of EUR 24,000 million since the end of 2009 in the commercial gap (EUR 3,000 in 2011). This improved the loan-to-deposit ratio from 159% in December 2009 to 122% at the end of 2011.

**Results**

The main pillars of the income statement were the recovery in gross income, control of costs and reduced needs for specific provisions. They did not feed through to profits, however, because of the lower release of generic provisions.

Gross income was EUR 4,400 million, 2.4% more and reversing the trend of the last two years of lower revenues.

Growth was mainly due to net interest income (+3.0%) as the strategy to improve spreads, particularly on deposits, enabled the customer spread (the yield on lending less the cost of funds) to increase by almost one p.p. (from 1.49% in the fourth quarter of 2010 to 2.29% a year later).

Net fee income rose 1.7% and was higher in each quarter of 2011 than in the same periods of 2010. The fall in income from mutual and pension funds were offset by the rise in that from selling and buying securities, means of payment and, mainly, insurance. In the latter, both from protection (accidents, household and life), the most traditional insurance products, as well as new ones (cars and legal security).

Of note in protection insurance was *Open Market* (not linked to finance operations), with 170,000 policies (+38%). In car insurance, the *Súper Buscador Santander* gained more than 12,000 policies in just three months. The branches received more than 60,000 price requests.

Gains on financial transactions, in an unfavourable market, remained virtually stable.

Operating expenses continued the downward trend begun in 2010 (-1.2% in 2011), which is particularly significant as inflation was around 3% and the branch network's commercial capacity remained virtually unchanged. There were no significant closures of branches unlike the general trend in the sector.

The efficiency ratio improved 1.7 p.p. to 46.5% (43% excluding amortisations) and net operating income rose 5.7% to EUR 2,353 million.

Credit risk and NPL management continued to be given maximum priority. The NPL ratio was 8.47% in the retail network (excluding wholesale activities) and 5.99% at the parent bank. The latter ratio is more comparable with the rest of institutions, which are banks, and was well below the average of them. NPL coverage ratios were 40% for the network and 39% for the parent bank.

In August, the bank launched the campaign *Moratoria hipotecaria*, which aims to help those customers going through temporary difficulties as a result of the economic crisis in Spain. Almost 6,000 customers for EUR 1,000 million have benefited from this campaign.

Net loan-loss provisions made in 2011 were EUR 1,437 million, 31.7% more than in 2010 due to the net impact from the regulatory effect of generic provisions (EUR 298 million released, all in the first half of the year, compared to EUR 1,364 million in 2010) and specific provisions that were EUR 720 million less (-29.3%) than in 2010.

Net operating income after provisions was EUR 916 million, 19.4% less than in 2010 while attributable profit was EUR 660 million.

**Net operating income**
*Million euros*

+5.7% 2011-2010

**Attributable profit**
*Million euros*

-22.1% 2011-2010

**Banco Santander NPL ratio** *%*

**Banco Santander NPL coverage** *%*

## Banesto

- The balance sheet, the capital and liquidity were strengthened.
- Management of spreads, the balance sheet and greater customer linkage limited the impact on revenues from reduced business and higher funding costs.
- Very disciplined costs, which continued to decline.
- Provisions increased because of lower release of generic provisions. Specific provisions fell sharply.
- Good relative evolution of risk quality, better than our competitors.
- Euromoney prize for the best bank in Spain, and among the world's 50 most solvent banks, according to Global Finance.

Banesto generated an attributable profit to the Group of EUR 130 million, 68.9% lower than in 2010, after assigning more than EUR 900 million to strengthening provisions.

**Strategy**
The year 2011 was a complicated one for banks, because as well as the still weak economic growth there were strong tensions and high volatility in the markets in the second part of the year. The sector's non-performing loans continued to rise and interest rates were unstable. Liquidity tensions in the financial system triggered a rise in wholesale funding costs.

In this context, Banesto prioritised its objectives and focused on improving the quality of assets, strengthening the financial position and optimising liquidity. It also continued to improve its competitive position, thanks to exploiting its technology and innovation capacities. This produced further gains in efficiency, either by improving procedures and already existing products or by launching new initiatives, such as expanding the range of foreign trade services.

In business activity, the priorities were to capture and link corporate and individual customers and become their reference bank.

Quality of service has become the driver behind improving and consolidating the value offer for customers. The main indicators of quality put Banesto among the reference banks in Spain.

In 2011, for the fourth year running, Banesto was chosen by the magazine Euromoney as the best bank in Spain, and it was recently included by Global Finance among the world's 50 most solvent banks.

**Activity**
The bank's liquidity situation and its large number of customers facilitated profitable and efficient management of funds.

Total customer funds amounted to EUR 82,444 million, of which EUR 51,220 million (-14%) were on-balance sheet including the commercial paper issued in the fourth quarter. This reduction was due to the bank's policy of renewing part of the deposits captured in the special campaign launched in the second quarter of 2010. Excluding this operation, the decline was 2%.

Lending continued to decline because of the weak demand and the environment of greater credit and liquidity risks. The volume stood at EUR 68,850 million at the end of 2011, 9% less than a year ago.

The weak environment and the fall in lending pushed up the NPL ratio to 5.01%. The increase in non-performing loans was EUR 402 million, which compares well with the average of around EUR 1,000 million in 2010 and 2009. Moreover, the ratio compares very favourably with the sector's average.

NPL coverage was 53%.

Liquidity management, one of the year's priorities, improved the commercial gap and enabled wholesale funding to be reduced by almost EUR 5,600 million. This, in turn, enabled the EUR 2,200 million of debt issues during the year to give priority to cost optimisation over volume.

**Activity**
*Annual variation in billion euros*

(*) W/o REPOs. Including retail commercial paper

**Loans / deposits***
*%*

(*) Including retail commercial paper

**Return / cost**
*%*

(*) Retail Banking

**Net interest inc. / ATAs***
*%*

(*) Retail Banking

The level of available liquid assets means that Banesto can comfortably meet the wholesale funding maturities of EUR 4,700 million in 2012, even in a scenario of not issuing any debt.

**Results**

The three pillars of the income statement were defending revenues, controlling costs and rigorous risk management.

Net interest income was EUR 1,351 million, 11.1% less than in 2010. The reduction was due to the impact of lower activity on business and the rise in finance costs which, however, was limited by management of prices and of the balance sheet.

The credit spread of the front book increased from around 3% at the beginning of 2010 to close to 5% in the fourth quarter of 2011. Although this increase is already reflected in the stock, it still has not fully fed through. In customer deposits, the cost has been falling from the highs in the second half of 2010.

Management and linkage of customers produced a rise in transactions and use of value-added services, which resulted in a 2.6% rise in revenues from services. Net fee income from mutual and pension funds was 16.4% lower, due to the drop in the average commission and customer preference for other types of savings. Total net fee income was EUR 616 million, almost the same as in 2010.

The tensions in markets in the second half of the year impacted gains on financial transactions, due, on the one hand, to losses on assets valuation and, on the other, reduced customer activity in these products. Gains were 49.9% less at EUR 98 million.

Gross income was EUR 2,113 million, 12.1% less than in 2010.

The non-renounceable goal of controlling efficiency is the key to the present situation. Thanks to this, operating expenses of EUR 1,001 million were 2.5% less than in 2010. The efficiency ratio was 47.4% at the end of 2011.

Net operating income declined 19.2% to EUR 1,112 million.

Net loan-loss provisions were EUR 661 million, 6.8% lower than the EUR 709 million in 2010. This evolution is the net between lower specific provisions (-38.8%) and lower use of generic provisions (EUR 445 million less than in 2010).

Furthermore, Banesto made additional provisions of EUR 251 million to strengthen its financial position, basically for foreclosed properties and loans, and for early retirements made in the first half.

Profit before tax was EUR 200 million. Attributable profit after taxes and minority interests was EUR 130 million (-68.9%).

**Net operating income**
*Million euros*

-19.2% 2011-2010

**Attributable profit**
*Million euros*

-68.9% 2011-2010

**NPL ratio**
*%*

**NPL coverage**
*%*

## Santander Consumer Finance

- Successful business model during the crisis (2008-2011); attributable profit increased 76% and the return on assets was double that of the average of our competitors.
- Profit surged 51.5%, fuelled by gross income (+14.0%), efficiency ratio of 31.8% and a 19.1% drop in loan-loss provisions.
- Solid contribution from all core countries, which registered double-digit growth in profits.
- Sharp improvement in credit quality (lower NPL ratio at 3.77% and high coverage at 113%).
- Better liquidity position via deposit capturing and greater diversification of wholesale funding sources.

### Car financing market

*Market share new business - new and used car*

Source: Local Consumer Finance Associations or internal estimates based on the publics statistics

Santander Consumer Finance's attributable profit was EUR 1,228 million, 51.5% more than in 2010.

**Strategy**

The results in 2011 joined the unit's differentiating performance in the two prior years, the most demanding of the international financial and economic crisis. SCF performed better than comparable business units.

Since the end of 2008, the area has almost doubled its quarterly generation of attributable profit, while also offering a rising return on assets consistently higher than that of the large European competitors. After the strong growth in 2011, the return is double that of those.

The SCF business model is based on portfolio diversification, leadership in core markets, efficiency, control of risks and recoveries and a single pan-European platform.

In Europe, the focus was on organic growth and cross-selling, backed by brand agreements (37 with 9 manufacturers), which increased the recurrence of profits and boosted new car business, particularly in Germany and the UK.

Increased penetration of the second hand car sector and in new car sales in central European and Nordic countries. The first steps were also taken in Germany by Santander Retail (former SEB) focusing in mortgages and in capturing customer funds.

In the US, high growth in new loans and the capacity to extract value from a greater presence in the market doubled profits.

This attractive performance made it possible for new partners to enter SC USA, formalised in the fourth quarter, and inject $1,150 million of capital. This operation strengthes business and increases its future growth capacity.

### Diversified by products

*%*

### Net operating income

*Million euros*

+7.2% 2011-2010

### Attributable profit

*Million euros*

+51.5% 2011-2010

## Activity

Gross lending amounted to EUR 62,959 million, 7% less than in 2010 because of the consolidation of SC USA by the equity accounted method in December. Excluding this impact, gross lending was 16% higher, due to organic growth and the integration of businesses in Germany.

New lending amounted to EUR 27,396 million (+11%), spurred by auto finance for used cars (+13%) and direct lending (+16%), particularly in Germany. Weaker activity in durable goods (-1%). New cars increased 5.0%, well above the whole of the European market (-1%).

This growth, plus that in 2010, was achieved with strict management of spreads and risk (admission policies), which improved net interest margins and the risk performance (risk premiums at a minimum).

In local currency terms, lending rose in Germany (+15%), the Nordic countries (+8%), the US (+51%), Spain (+11%) and Poland (+28% backed by the integration of AIG in 2010). On the other hand, declines in Italy (-12%) and the UK (-4%), although in line with these markets.

Customer deposits increased 28% to EUR 33,198 million, fuelled by SC Germany and the entry of Santander Retail. The latter unit took advantage of its "welcome" campaigns to grow in balances and customers (+EUR 2,500 million).

The wholesale market increased the diversification of its funding sources with new issuance units. Of note was Norway where SCF made its first securitisation of car loans in the country. In Europe, the area placed EUR 5,000 million in securitisations and structured financing in the markets at competitive costs, clearly reflecting the attractiveness of our portfolios for investors in key European markets.

All of this enhanced SCF's liquidity position (customer deposits and medium- and long-term funding cover 66% of loans, 7 p.p. more than in 2010) and continued to reduce recourse to the parent bank (already below 10% of loans).

## Results

Gross income increased 14.0%, backed by the most basic revenues: net interest income (+13.6%), due to the rise in the average portfolio and better spreads; fee income (+18.0%), basically due to servicing in the US, and greater penetration in key European countries (Germany, Poland and Norway).

Higher expenses (+31.8%) due to the new incorporations. The new units brought the efficiency ratio to 31.8%, with clear opportunities for improvement once they are integrated.

Sharp fall in loan-loss provisions (-19.1%), causing net operating income after provisions to increase 46.8%. The lower provisions reflect the improvement in the quality of the portfolio, even after absorbing the incorporations.

The NPL ratio dropped from 4.95% in 2010 to 3.77% and coverage remained high at 113%, as both ratios were well supported by recoveries (+38%). The exit of SC USA because of its integration by the equity accounted method hardly affected the NPL ratio, but it has a greater impact on coverage, given its high coverage ratio, above 200%. On a like-for-like basis, the coverage ratio stood at 113%, up from 104% in 2010.

These trends in revenues, costs and provisions produced the 51.5% jump in attributable profit, with positive contributions from all the core units.

Santander Consumer USA doubled its profits (+99.2% in dollars), due to its basic drivers: larger average volumes, higher revenues from servicing and the lower cost of credit. Germany's profits grew 10.0%, driven by growth in lending and the risk improvement.

The performance was very positive in the rest of the units, particularly the Nordic countries (attributable profit: +14.5% in local currency), the UK (+38.1% in sterling) and in Spain, which returned to profit thanks to lower provisions.

Lastly, the unit in Poland more than doubled its profit because of the incorporation of AIG.

**Gross customer loans**
*Billion euros*

Nota: In December SC USA began to consolidate by the equity accounted method

(*) Before impact from consolidated by the equity accounted method from SC USA. Considering impact: -7%

**NPL ratio**
*%*

**NPL coverage**
*%*

## Portugal

- Activity affected by the adjustment plan and the restructuring measures of Portuguese banks agreed with international institutions.
- Priority given to strengthening the balance sheet:
  - Solvency and credit quality ratios were better than those of competitors.
  - The deleveraging goal set for the year was met after reducing lending by 6% and increasing deposits 8%.
  - Good result in the inspection programme conducted by the Troika.
  - The highest rating among banks in Portugal (equal to the sovereign).
- In results:
  - Profits plunged 61.8%, due to the 18.3% fall in gross income and the 87.7% rise in provisions.
  - Costs (-2.1%) fell for the second year running.
- Best Bank in Portugal prize from The Banker and Euromoney

Santander Totta's attributable profit was EUR 174 million, 61.8% less than in 2010. This was due to the 18.3% reduction in gross income, as a result of deleveraging and higher funding cost, and the rise of 87.7% in provisions.

**Environment**

Economic conditions worsened, particularly in the fourth quarter, which intensified the recession, especially domestic demand. The unemployment rate rose to around 13%, disposable income dropped because of higher taxes and conditions in the financial markets deteriorated with higher spreads on Portuguese loans.

In this difficult environment, the government continued to take measures to meet the budget deficit target of 5.9% of GDP in 2011. Pensions funds were transferred from the banking sector to social security to cover part of the extraordinary overshoot in spending. The IMF, in its second assessment of the adjustment programme, said "notable progress was made (…) and the specific measures included in the budgets should enable the 2012 fiscal challenges to be attained."

Meanwhile, under the Special Inspection Programme of the troika assessments of risk and solvency for the eight largest Portuguese banking groups at June 2011 were made in their workstreams one and two. The analysis of credit figures revealed a provisions deficit of EUR 838 million (0.3% of total lending), with a part already covered. Santander Totta's provisions were considered adequate, and so it has no deficit, and the assessment of its solvency levels led to an increase of 10 basic points in its Tier 1 ratio.

**Strategy**

Following the country's request for aid at the beginning of 2011, the financial sector had to refocus its strategy in order to meet the targets on capital, deleveraging and liquidity necessary to comply with the Financial Plan agreed with European Authorities.

Santander Totta has adopted measures that enable it to advance in the plan's financial targets, while strengthening the relationship with its customers by offering products adequate to the customers' savings needs (*Depósito Vencedor, Seguros Financieros, Cuentas Poupança*) which would offer them liquidity and profitability at various maturities.

This strategy, coupled with increased transactions with customers, enabled the bank to significantly increase its deposit base.

Selective growth in lending, while tending to the corporations financial needs mainly through products such as factoring/confirming and international factoring, reaching market shares of 19% and 23% respectively. Moreover, the support of SMEs via the program with government's guarantee (*PME Investe*), gave Santander Totta an 18% participation in these operations.

**Total assets**
*Billion euros*

-9.6% 2011-2010

**Activity**
*% variation 2011 / 2010*

**Reduction commercial GAP**
*Billion euros*

**Loans / deposits**
*%*

In addition, Santander Totta started an innovative project in the country to support exporting companies (*Solução Exportacão*), through the offer of products suitable for this segment and advice by specialists of the bank. For this purpose Santander Totta can count on the support of the Group's international network, incorporating the companies to the *International Desk* model, providing them with a rapid route of contacts abroad as well as integrated solutions. This operation directly supports not only the sector's companies, but also the country's growth.

Additionally, Santander Totta has three main finanial strategic lines:

- Large deleveraging, reflected in the improvement in the commercial gap and in the loan-to-deposit ratio, which improved from 216% at the end of 2009 to 139% in 2010 and 121% in 2011.
- Strengthening of the balance sheet, with a big rise in provisions.
- Strict control of costs (-2.1% in nominal terms).

**Activity**

Deposits kept its dynamic evolution and amounted to EUR 23,465 million, 8% more than in 2010. Lending, on the other hand, reflected the deterioration of economic conditions and dropped 6% to EUR 28,403 million in all segments (SMEs: -12%, companies: -14% and individuals -3%).

The evolution of deposits and lending, the result of deleveraging, improved the structure of the balance sheet and reduced the commercial gap by EUR 3,436 million (initially goal of EUR 2,000 million for the whole year).

Mutual funds declined 42%, and reflected the greater aversion to risk and the greater focus on on-balance sheet products.

**Results**

Santander Totta's results compared to 2010 were as follows.

Gross income was determined by the performance of net interest income, which was 18.2% lower than in 2010 at EUR 592 million. This evolution was due to lower lending and the higher cost of wholesale and retail funding due to the tougher competition in capturing deposits. These effects could not be offset by an improvement in credit spreads.

Net fee income dropped 3.5% to EUR 345 million, reflecting the net difference between the drop in lending, mutual funds and financial insurance and the better performance of fee income from GBM.

The rest of income amounted to EUR 35 million, less than in 2010 because of reduced gains on financial transactions and lower results from insurance activity. Income from the equity accounted method increased 37.7%.

Gross income declined 18.3% to EUR 972 million.

Operating expenses declined in all lines (personnel, other administrative costs and amortisations) for the second straight year and were 2.1% lower.

Loan-loss provisions were 87.7% higher at EUR 206 million. This increase reflects a prudent policy of adapting to the difficulties of the economic cycle, which are strongly increasing NPLs. At the end of 2011 the NPL ratio stood at 4.06% and coverage at 55%.

In this environment Santander Totta's credit quality indicators continue to be clearly above the sector's average.

Profit before tax was EUR 187 million, 66.7% lower than in 2010. Attributable profit after taxes and minority interests was EUR 174 million.

In short, in a extremely complex year in the country to carry out banking business, Santander Totta was the only large bank to produce profits, it has the most solid balance sheet of the Portuguese banking sector. Its NPL ratio is well below that of competitors, it has higher coverage ratios and a better capital ratio.

**Net operating income**
*Million euros*

-31.9% 2011-2010

**Attributable profit**
*Million euros*

-61.8% 2011-2010

**NPL ratio**
*%*

**NPL coverage**
*%*

## Retail Poland (BZ WBK)

- Consolidated as of April 1, 2011.
- Attributable profit of EUR 232 million in the three quarters. On a local pro forma basis, profit was 21.6% higher for the whole year.
- Both lending and deposits increased 14% since the bank's incorporation to the Group.
- Solid funding structure: loan-to-deposits ratio of 82%.
- High growth potential due to the favourable macroeconomic environment, solid presence in the market, management capacity and generation of synergies.

BZ WBK, in the nine months of its consolidation, posted an attributable profit of EUR 232 million. For comparison purposes, the profit for the whole year in local criteria was EUR 288 million (+21.6%).

**Environment**
BZ WBK enables Grupo Santander to develop its activity in Poland, a country with considerable potential: 38.5 million citizens and an economy whose size is more than 40% of that of the other new EU members.

Its economy is stable (it is the only EU country not to have suffered a recession in the last decade), growing (4% forecast for 2011) and supported by domestic demand (acceleration of consumption and pick up in investment). Inflation rose during the first 10 months of the year to 4.3% and made the country's central bank raise its interest rates to 4.5% (+100 b.p. since the end of 2010). The zloty remained stable against the euro until August when uncertainty in the markets weakened the currency (PLN 4.46 at the end of 2011).

Banking business grew at rates of close to 10%.

Poland needs to complete its infrastructure and it has a low level of "bankarisation" (loans only represent around 50% of GDP).

All of this raises good expectations for banking business.

**Strategy**
On April 1, Banco Santander completed the acquisition of 96% of BZ WBK after the takeover launched in the first quarter for 100% and the 50% of BZ WBK Asset Management still in the hands of AIB. The BZ WBK Group is now integrated into Grupo Santander, consolidating its results and business as of the second quarter.

BZ WBK has the third largest branch network in Poland (622 including 96 agencies), 9,382 employees, 2.4 million retail customers and close to EUR 20,000 million of loans and customer funds (mostly deposits).

Its business model is commercial banking, focusing on retail and company clients (SMEs and corporations), complemented by a notable presence in asset management, brokerage of securities and leasing. All of this fits well with Santander's retail business model and provides a significant growth potential in results in the next few years, both via business as well as from synergies.

As part of the bank's integration into Grupo Santander, in the first nine months under Santander management, and in cooperation with the local management team, the first steps were taken to ensure the improvements in operational and commercial efficiency announced to the market. Of note were:

- Measures to control costs in technology and operations were made, as well as the global integrator of Group purchases, with short-term goals.
- The financial and risk areas adjusted their structures, processes and information systems in order to ensure control and homogeneity. Of note was the progress made in implementing the corporate risk model.

**Loans** (Local criteria)
*Constant million euros*

+14.5% 2011-2010

**Deposits** (Local criteria)
*Constant million euros*

+13.8% 2011-2010

**Net operating income**
(Local criteria) *Million euros*

+4.3%* 2011-2010

(*) Excluding exchange rate impact: +7.4%

**Attributable profit**
(Local criteria) *Million euros*

+18.1%* 2011-2010

(*) Excluding exchange rate impact: +21.6%

- The launch of global business units which garner local knowledge and the Group's experience. Tangible progress was made in Global Banking and Markets on the basis of the clients of the Global Relationship Model in the country.
- Analysis and identification of the best practices in commercial banking, based on the long experience of both banks.

**Activity**
BZ WBK registered as of September EUR 8,479 million of net loans and EUR 10,359 million of deposits (1.1% and 1.6% of the Group's total lending and deposits, respectively).

In the first nine months under Santander management, loans and deposits increased 14%, with a double-digit rise in the balances of companies and high single digit with individual customers.

**Results**
Attributable profit (nine months) was EUR 232 million, backed by solid gross income of EUR 690 million. Of this amount, EUR 371 million came from net interest income, which improved its return on assets after the rise in interest rates, and EUR 248 million from fee income, due to the importance of asset management business and brokerage of securities.

Loan-loss provisions (EUR 60 million) absorbed only 16% of net operating income. In line with the macroeconomic situation, the NPL ratio was 4.89%, lower than when the bank was integrated into Grupo Santander, and coverage 65%.

In local criteria, these results compared very well with those of 2010, as basic revenues increased 8.2%, provisions were 12.8% lower and attributable profit 21.6% higher.

## Other Continental Europe

Attributable profit was EUR 424 million, 48.5% less than in 2010. The performance of the various businesses (GBM, asset management, insurance and Banif) varied.

Global Wholesale Banking, which provided 69% of gross income and 90% of profits, posted a 51.7% fall in attributable profit (EUR 382 million), hit by market weakness and tensions in the last few quarters, as well as by the Group's strategy to give priority to reducing risk and releasing capital and liquidity.

Gross income was 24.5% lower, due to gains on financial transactions, as in 2010 they amounted to EUR 452 million (loss of EUR 57 million in 2011, affected by the negative performance of the last few quarters). Net interest income rose 12.6%.

Costs rose 8.0%, due to the investments in equipment and technology, while provisions increased due to the environment and the lower use of generic provisions.

Better performance of insurance business. Attributable profit was 29.5% higher at EUR 35 million, fuelled by revenues (+9.1%) and management of costs (-19.2%).

Banif's net interest income and fee income increased 7.8%, which coupled with a fall in loan-loss provisions and writedowns pushed up attributable profit by 39.7% to EUR 22 million.

Attributable profit from asset management was EUR 10 million (EUR 11 million in 2010). The main developments were in gross income, which remained virtually unchanged, lower costs and an unfavourable impact in taxes. Net operating income was better, spurred by mutual funds that did not feed through to profits because of the impact of higher taxes.

## United Kingdom

*Million euros*

| | 2011 | 2010 | Variation amount | % |
|---|---|---|---|---|
| **Income statement** | | | | |
| **Net interest income** | **4,176** | **4,766** | **(590)** | **(12.4)** |
| Net fees | 1,070 | 1,027 | 44 | 4.3 |
| Gains (losses) on financial transactions | 405 | 462 | (57) | (12.4) |
| Other operating income [1] | 26 | 30 | (4) | (12.8) |
| **Gross income** | **5,678** | **6,285** | **(607)** | **(9.7)** |
| Operating expenses | (2,554) | (2,549) | (5) | 0.2 |
| General administrative expenses | (2,203) | (2,241) | 37 | (1.7) |
| *Personnel* | *(1,391)* | *(1,295)* | *(96)* | *7.4* |
| *Other general administrative expenses* | *(812)* | *(946)* | *134* | *(14.1)* |
| Depreciation and amortisation | (351) | (309) | (42) | 13.6 |
| **Net operating income** | **3,123** | **3,735** | **(612)** | **(16.4)** |
| Net loan-loss provisions | (585) | (930) | 345 | (37.1) |
| Other income | (972) | (105) | (866) | 822.7 |
| **Profit before taxes** | **1,567** | **2,700** | **(1,133)** | **(42.0)** |
| Tax on profit | (422) | (734) | 313 | (42.6) |
| **Profit from continuing operations** | **1,145** | **1,965** | **(820)** | **(41.7)** |
| Net profit from discontinued operations | — | — | — | — |
| **Consolidated profit** | **1,145** | **1,965** | **(820)** | **(41.7)** |
| Minority interests | 0 | 0 | (0) | (99.5) |
| **Attributable profit to the Group** | **1,145** | **1,965** | **(820)** | **(41.7)** |
| **Balance sheet** | | | | |
| Customer loans [2] | 252,154 | 233,856 | 18,298 | 7.8 |
| Trading portfolio (w/o loans) | 41,440 | 45,187 | (3,747) | (8.3) |
| Available-for-sale financial assets | 55 | 204 | (149) | (73.0) |
| Due from credit institutions [2] | 19,672 | 29,137 | (9,465) | (32.5) |
| Intangible assets and property and equipment | 2,288 | 2,323 | (35) | (1.5) |
| Other assets | 39,833 | 42,063 | (2,230) | (5.3) |
| **Total assets/liabilities & shareholders' equity** | **355,443** | **352,769** | **2,673** | **0.8** |
| Customer deposits [2] | 194,318 | 184,548 | 9,770 | 5.3 |
| Marketable debt securities [2] | 70,504 | 64,326 | 6,179 | 9.6 |
| Subordinated debt [2] | 8,260 | 8,143 | 116 | 1.4 |
| Insurance liabilities | — | 1 | (1) | (100.0) |
| Due to credit institutions [2] | 31,178 | 54,179 | (23,000) | (42.5) |
| Other liabilities | 38,330 | 29,811 | 8,519 | 28.6 |
| Shareholders' equity [3] | 12,852 | 11,762 | 1,090 | 9.3 |
| **Other customer funds under management** | **15,744** | **14,369** | **1,375** | **9.6** |
| Mutual funds | 15,744 | 14,369 | 1,375 | 9.6 |
| Pension funds | — | — | — | — |
| Managed portfolios | — | — | — | — |
| Savings-insurance policies | — | — | — | — |
| **Customer funds under management** | **288,826** | **271,386** | **17,440** | **6.4** |

(1).- Including dividends, income from equity-accounted method and other operating income/expenses
(2).- Including all on-balance sheet amounts for this item
(3).- Not including profit of the year

## United Kingdom

- Attributable profit of £993 million:
  - Lower revenues (-8.6%) impacted by increased liquidity requirements, higher funding costs and lower trading gains.
  - Provisions 36.3% lower, with arrears performing better than envisaged.
  - Provision of £538 million net of tax in June for payment protection insurance (PPI) remediation.
- Moderate increase in lending (+4.6%) and in deposits (+2.2%).
- Better funding structure: £25,000 million of medium-term funding issuances, with management seeking to reduce short-term funding and unprofitable retail deposits.
- Awarded 'UK Bank of the Year' by The Banker for the third year in succession.

Santander UK posted an attributable profit of £993 million, 41.0% less than in 2010.

This included the impact net of tax of a provision of £538 million in the second quarter, related to payment protection insurance (PPI) remediation, in line with what has been done by other British banks. In addition, there were higher costs derived from regulatory changes affecting increased liquidity requirements and higher wholesale funding costs. All of this was in the context of a weak growth and low interest rates environment.

### Environment

GDP growth continued to grow weakly, with an increase of 0.9% for 2011, but with gradually worsening growth rates which resulted in a negative fourth quarter (-0.8%) annualised. Inflation (4.5% on average for the year) increased at a faster pace than the average growth of wages and this reduction in real terms is impacting consumers and eroding confidence indices.

In this environment of uncertainty, the Bank of England held base rates at 0.5% and boosted its quantitative easing programme by £75,000 million to £275,000 million, despite the increased rate of inflation in 2011.

### Strategy

Santander UK maintained market shares of 14% in residential mortgages and 10% in retail deposits. It also continued to widen its range of products and services, while growth in lending to SMEs remained one of its main priorities.

Santander UK's goal is to become a full service, diversified, customer-centred commercial banking franchise. The strategy has three basic principles: focus on the customer more than on the product, business diversification toward a more balanced mix and continued operational efficiency compatible with a good level of customer service.

Our proprietary market-leading IT platform is integral to meeting these goals. We will invest £490 million over the next three years to further improve its functionality and capabilities, at which point the ability to differentiate and grow the businesses faster will be in place.

### Activity

Santander UK is focused on the United Kingdom (85% of its balance sheet). More than 80% of customer loans are mortgages for homes in the UK. The portfolio of mortgages is of a high quality, with no exposure to self-certified or subprime mortgages and less than 1% of buy-to-let loans.

The loan-to-deposit ratio was 130% at the end of 2011, a slight deterioration compared to 2010, largely due to the managed outflow of rate-sensitive deposits in the second half of 2011.

The following information on activity is in local criteria. Customer loans amounted to £203,261 million, 2% more than in 2010 and driven by the strong increase in loans to SMEs (+25%), offsetting the reduction in unsecured personal loans. The stock of residential mortgages was largely unchanged.

Gross mortgage lending amounted to £23,705 million, £477 million less than in 2010. Despite this decline, our gross lending market share in the fourth quarter increased to 19.5%, well above our stock share. The fourth quarter results followed the improved position of the third quarter, following a sluggish start to the year. Spreads improved, while the new business loan-to-value (LTV) was 65% and the indexed stock LTV was 53%.

Loans to SMEs via the network of regional business centres kept up their strong pace of growth and amounted to £10,748 million at the end of 2011, 25% higher than in 2010. The market share was 4.3%, 0.7 p.p. greater than in December 2010.

**Mortgages**
*Billion sterling* (local criteria)

0% 2011-2010

**Companies' loans**
*Billion sterling* (local criteria)

+16% 2011-2010

**Activity**
*% variation 2011 / 2010 in sterling*

**Loans / deposits**
*%*

In line with the policy of restricting personal loans (UPLs), the balance was 13% lower than in 2010 (£2,883 million). During 2011, this product began to be selectively marketed at better risk-adjusted spreads to low risk customers. Gross lending increased 14% relative to 2010.

Santander UK continued to dispose of non-core assets. The portfolio ended the year at £5,889, 38% lower than at end 2010 and 73% below December 2008.

Retail deposits (£149,192 million) were 3% lower than in 2010. The acquisition of deposits slowed in what was a smaller market of flow and where increased competition led to negative pricing and margins. A managed outflow of these more rate-sensitive and shorter term deposits was more than offset through the additional issuance of medium-term funding.

This strategy enabled the bank's funding position to improve with medium-to long-term funding issuances of £25,000 million and a substantial reduction in short-term financing. The issuances cover a wide range of products at attractive rates within the market environment.

The opening of some 836,000 current accounts in 2011 continued to reflect the effort and success in attracting quality customers.

A marketing campaign was launched in September to promote new current accounts and credit cards, as part of a new strategy to develop better and more lasting relations with customers. The new current account offers better incentives to existing customers, who change their primary account to Santander, and the 123 Cashback credit card offer (reimbursements / rebates on purchases) has helped to increase openings of credit cards (total: 543,000; +25%).

**Results**

Gross income declined from £5,386 million in 2010 to £4,925 million, largely due to increased regulatory liquidity requirements and the higher costs of funding.

Net interest income was 11.3% lower, reflecting the higher cost of liquid assets. The total commercial spread was lower at 1.85%, with higher spreads on loans more than offset by the greater cost of liquidity and funding. Increases in the proportion of customers on standard variable rate mortgages helped to partly mitigate the impact of low interest rates. Higher net interest income in SMEs and corporations reflected growth in deposits and loans, with spreads on new loans continuing to increase.

Net fee income was 5.5% higher, due to a new pricing structure for current accounts where overdraft interest charges have been replaced with a flat fee.

Gains on financial transactions declined 11.3%, due to the impact of lower market activity.

Operating expenses were 1.4% higher, (3% lower in real terms) due to the recruitment of 1,100 people to improve customer service, completed in the first half of 2011, which enabled Santander UK to repatriate to the UK call centres that were abroad, as well as continued investments in Corporate Banking and Global Banking & Markets. The efficiency ratio was 45.0%.

Loan-loss provisions were 36.3% lower, due to the improved evolution of retail products and to a better than expected arrears performance in the current environment.

The NPL ratio was 1.86%, 0.10 p.p. higher than that of 2010. There was a better performance in all retail products, particularly mortgages and unsecured personal loans, and a slight deterioration in the fourth quarter in corporate loans, including real estate. The stock of properties in possession remained very low (0.06% of the total portfolio compared to 0.05% at the end of 2010). In general, the trends were better than the sector's, according to the data from the Council of Mortgage Lenders (CML).

As a result, attributable profit for the year was £993 million.

**Net operating income**
*Million euros*

-16.4%* 2011-2010

(*) In sterling: -15.4%

**Attributable profit**
*Million euros*

-41.7%* 2011-2010

(*) In sterling: -41.0%

**NPL ratio**
*%*

**NPL coverage**
*%*

## Latin America

*Million euros*

| | 2011 | 2010 | Variation amount | % |
|---|---|---|---|---|
| **Income statement** | | | | |
| **Net interest income** | **16,473** | **14,678** | **1,795** | **12.2** |
| Net fees | 4,992 | 4,661 | 331 | 7.1 |
| Gains (losses) on financial transactions | 1,067 | 1,410 | (344) | (24.4) |
| Other operating income [1] | (90) | (74) | (16) | 22.0 |
| **Gross income** | **22,442** | **20,676** | **1,766** | **8.5** |
| Operating expenses | (8,909) | (7,971) | (938) | 11.8 |
| General administrative expenses | (7,984) | (7,193) | (790) | 11.0 |
| *Personnel* | *(4,456)* | *(3,955)* | *(501)* | *12.7* |
| *Other general administrative expenses* | *(3,528)* | *(3,238)* | *(290)* | *9.0* |
| Depreciation and amortisation | (925) | (778) | (148) | 19.0 |
| **Net operating income** | **13,533** | **12,705** | **828** | **6.5** |
| Net loan-loss provisions | (5,447) | (4,687) | (760) | 16.2 |
| Other income | (1,029) | (747) | (282) | 37.7 |
| **Profit before taxes** | **7,057** | **7,271** | **(214)** | **(2.9)** |
| Tax on profit | (1,654) | (1,693) | 39 | (2.3) |
| **Profit from continuing operations** | **5,402** | **5,578** | **(175)** | **(3.1)** |
| Net profit from discontinued operations | — | — | — | — |
| **Consolidated profit** | **5,402** | **5,578** | **(175)** | **(3.1)** |
| Minority interests | 738 | 850 | (111) | (13.1) |
| **Attributable profit to the Group** | **4,664** | **4,728** | **(64)** | **(1.4)** |
| | | | | |
| **Balance sheet** | | | | |
| Customer loans [2] | 139,867 | 127,268 | 12,599 | 9.9 |
| Trading portfolio (w/o loans) | 31,705 | 31,580 | 125 | 0.4 |
| Available-for-sale financial assets | 26,186 | 30,697 | (4,511) | (14.7) |
| Due from credit institutions [2] | 19,181 | 21,632 | (2,450) | (11.3) |
| Intangible assets and property and equipment | 4,312 | 4,880 | (568) | (11.6) |
| Other assets | 53,594 | 57,186 | (3,592) | (6.3) |
| **Total assets/liabilities & shareholders' equity** | **274,845** | **273,243** | **1,603** | **0.6** |
| Customer deposits [2] | 134,078 | 137,848 | (3,770) | (2.7) |
| Marketable debt securities [2] | 23,253 | 15,376 | 7,877 | 51.2 |
| Subordinated debt [2] | 6,015 | 5,683 | 332 | 5.8 |
| Insurance liabilities | — | 9,515 | (9,515) | (100.0) |
| Due to credit institutions [2] | 46,813 | 38,103 | 8,710 | 22.9 |
| Other liabilities | 45,170 | 45,913 | (743) | (1.6) |
| Shareholders' equity [3] | 19,516 | 20,805 | (1,289) | (6.2) |
| **Other customer funds under management** | **69,902** | **77,180** | **(7,278)** | **(9.4)** |
| Mutual funds | 55,829 | 61,621 | (5,792) | (9.4) |
| Pension funds | — | — | — | — |
| Managed portfolios | 14,073 | 14,800 | (728) | (4.9) |
| Savings-insurance policies | — | 758 | (758) | (100.0) |
| **Customer funds under management** | **233,248** | **236,087** | **(2,838)** | **(1.2)** |

(1).- Including dividends, income from equity-accounted method and other operating income/expenses
(2).- Including all on-balance sheet sheet balance sheets for this item
(3).- Not including profit of the year

## Latin America

- Basic revenues from business increased 12.1% and were the main driver in profit growth.
- Costs were 13.0% higher due to installed capacity and some pressure from inflation and the signing of collective agreements.
- Loan-loss provisions were 16.7% higher, below lending growth.
- Net operating income after provisions increased 1.9%.
- Strong business activity, reflected in a faster pace of lending (+18%) and deposits (+9%) in all countries.
- Best bank in Latin America according to Euromoney.

Santander generated attributable profit of EUR 4,664 million in 2011, 1.4% less than in 2010 (+0.1% in constant currency).

The main developments were the notable rise in basic revenues (+12.1%), which did not feed through to profits as it was offset by the fall in gains on financial transactions due to the market situation, the commercial investments and the rise in loan-loss provisions (+16.7%, but less than the 18% increase in lending).

**Economic environment**

Following the solid recovery in 2010, overcoming the crisis of 2008-2009, Latin America's economic growth eased in 2011 to more sustainable rates (around 4%), and some countries are beginning to be affected by the deterioration of the International environment.

Domestic demand remained buoyant, although on a downward trend during 2011. The contribution of external demand was less negative than in 2010, due to a sharper fall in imports than in exports.

Inflation began to rise and reached an average of 5.7% in September, to end the year at 5.6%, slightly above the 5.5% of 2010.

The emergence of an increasingly more adverse external scenario as the year progressed, particularly in the second quarter, led central banks to change the bias of their monetary policies. After raising interest rates until July, they began to show their readiness to lower them. Only Brazil's central bank decided to begin to cut interest rates, leaving the Selic at 11% at the end of the year (-150 b.p. since July). The central banks of Colombia and Uruguay were the only ones to break with this trend and in the last months of 2011 lifted their key rates by 25 b.p. in Colombia to 4.75% and by 75 b.p. in Uruguay to 8.75%.

Budget deficits continued the reduction begun in 2010, although at a more moderate pace, thanks to higher tax receipts and the end of public investment programmes begun in 2008-2009. The fiscal deficit was around 2.3% of GDP for the region, slightly better than in 2010 (2.4%), but a very healthy level. The region thus has a good starting point if the situation worsens and makes it necessary to implement a more expansive policy. The public debt to GDP ratio is very moderate at close to 30% on the average for the region.

The evolution of external accounts was also good, with a larger trade surplus than in 2010, as a result of lower growth in imports than in exports, although both continued to expand at double-digit rates in most countries. Thanks to this, the current account deficit for the region remained below 2% of GDP, in line with 2010. This presents no funding problems given the high level of international reserves (close to $680,000, or 14% of the region's GDP).

The main impact of the international financial turbulence on Latin America was felt in its currency and stock markets. Latin American currencies depreciated 10.6% on average in 2011 against the dollar and the main stock market indices fell 14.7% in local currency.

On the basis of the countries where Santander operates (Brazil, Mexico, Chile, Argentina, Colombia, Uruguay, Peru and Puerto Rico), banking business recovered its growth rates and increased 17%. Lending accelerated to 20%, excluding the exchange rate impact. Loans to individual customers grew 21% (cards: +23%; consumer: +17% and mortgages: +27%), while credit to companies and institutions increased 19%.

Savings growth eased a little, but remained double-digit (+15%). Demand deposits rose 13%. Generally speaking, and on the basis of the main financial systems, Brazil's growth was the most dynamic, while that of Chile (together with Mexico) was more moderate.

**Loans**
*% y-o-y variation w/o forex impact*

**Savings**
*% y-o-y variation w/o forex impact*

**Net interest income / provisions** *% o/ ATAs*

**Net operating income**
*Million euros*

+6.5%* 2011-2010

(*) Excluding exchange rate impact: +7.3%

Because of their impact on business and on converting figures into euros, the evolution of interest rates and exchange rates is commented on:

- Average short-term interest rates, based on the region's average weighted rate, rose between 2010 and 2011.
- The evolution of results in euros is affected by average exchange rates. In global terms, Latin American currencies appreciated against the dollar (except the Argentine peso), while the dollar, the reference currency in Latin America, depreciated 5% against the euro. In average terms, the Brazilian real and the Chilean peso appreciated a little (from 2.33 to 2.32 and from 674 to 672, respectively), while the Mexican peso depreciated from 16.70 to 17.25.

**Strategy in 2011**

The financial systems maintained high levels of solvency, liquidity and credit quality. The strong growth in lending and savings is beginning to slacken due to the international scenario.

In these circumstances, the Bank continued to keep watch on its levels of capital, liquidity and exposure to business risks. This resulted in harmonious growth in the balance sheet, but with a clear emphasis on customer deposits and safeguarding the liquidity position.

The Bank also continued to focus on selective growth in lending, managing spreads, optimising the mix of products and segments and handling appropriately the risk/return relation.

In a less dynamic context, the bank weighed up all the new commercial projects from the standpoint of future profitability, within the principles of austerity and efficiency which create shareholder value.

The Group also kept the emphasis on customer management, focusing on linkage, transactions and better quality service.

In 2011, Grupo Santander carried out the following operations in Latin America:

- Santander Mexico acquired in the second quarter a portfolio of mortgages from GE Capital Corporation for $1,870 million.

**Main focuses of management in 2011**

1. Permanent watch on capital, liquidity and business risks
2. Focus on generating revenues, with strong business, management of spreads and activities that generate fee income.
3. Selective growth in lending centred on net risk premiums.
4. Management of customers, focused on linkage, transactions and credit quality improvement.
5. Investment in installed capacity in all countries under the principle of austerity and efficiency.

- In July, a global agreement was reached with Zurich for it to acquire 51% of the holding which groups the insurers in Argentina, Brazil, Chile, Mexico and Uruguay, as well as a product distribution agreement in those countries. During the third and fourth quarters, the 51% stake was sold to Zurich and it incorporated the insurers in the countries, after obtaining authorisations from local supervisors and from the European Union.
- In the fourth quarter, the Group completed the sale in the secondary market of 7.82% of Banco Santander Chile for $950 million. This left Grupo Santander with 67% of this bank.
- Also in the fourth quarter, the Group announced an agreement to sell its business units in Colombia to the Chilean group CorpBanca for $1,225 million (estimated capital gains of EUR 615 million). This operation is due to be completed during 2012 and it is subject to obtaining the authorisations from the regulatory bodies and a takeover bid delisting Banco Santander Colombia shares aimed to minority shareholders who have 2.15% of Santander Colombia. The 2011 results do not yet incorporate these capital gains.

**Net operating income after LLPs** *Million euros*

+0.8%* 2011-2010

(*) Excluding exchange rate impact: +1.9%

**Attributable profit** *Million euros*

-1.4%* 2011-2010

(*) Excluding exchange rate impact: +0.1%

**NPL ratio** *%*

**NPL coverage** *%*

At the end of 2011, Grupo Santander had 6,046 points of attention in Latin America including traditional branches and other points of attention and 27,975 ATMs.

The number of customers reached 41.7 million, an increase of 1.4 million. The Group's strategic in 2011 was focused more on customer linkage than on capturing new customers. Grupo Santander is the leading franchise in the region, with business volumes almost double those of the next competitor. Taking advantage of the synergies of Santander's differential position in the region, the bank launched *International Desk*, a project designed to support SMEs in their internationalisation process, exploiting the competitive advantage of having the largest branch network in Latin America.

The main developments in business 2011 are set out below. All percentage changes exclude the exchange-rate impact.

**Activity**

In Latin America (excluding the balances in the New York branch, which are more volatile), lending increased 18% (cards: +25%; commercial credits – companies and institutions – +18%: mortgages: 25% and consumer loans +14%).

Also excluding the New York branch, savings rose 5%. Deposits excluding repos increased 9%, with good performance of time deposits: +22%, while mutual funds dropped 2%.

The average market shares in the countries where the Group operates are 11.2% in loans; 8.3% in savings and 9.4% in total banking business.

**Results**

Net interest income rose 13.1%, due to larger volumes and management of spreads in a context of higher interest rates than in 2010.

Net fee income increased 8.7%, with that from insurance up 31.7% and cards 23.7%, while those from managing accounts fell 16.6%. Income from insurance business grew 16.9%, affected by the impact of the agreement with Zurich (excluding this impact: +34.8%).

As a result, basic revenues were 12.1% higher than in 2010, and the fourth quarter was a record one.

Gains on financial transactions dropped 23.5%, due to the volatility of markets in the third and fourth quarters. This fall was more than offset by the rise in basic revenues and gross income increased 9.5%.

Operating expenses were up 13.0%, higher than the inflation rate, due to various factors: growth in staff in the networks, renegotiation of fees and collective agreements, new business projects, increased installed capacity and redesigning points of attention. The efficiency ratio remained at around 40%.

Loan-loss provisions rose 16.7%, partly due to greater generic provisions. The risk premium went from 3.63% in 2010 to 3.81% in 2011. The NPL ratio was 4.32% and coverage 97%, (4.11% and 104% respectively in 2010).

The Group's attributable profit in the region was EUR 4,664 million.

Retail Banking's attributable profit rose 0.8%, while Global Wholesale Banking and Asset Management and Insurance's dropped 1.5% and 1.4% respectively.

## Latin America. Income statement

*Million euros*

| | Gross income | | Net operating income | | Attributable profit to the Group | |
|---|---|---|---|---|---|---|
| | **2011** | Var (%) | **2011** | Var (%) | **2011** | Var (%) |
| Brazil | 15,940 | 11.3 | 9,963 | 10.6 | 2,610 | (7.2) |
| Mexico | 2,383 | 1.1 | 1,387 | (3.3) | 936 | 40.9 |
| Chile | 2,077 | 2.2 | 1,264 | (2.5) | 611 | (9.0) |
| Argentina | 926 | 12.3 | 472 | 4.7 | 287 | (2.7) |
| Uruguay | 172 | 1.6 | 40 | (46.8) | 20 | (70.3) |
| Colombia | 207 | 11.0 | 91 | 21.8 | 58 | 43.0 |
| Puerto Rico | 344 | (5.3) | 169 | (9.3) | 34 | (10.1) |
| Rest | 105 | (24.3) | (15) | — | (24) | — |
| **Subtotal** | **22,153** | **8.6** | **13,371** | **6.6** | **4,531** | **(1.2)** |
| Santander Private Banking | 289 | 2.2 | 162 | (0.4) | 133 | (4.8) |
| **Total** | **22,442** | **8.5** | **13,533** | **6.5** | **4,664** | **(1.4)** |

## Latin America. Main units

*Million euros*

| | Brazil | | Mexico | | Chile | |
|---|---|---|---|---|---|---|
| | 2011 | Var (%) | 2011 | Var (%) | 2011 | Var (%) |
| **Income statement** | | | | | | |
| **Net interest income** | **12,061** | **15.3** | **1,680** | **4.1** | **1,543** | **2.9** |
| Net fees | 3,253 | 8.4 | 603 | 6.3 | 422 | 2.7 |
| Gains (losses) on financial transactions | 757 | (22.4) | 98 | (44.3) | 77 | (14.3) |
| Other operating income [1] | (131) | 15.2 | 1 | — | 36 | 8.1 |
| **Gross income** | **15,940** | **11.3** | **2,383** | **1.1** | **2,077** | **2.2** |
| Operating expenses | (5,976) | 12.4 | (996) | 8.0 | (814) | 10.4 |
| General administrative expenses | (5,326) | 10.8 | (887) | 8.9 | (724) | 11.2 |
| *Personnel* | *(2,927)* | *12.9* | *(466)* | *8.4* | *(459)* | *12.2* |
| *Other general administrative expenses* | *(2,399)* | *8.3* | *(422)* | *9.5* | *(265)* | *9.4* |
| Depreciation and amortisation | (651) | 27.9 | (108) | 1.2 | (89) | 4.5 |
| **Net operating income** | **9,963** | **10.6** | **1,387** | **(3.3)** | **1,264** | **(2.5)** |
| Net loan-loss provisions | (4,508) | 21.5 | (337) | (28.0) | (380) | 17.6 |
| Other income | (1,102) | 47.6 | 33 | — | 40 | 31.8 |
| **Profit before taxes** | **4,354** | **(4.3)** | **1,083** | **15.7** | **924** | **(7.9)** |
| Tax on profit | (1,198) | (0.1) | (145) | 2.2 | (126) | (18.9) |
| **Profit from continuing operations** | **3,156** | **(5.9)** | **938** | **18.1** | **798** | **(5.9)** |
| Net profit from discontinued operations | — | — | — | — | — | — |
| **Consolidated profit** | **3,156** | **(5.9)** | **938** | **18.1** | **798** | **(5.9)** |
| Minority interests | 546 | 1.3 | 2 | (98.7) | 187 | 5.9 |
| **Attributable profit to the Group** | **2,610** | **(7.2)** | **936** | **40.9** | **611** | **(9.0)** |
| **Balance sheet** | | | | | | |
| Customer loans [2] | 78,408 | 10.4 | 18,185 | 20.0 | 25,709 | (0.1) |
| Trading portfolio (w/o loans) | 12,994 | 12.7 | 12,171 | (6.4) | 3,019 | (14.5) |
| Available-for-sale financial assets | 18,422 | (13.3) | 3,410 | (8.2) | 2,572 | (9.0) |
| Due from credit institutions [2] | 8,490 | (21.8) | 4,463 | (0.3) | 2,049 | (12.8) |
| Intangible assets and property and equipment | 3,228 | (15.3) | 369 | (7.8) | 350 | (6.5) |
| Other assets | 36,612 | (12.4) | 4,253 | (3.2) | 5,208 | 30.6 |
| **Total assets/liabilities & shareholders' equity** | **158,157** | **(1.3)** | **42,852** | **4.1** | **38,906** | **0.3** |
| Customer deposits [2] | 72,405 | (4.3) | 21,459 | 1.5 | 20,175 | 11.4 |
| Marketable debt securities [2] | 16,154 | 76.3 | 1,324 | 264.4 | 5,601 | 0.2 |
| Subordinated debt [2] | 4,515 | 3.3 | — | — | 1,285 | 16.9 |
| Insurance liabilities | — | (100.0) | — | (100.0) | — | (100.0) |
| Due to credit institutions [2] | 28,847 | 19.0 | 7,591 | 1.1 | 4,851 | (12.9) |
| Other liabilities | 25,795 | (2.2) | 8,715 | 11.2 | 5,112 | (13.6) |
| Shareholders' equity [3] | 10,440 | (10.1) | 3,763 | (5.7) | 1,882 | (13.9) |
| **Other customer funds under management** | **42,785** | **(12.2)** | **9,432** | **(6.8)** | **4,846** | **(17.5)** |
| Mutual funds | 39,414 | (10.3) | 9,432 | (5.7) | 4,846 | (16.5) |
| Pension funds | — | — | — | — | — | — |
| Managed portfolios | 3,371 | (19.8) | — | — | — | — |
| Savings-insurance policies | — | (100.0) | — | (100.0) | — | (100.0) |
| **Customer funds under management** | **135,859** | **(1.5)** | **32,214** | **1.9** | **31,908** | **4.0** |

(1).- Including dividends, income from equity-accounted method and other operating income/expenses
(2).- Including all on-balance sheet amounts for this item
(3).- Not including profit of the year

## Brazil

- Greater activity and management of spreads fuelled basic revenues growth (+13.7%).
- Higher operating expenses (+12.3%) reflected the commercial investment (opening 154 branches) and the collective agreement.
- Higher provisions (+21.4%) due to increased business and moderate rise in the sector's NPLs.
- Net operating income after provisions increased 2.9%.
- Lending and savings grew 20% and 16%, respectively.
- The main three rating agencies upgraded Santander Brazil's ratings giving it the highest rating of any Brazilian institution (long-term debt in foreign currency).

Santander Brazil generated attributable profit of EUR 2,610 million, 7.2% lower than in 2010 (-7.3% in local currency).

The top part of the income statement is very solid. Gross income rose 11.2% in local currency, spurred by net interest income and fee income, which coupled with a slight improvement in the efficiency ratio, produced a 10.5% increase in net operating income. This increase enabled the larger provisions to be absorbed, maintaining net operating income after provisions in positive growth rates (+2.9%). This, however, did feed through to profits mainly because of labour disputes, higher tax rate and minority interests.

**Economic environment**

The latest figures continue to show a favourable picture, with GDP growing at 3% in 2011, fuelled by domestic demand and an outlook of sustained growth in the coming years of around 3-4%.

According to IMF estimates, Brazil is the world's sixth largest economy.

Employment rates continued their positive trend, where the jobless rate reached a record low of 4.7%. In twelve months, 1.9 million new jobs were created and real income increased 7%.

Inflation ended the year at 6.5%, the upper ceiling established by the central bank.

In this context, the central bank, given the international scenario, started to ease the interest rates (Selic) ending the year at 11%, after reaching 12.5% in the first half of the year.

With the latest available data, the banking system's total lending grew 18% and savings 16%.

**Strategy**

Santander Brazil is the third largest private sector bank in terms of assets, and the leading foreign bank, with a market share of 10.5% in loans. It operates in the main regions, with 3,775 branches and points of banking attention, 18,419 ATMs and 25.3 million customers, of which 19.3 million hold current accounts.

The bank's strategy is based on the following goals:

- be the best in quality of service, backed by the strength of the IT platform;
- intensify relations with customers improving service quality and infrastructure (it aims to open around 100 - 120 branches each year, in 2011-2013);
- business strengthening in key segments such as SMEs, acquiring business, cards, real estate loans and consumer credit; and boost cross-selling;
- better recognition of the Santander brand;
- all of this accompanied by prudent risk management.

Technology integration was completed in the first half of 2011, adding to unification of the brand carried out in 2010. Functions were improved in the new unified platform, which is more agile and has a wider range of products and services, enabling the bank to develop activity more productively.

In products and collectives, an alliance was reached with Telefónica and with the owners of the Esso, Shell and Mobil brands in Brazil to launch the new Santander Esso and Santander Shell cards. Another key segment in the Group's strategy is real estate credit, where specific products were developed for high income customers, such as personalised advice, discounts in home insurance and special conditions for investments in time deposits and pension funds.

**Loans**
*% y-o-y variation w/o forex impact*

**Savings***
*% y-o-y variation w/o forex impact*

(*) Including "letras financeiras"

**Net interest income / provisions** *% o/ ATAs*

**Net operating income**
*Million euros*

+10.6%* 2011-2010

(*) Excluding exchange rate impact: +10.5%

In the acquiring business, Santander Brazil maintained its good results and attained a base five times higher than in 2010. It was the first bank to unite acquiring services with banking services, which is very attractive for SMEs.

As part of its strategy to become the best and most efficient universal bank in the country, Santander Brazil launched the *Piloto del Modelo de Atención* in order to increase customer satisfaction.

Also, in order to improve quality and provide a better capacity of response, improvements were made to the telephone attention centres for individuals and companies.

Lastly, and in order to be more agile in risks, the system has a new tool which will enable operations to be approved more quickly, minimise errors and enhance analysis of results.

**Activity**
Lending kept up the growing trend started in 2010. It rose 20%, with growth across all segments.

- Loans to individuals (+23%), particularly mortgages (+40%) and cards (+31%)
- SMEs and companies (+26% combined).
- Large companies (+12%).

Deposits excluding repos rose 6%, with a good performance in time deposits: +30%, coupled with strong capturing in *letras financeiras*, an instrument that provides greater stability and which started to be marketed in 2010. Including them, customer deposits rose 16%.

The market share in lending was 10.5% (11.7% in unrestricted lending) and 7.9% in deposits.

**Results**
In results (always in local currency), gross income kept up the growing trend started in 2010. It amounted to EUR 15,940 million, 11.2% higher.

The main component of growth was net interest income (+15.2%), spurred by the larger volumes and management of spreads.

The good trend in fee income, (+8.3%) backed by cards and insurance, which increased by more than 30%. The recurrence ratio was 61.1%.

Gains on financial transactions were EUR 757 million, 22.5% lower due to the lesser contribution from activities linked to the markets. They only accounted for 5% of total revenues reducing their share.

In short, gross income continued to grow, as the net interest income has increased in all quarters during the last four years and fee income has done so in four of the last seven quarters. Total basic revenues grew 13.7% in 2011 against 5.9% in 2010.

Operating expenses grew 12.3%, due to:

- the investment made to increase the distribution capacity (opening of 154 traditional branches in 12 months)
- the new IT platform and
- collective agreements

Net operating income rose 10.5% to EUR 9,963 million and the efficiency ratio was 37%, similar to that of 2010.

Provisions for loan losses were 21.4% higher than in 2010, due to the increase of close to 20% in lending balances and a moderate rise in the NPLs of individual borrowers, mainly in consumer credit and cards. The NPL ratio was 5.38% (4.91% in December 2010) and coverage 95%.

Net operating income after provisions increased 2.9%, driven by the strength of the most basic revenues, which absorbed the investments in installed capacity and provisions.

Including the higher provisions for labour disputes, the higher tax rate and larger minority interests from the partial placement of shares in 2010, attributable profit was 7.3% lower at EUR 2,610 million.

Retail Banking and Asset Management and Insurance's attributable profit was 12.2% and 8.1% lower respectively, while that of GBM rose 4.2%.

**Net operating income after LLPs** *Million euros*

+3.0%* 2011-2010

(*) Excluding exchange rate impact: +2.9%

**Attributable profit** *Million euros*

-7.2%* 2011-2010

(*) Excluding exchange rate impact: -7.3%

**NPL ratio** *%*

**NPL coverage** *%*

## Mexico

- Stronger franchise reflected in business and profits performance.
- Basic revenues continued to accelerate (+8.6%) fuelled by increased activity and spreads management.
- Costs rose 11.6% because of increased commercial capacity and perimeter.
- Lower NPLs produced a 25.7% fall in loan-loss provisions.
- Net operating income after provisions increased 12.4% and profit before minority interests 22.0%.
- Strong rise in business: lending rose 22% on a like-for-like basis and deposits 10%.

Attributable profit was 40.9% higher at EUR 936 million (+45.6% in local currency), partly benefiting from lower minority interests.

Results showed a good trend, with growth in net interest income and fee income and lower provisions.

**Economic environment**
GDP growth slowed in 2011 (to 3.8% from 5.4% in 2010, according to the latest estimates), with more moderate domestic demand, due to an easing of both private and public consumption, while investment grew strongly and recovered the pre-crisis levels. The contribution of net external demand was similar to that of 2010, but with a significant moderation in exports and imports.

Job creation continued but at a slower pace (610,000 in 2011).

Inflation was around 3.5% in 2011, closing the year at 3.8%. Medium- and long-term expectations continued at these rates (3.5%), despite the peso's depreciation. In this context, the Bank of Mexico held its key rate at 4.5%.

The 11.2% depreciation of the Mexican peso against the dollar was one of the main effects of turbulence in the international markets. In order to limit exchange-rate volatility and inject dollar liquidity into the Mexican market, the Bank of Mexico decided at the end of November to auction daily $400 million provided the exchange rate varied in the day by more than 2% against the dollar. At the same time, it suspended the monthly auctions of dollars. This measure produced very good results in the 2008-2009 crisis and, judging by the high level of international reserves of more than $140,000 million, it will do so again.

Business picked up. Lending increased 16% (consumer credit and cards: +23%) and savings 11%.

**Strategy**
The Mexican financial system remains solid and liquid and has good risk quality indicators. The international environment has not hit banking activity and growth in both lending and savings remains strong.

In this context, Santander is the third largest banking group by business volume, with market shares of 16.0% in lending and 14.7% in savings. The Group has 1,125 branches and 9.3 million customers.

In 2011, Santander Mexico continued to consolidate its franchise by increasing its customer base and linkage and improving the quality of its services. Integral risk management and efficiency in costs continue to complement a strategy aimed at creating value for customers and shareholders.

The bank offered its customers innovative products and of high value added, tailored to each segment.

The strategy in mortgages is aimed at medium and residential housing segments (market share of close to 19%, 7 p.p. more than in 2010). This sharp rise was due to organic growth, with the launch of products such as *Hipoteca Light* and the acquisition of GE Capital Corporation's mortgage portfolio in Mexico.

The strategy in credit cards focused on placing new accounts mainly with current customers, paying particular attention to the quality of the portfolio. In consumer credit, the use of alternative channels is key for increasing balances (more than 30%), which was achieved with an improvement in the index of the past-due portfolio. Other campaigns for customers were *Vive la magia, Ganas o ganas* and *Auto compara* in car insurance.

**Loans*** *% y-o-y variation w/o forex impact*

(*) Without perimeter: +22.4%

**Savings** *% y-o-y variation w/o forex impact*

**Net interest income / provisions** *% sobre ATAs*

**Net operating income** *Million euros*

-3.3%* 2011-2010

(*) Excluding exchange rate impact: -0.1%

In SMEs, one of the strategic segments, programmes were strengthened with NAFIN (Nacional Financiera) to support entrepreneurs, constructors and travel agencies. The market share rose by more than two points in 2011 to more than 21%. In corporate finance and companies, strategies were implemented to increase the number of customers and products were designed for agricultural business, confirming and foreign trade, which help to boost volumes. The magazine Trade Finance awarded the bank its "Deal of the year" prize for financing Volkswagen.

Other recognitions came from the magazine América Economía as the best bank in Mexico in its ranking of 25 banks in Latin America, and from Global Finance, which recognised Santander as the safest bank in Mexico in its Latin American ranking.

**Activity**

As a result of this activity, the Group 's growth in lending accelerated (+31%), with all products performing well and spurred by the acquisition of GE Capital Corporation's mortgage portfolio.

Lending rose 22% on a like-for-like basis (excluding GE). Mortgages increased 81% (+30% on a like-for-like basis), commercial credit 22% and consumer loans 33%, while loans via cards increased 14%.

Savings increased 8%, with demand deposits up 14%, time 6% and mutual funds 3%.

**Results**

Gross income increased 4.5%. Net interest income grew 7.5% due to greater activity and active management of spreads (record fourth quarter). Fee income rose 9.8%, with a positive performance in insurance and transactional banking and a decline from cards and mutual funds.

Gains on financial transactions dropped 42.5%, as a result of the market's instability and volatility of interest rates.

Operating expenses were 11.6% higher, reflecting the larger perimeter and greater installed capacity. Provisions confirmed the trend of previous quarters, falling 25.7%, in line with the improvement in risk premiums.

Net operating income after provisions increased 12.4%.

Attributable profit jumped 40.9% to EUR 936 million, mainly due to lower minority interests (+45.6% in local currency).

Retail banking's profit was up 69.7% due to lower provisions and revenues recovery. Asset Management and Insurance's rose 46.9% and Global Wholesale Banking's dropped 22.8%, due to reduced results from markets and the worsening global economic environment.

The efficiency ratio was 41.8%, the recurrence ratio 68.0% and ROE 21.2%. The NPL ratio (1.82%) and coverage (176%) were still of high quality and evolved favourably during the year.

**Net operating income after LLPs** *Million euros*

+8.8%* 2011-2010

(*) Excluding exchange rate impact: +12.4%

**Attributable profit** *Million euros*

+40.9%* 2011-2010

(*) Excluding exchange rate impact: +45.6%

**NPL ratio** *%*

**NPL coverage** *%*

## Chile

- Basic revenues rose 2.7%. Net interest income accelerated in the fourth quarter (+13.8% over the same period of 2010).
- Operating expenses rose 10.1% because of the signing of the collective agreement and greater business.
- Loan-loss provisions were 17.3% higher.
- Net operating income after provisions dropped 9.4%.
- Focus on strengthening liquidity: deposits increased 19% and loans 7%.

Attributable profit was EUR 611 million, 9.0% less than in 2010 (-9.3% in local currency).

Santander is the largest financial group in Chile in terms of assets and profits. It has 499 branches and more than 3.5 million customers and market shares of 19.7% in loans and 17.3% in savings.

### Economic environment

The pace of growth during 2011 returned to a more "normal" rate as the impact of the post-earthquake recovery wore off. Domestic demand, however, continued to grow a brisk pace (close to 10% for the whole year). External demand's contribution to GDP growth was negative, due to imports rising faster than exports.

Inflation gradually rose to 4.4%, higher than initial expectations. In this context, the central bank raised its key rate by 200 b.p. to 5.25% during the first half of the year and then introduced a downward bias in its monetary policy as a result of the worsening of the international context. It cut its key rate to 5.0% in January 2012. The peso depreciated 9.8% against the dollar, but the central bank continued to buy dollars in order to fulfil its goal of increasing the stock of reserves.

Lending rose 17% (+18% in consumer credit and cards and +19% in commercial credit). Savings rose 14%.

### Strategy

Santander Chile's strategy in 2011 was focused on strengthening its retail banking and improving customer management by combining commercial assertiveness with prudence in risks.

Moreover, the strategy was aimed at obtaining the highest return from the various businesses, particularly via loans and savings with individual customers and SMEs, with special focus on deposits to boost the liquidity position.

2011 was the "Year of Service" for Santander Chile through a customer plan focused on retention, improving service and working on key factors that impact on customer relations. The central idea was to foster changes in attitude toward the customer and the quality of attention, using parameters of quality and transparency.

Grupo Santander sold 7.82% of Banco Santander Chile for $950 million, leaving it with 67%.

The UK magazine The Banker chose Banco Santander as "Bank of the Year" in Chile and the fourth safest bank in emerging markets (the safest in Latin America), according to the magazine Global Finance.

### Activity

Lending accelerated thanks to the higher economic growth and the positive impact of reconstruction following the 2010 earthquake. Loans rose 7%, with cards up 15%, mortgages 10% and consumer credit 8%. Commercial credit grew 4%.

Savings grew 11%. Time deposits increased 29% and mutual funds declined 10%.

### Results

In results (and always in local currency), gross income rose a modest 1.9%, although the quarterly trend has been good. Net interest income increased 2.6%, affected by higher interest rates and pressure on lending spreads.

**Loans**
*% y-o-y variation w/o forex impact*

**Savings**
*% y-o-y variation w/o forex impact*

**Net interest income / provisions** *% sobre ATAs*

**Net operating income**
*Million euros*

-2.5%* 2011-2010

(*) Excluding exchange rate impact: -2.7%

Fee income, on the other hand, rose 2.4%, with a good performance in that from cash management (+12.0%) and cards (+7.7%), while that from administration of accounts and mutual funds dropped 20.7% and 5.2% respectively. Fee income from insurance remained virtually flat (-0.5%).

Gains on financial transactions were 14.5% lower.

Operating expenses rose 10.1%, higher than inflation, due to the collective agreement, the increase in the rent for branches following their transfer in the second half of 2010 and strengthening business activity.

Net loan-loss provisions rose 17.3% and attributable profit was 9.0% lower at EUR 611 million (-9.3% in local currency).

Retail Banking's profit dropped 14.8%, Asset Management and Insurance's was 3.3% lower and Global Wholesale Banking's increased 16.1%.

The efficiency ratio was 39.2%, the recurrence ratio 58.2% and ROE 25.4%. The NPL ratio was 3.85% and coverage 73%.

**Net operating income after LLPs** *Million euros*

-9.2%* 2011-2010

(*) Excluding exchange rate impact: -9.4%

**Attributable profit** *Million euros*

-9.0%* 2011-2010

(*) Excluding exchange rate impact: -9.3%

**NPL ratio** *%*

**NPL coverage** *%*

## Argentina

**Activity** *% y-o-y variation w/o forex impact*

**Attributable profit** *Million euros*

-2.7%* 2011-2010

(*) Excluding exchange rate impact: +8.0%

Attributable profit was EUR 287 million, 2.7% lower (8.0% higher in local currency).

Santander Río is one of the country's leading banks, with market shares of 8.9% in lending and 10.1% in savings. It has 358 branches and 2.5 million customers.

Santander Río was chosen as the best bank in Argentina in 2011 by The Banker, Euromoney and Global Finance.

### Economic environment

The economy grew briskly, although with some slowing down (estimated 7% for the year). Domestic demand eased and the net contribution of external demand to GDP growth was more negative.

Export growth in real terms dropped sharply from 14% in 2010 to 4%, while imports continued to grow at double-digit rates.

Inflation was 9.5% in December, while interest rates rose significantly in the last months of 2011. The Badlar rate for private sector banks rose above 21% before ending the year at around 19% (+750 b.p. over 2010).

The peso depreciated 7.7% against the dollar and international reserves dropped by $5,600 to $46,000 million (10.6% of GDP).

Growth in the financial system's savings and lending was 28% and 50%, respectively, maintaining high levels of liquidity and a capitalisation ratio of close to 16%. The NPL ratio was 1.4% and coverage 172%.

### Strategy

The Group focused its strategy in 2011 on maximising the strengths of the franchise, sustained by a successful transactional banking model resting on low funding costs (demand deposits accounted for 68% of total deposits) and high levels of revenues from services (recurrence ratio of 88%).

The bank increased its retail network by 10%, mainly in the interior of the country and within what it calls its "strategic corridor" (high income regions, with strong growth prospects and trade links with Brazil).

The strategy rested on balance sheet strength (liquid and well capitalised) and focused on business and management of NPLs, coupled with a differentiated customer attention model, a multichannel distribution network and an offer of products tailored to needs.

Santander Río launched in 2011 the *Super Préstamo Inversión* pyme which offers long-term financing to SMEs.

Emphasis was also placed on customer satisfaction, with improvements in quality and service levels.

**Activity and Results**
During the year lending continued to grow strongly (+28%) and also savings (+27%). Demand deposits rose 20%, time 42% and mutual funds 35%.

Gross income rose 24.7%, fuelled by basic revenues (+26.1%).

Operating expenses rose 34.8%, due to inflation and growth in installed capacity (net opening of 34 branches between 2010 and 2011, from 324 to 358). In addition, the number of contact-centre positions increased and the number of employees from 6,466 to 6,777.

Net operating income increased 16.3%. Provisions were 121.6% higher, mainly due to the increase in generic provisions. This produced an 8.2% increase in net operating income after provisions and attributable profit rose 8.0%.

The efficiency ratio was 49.0%, the recurrence ratio 88.4% and ROE 52.1%. The NPL ratio was 1.15% and coverage 207%.

## Uruguay

**Activity**
*% y-o-y variation w/o forex impact*

**Attributable profit**
*Million euros*

-70.3%* 2011-2010

(*) Excluding exchange rate impact: -69.9%

Attributable profit was EUR 20 million, 70.3% lower (-69.9% in local currency), due to the 50.8% fall in gains on financial transactions (capital gains in 2010 in the portfolio of securities), costs (+42.5%) resulting from the new collective agreement and the new IT platform.

Good performance of basic revenues which rose 27.9% in the year.

Santander is the largest private sector bank in the country in terms of the number of branches (78) and business (market share of 18.6% in lending and 16.0% in deposits). It has 247,000 customers.

The economy grew 6.4%, according to the most recent estimates, down from 8.5% in 2010. Domestic demand growth remained very high at close to 9%, with strong private consumption and investment. However, due to the sharp slowdown in exports in real terms, the contribution of net external demand was more negative (reducing GDP growth by three points).

As a result of inflation rising continuously, the central bank raised its key rate by 225 b.p. to 8.75%. The exchange rate remained stable against the dollar (19.95 pesos/$). International reserves ended the year at $10,300 million (over 20% of GDP) and $2,600 million more than in 2010.

In local currency, the financial system's lending rose at a slower pace (+22%) and deposits grew 13%.

The Group focused on retail business, creating a more massive model with new products and channels. Since 2010, it has conducted insurance business, making Santander the only bank in the country to be involved in this market. Under the framework of this strategy of increasing the number of customers to be offered this type of product, a finance company, Creditel, was acquired which has a strong position in medium and low sectors, enabling it to not only expand business but also incorporate the know how to get closer to customers.

Lending rose 39% with the incorporation of Creditel and 30% on a like-for-like basis. Savings rose 8%. The efficiency ratio is 76.5%, the recurrence ratio 29.8%, the NPL ratio is only 0.64% and coverage remains very high.

## Colombia

**Activity**
*% y-o-y variation w/o forex impact*

**Attributable profit**
*Million euros*

+43.0%* 2011-2010

(*) Excluding exchange rate impact: +46.5%

Attributable profit was 43.0% higher at EUR 58 million (+46.5% in local currency), due to gross income (+13.7%), controlled costs (+6.3%, a little above inflation) and provisions for loan losses (-5.0%).

The Group has 80 branches, 297,000 customers and a market share of 2.7% in banking business.

The economy showed no signs of slowing down, and grew by more than 5%, Domestic demand was buoyant, while the contribution of net external demand to GDP growth, was negative.

Inflation rose to 3.7% from 3.2% at the end of 2010, leading the central bank to raise its key rate, despite the deterioration of the external scenario in the second half, to 4.75% (+175 b.p. during the year).

The peso depreciated 8% against the dollar in the second half, but compared to the end of 2010 the weakening was very moderate (only 1.0%). International reserves increased by $3,800 million to $32,300 million.

In 2011, the strategy focused on selective growth in business, preserving appropriate levels of customer linkage of high and medium income customers and boosting transaction and insurance business. Management of NPLs is based on anticipation and knowledge of the customer.

Lending increased 12% and savings 21%. The efficiency ratio is 56.2% and the recurrence ratio 49.0%. The NPL ratio is 1.01% and coverage 299%.

As already mentioned, the Group announced agreement to sell its business in Colombia to the Chilean group CorpBanca. The operation is expected to be completed in the first quarter of 2012, once the regulatory authorisations have been obtained.

## Puerto Rico

**Activity**
*% y-o-y variation w/o forex impact*

**Attributable profit**
*Million euros*

-10.1%* 2011-2010

(*) Excluding exchange rate impact: -5.6%

Attributable profit was EUR 34 million, 10.1% lower (-5.6% in dollars), because of higher taxes, as net operating income after provisions increased 42.4% thanks to lower provisions.

Santander has 121 branches, 508,000 customers and market shares of 10.2% in loans, 11.8% in deposits and 21.6% in mutual funds.

In a context of recession, the bank remained one of the three main banks by volume of loans, deposits and mutual funds, and it continued to strengthen recovery management of loans in an irregular situation and grow selectively in business with individuals and companies.

For the fifth year running the magazine Global Finance recognised Santander Puerto Rico as the best bank in Puerto Rico and The Banker for the sixth year.

The bank improved the diversification of its revenues toward other stable and recurrent sources. A great effort was made to maximise linkage of customers right from the start of their relation with the bank, while using the channels available for reducing the costs of acquisition boosted commercial productivity.

The efficiency ratio was 50.9%, the recurrence ratio 39.2%, the NPL ratio 8.64% and coverage 51%.

## Perú

**Activity**
*% y-o-y variation w/o forex impact*

**Attributable profit**
*Million euros*

+56.4%* 2011-2010

(*) Excluding exchange rate impact: +60.3%

Activity is focused on companies and to the Group's global customers. Attributable profit was EUR 11 million (EUR 7 million in 2010), due to the good evolution of net interest income (+56.0%).

## Sovereign
*Million euros*

| | 2011 | 2010 | Variation amount | % |
|---|---|---|---|---|
| **Income statement** | | | | |
| **Net interest income** | **1,678** | **1,736** | **(57)** | **(3.3)** |
| Net fees | 374 | 408 | (33) | (8.2) |
| Gains (losses) on financial transactions | 190 | 29 | 161 | 560.8 |
| Other operating income [1] | (55) | (66) | 11 | (17.3) |
| **Gross income** | **2,188** | **2,106** | **82** | **3.9** |
| Operating expenses | (976) | (937) | (39) | 4.2 |
| General administrative expenses | (863) | (832) | (31) | 3.7 |
| *Personnel* | *(469)* | *(468)* | *(1)* | *0.3* |
| *Other general administrative expenses* | *(394)* | *(364)* | *(30)* | *8.1* |
| Depreciation and amortisation | (113) | (105) | (8) | 8.0 |
| **Net operating income** | **1,212** | **1,169** | **43** | **3.7** |
| Net loan-loss provisions | (374) | (510) | 136 | (26.6) |
| Other income | (61) | (92) | 30 | (33.1) |
| **Profit before taxes** | **776** | **567** | **209** | **36.9** |
| Tax on profit | (250) | (143) | (107) | 75.0 |
| **Profit from continuing operations** | **526** | **424** | **102** | **24.0** |
| Net profit from discontinued operations | — | — | — | — |
| **Consolidated profit** | **526** | **424** | **102** | **24.0** |
| Minority interests | — | — | — | — |
| **Attributable profit to the Group** | **526** | **424** | **102** | **24.0** |
| **Balance sheet** | | | | |
| Customer loans [2] | 40,194 | 36,724 | 3,470 | 9.4 |
| Trading portfolio (w/o loans) | 271 | 211 | 60 | 28.5 |
| Available-for-sale financial assets | 12,435 | 10,203 | 2,232 | 21.9 |
| Due from credit institutions [2] | 677 | 722 | (45) | (6.3) |
| Intangible assets and property and equipment | 480 | 507 | (27) | (5.3) |
| Other assets | 3,643 | 3,430 | 213 | 6.2 |
| **Total assets/liabilities & shareholders' equity** | **57,700** | **51,797** | **5,903** | **11.4** |
| Customer deposits [2] | 36,884 | 32,007 | 4,877 | 15.2 |
| Marketable debt securities [2] | 1,653 | 1,945 | (292) | (15.0) |
| Subordinated debt [2] | 2,275 | 2,781 | (506) | (18.2) |
| Insurance liabilities | — | — | — | — |
| Due to credit institutions [2] | 9,934 | 9,567 | 368 | 3.8 |
| Other liabilities | 2,412 | 2,297 | 115 | 5.0 |
| Shareholders' equity [3] | 4,542 | 3,200 | 1,341 | 41.9 |
| **Other customer funds under management** | **1** | **30** | **(29)** | **(98.0)** |
| Mutual funds | — | — | — | — |
| Pension funds | — | — | — | — |
| Managed portfolios | 1 | 30 | (29) | (98.0) |
| Savings-insurance policies | — | — | — | — |
| **Customer funds under management** | **40,812** | **36,763** | **4,049** | **11.0** |

(1).- Including dividends, income from equity-accounted method and other operating income/expenses
(2).- Including all on-balance sheet sheet balance sheets for this item
(3).- Not including profit of the year

### Loans
*% y-o-y variation w/o forex impact*

### Deposits
*% y-o-y variation w/o forex impact*

### Net interest income / provisions *% o/ ATAs*

### Net operating income
*Million euros*

+3.7%* 2011-2010

(*) Excluding exchange rate impact: +9.0%

## Sovereign

- Higher gross income (+9.2%) and lower provisions (-22.9%).
- Net operating income after provisions up 33.6%.
- Improved trend in loans over previous years (+6%) and deposits (+12%).
- Non-performing loans and coverage improved for the eighth quarter running.
- Sovereign was granted the licence to become a federal bank, which will enable a wider range of products to be offered to a lager number of customers.

Sovereign posted an attributable profit of $732 million (EUR 526 million), 30.3% more than in 2010.

**Economic environment**

Sovereign conducted its activity in an environment of slower GDP growth than in 2010, with a weak housing sector, a jobless rate close to historic highs and interest rates at minimums.

Lending by banks increased in the second and third quarters (+0.9% and 0.3%, respectively) for the first time since June 2008, although it is too early yet to speak of a change of trend. Growth was due to the increase in commercial loans (+1.8% in the second quarter and +0.3% in the third) and less in consumer credit (flat in the second quarter and +0.3% in the third). Deposits continued to flow toward those of the greatest availability (+4.9% over the second quarter) from time deposits (-2.4% vs. the second quarter).

**Strategy**

Sovereign, with 723 branches, 2,303 ATMs and more than 1.7 million customers, is developing a business model focused on retail customers and companies. It operates in the northeast of the US, one of the country's most prosperous areas, where it has significant market shares.

The transformation phase in 2010, which put the franchise on the path to profits, continued in 2011 with a phase of stabilisation and laying the foundations for the creation of a stronger retail and commercial bank in the northeast of the US.

In a year marked by low demand for loans, Sovereign focused on profitability.

In funds, the number of current accounts continued to grow, breaking the negative trend of previous years. This resulted in an increase in the volume of customer deposits, enabling the bank to finance growth in lending as well as reduce the volume of wholesale funding and improve the diversification and stability of the sources of financing.

The commercial drive also offset the negative impact on fee income of the new US regulatory framework.

Of note in liquidity was the positive impact of growth in deposits and the capacity to tap the US debt markets, underscored by the bank's issue during 2011.

Costs centred on creating the pillars to guarantee future growth. Particularly noteworthy were investments in human capital (teams in commercial and control functions) and in IT platforms (Partenon will be running during the second half of 2012).

Risk admission and renewal of loans remained rigorous together with their proactive management, reflected in a continuous improvement in NPL ratios, the lower need for provisions and higher coverage.

**Net operating income after LLPs** *Million euros*

+27.1%* 2011-2010

(*) Excluding exchange rate impact: +33.6%

**Attributable profit** *Million euros*

+24.0%* 2011-2010

(*) Excluding exchange rate impact: +30.3%

**NPL ratio** *%*

**NPL coverage** *%*

Lastly, an effort was made to adjust organisational and management structures in response to the increasing regulatory requirements. This process culminated with approval by the regulators of the change in the banking licence of Sovereign, which turned it into a National Bank Association in 2012.

The conversion of Sovereign into a National Bank is an important milestone which, coupled with the unification and the improvement process in the IT platform already begun, will convert a mainly single product bank into a retail franchise with a full range of products, improving both the offer capacity as well as the penetration of customers.

The strong generation of recurring results in 2011, high levels of efficiency, enhanced credit quality, solid capital ratios, comfortable levels of liquidity and the improved capacity to offer products, put Sovereign in a privileged position to bolster and expand the franchise and make it one of the reference banks in the north east of the US.

**Activity**

Balance sheet management remained characterised by an increase in profitability and a better mix of lending and funding products, enabling spreads to improve on new and renewed operations over those of 2010.

In lending, the portfolio continued to be repositioned, with a gradual exit from higher risk segments into more attractive ones. Although the bank continued to deepen business in residential segments, the asset mix benefited from growth in loans to companies and GBM. Sovereign continued to prepare its commercial and regulatory structure in order to take advantage of the incipient recovery in these segments.

Total lending grew 6% and 8% excluding the non-strategic portfolio. The improvement in the composition of the portfolio combined with risk management produced a further fall in the NPL ratio to 2.85% (4.61% in 2010) and a rise in coverage to 96% (75% in 2010). Both improved for the eighth quarter running.

The increase in lending was financed by the rise in customer deposits (+12%), which improved the diversification and stability of the funding sources. This, coupled with the reduction in the volume of wholesale financing, reduced the cost of deposits by 21 b.p.

The focus on expanding the customer base is beginning to bear fruit. The number of current accounts continuously rose in 2011, breaking the negative trend of 2010. The monthly record for opening new accounts was repeatedly broken.

**Results**

Gross income was $3,042 million (+9.2%). Net interest income (+1.6%) reflected management of volumes and prices that offset the impact of the sharp decline in interest rates. In fee income (-3.5%), the negative impact of the new US regulatory framework was offset partly by a greater business drive. Lastly, another contributor was the growth in capital gains generated in the ALCO portfolio.

The 9.5% growth in operating costs reflects the impact of investments in technology and the increase in commercial structures begun in the second half of 2010. The efficiency ratio was 44.6%, virtually the same as in 2010, and net operating income increased 9.0%.

Net loan-loss provisions were 22.9% lower, thanks to containment of NPLs and the recovery capacity throughout the credit cycle. This is reflected in a better than expected evolution in credit quality.

Net operating income after provisions was 33.6% higher at $1,165 million and profit before tax was $1,080 million (43.8%).

In short, the results show a solid income statement backed by the generation of recurring revenues, a reduction in the cost of deposits and an improvement in the levels of provisions. All of this was the result of the improvement in the balance sheet structure, which, together with the recovery in volumes of basic loans and control of spending, provide a solid base for 2012.

**Pro forma US results**

*Million $*

| | 2011 | 2010 | Var (%) |
|---|---|---|---|
| Gross income | 6,479 | 5,694 | 13.8 |
| Net operating income | 4,189 | 3,671 | 14.1 |
| Attributable profit to the Group | 1,472 | 1,020 | 44.3 |

Grupo Santander's total attributable profit from the US (Sovereign Bank, Santander Consumer USA, Santander Private Banking USA, Puerto Rico and the New York branch) amounted to $1,472 million, 44.3% more than in 2010.

The main reasons for this were strong growth by Sovereign and the consumer finance unit.

## Corporate Activities

*Million euros*

| | 2011 | 2010 | Variation amount | % |
|---|---|---|---|---|
| **Income statement** | | | | |
| **Net interest income** | **(2,172)** | **(1,828)** | **(344)** | **18.8** |
| Net fees | (16) | (40) | 24 | (60.3) |
| Gains (losses) on financial transactions | 605 | (142) | 746 | — |
| Dividends | 57 | 64 | (7) | (11.1) |
| Income from equity-accounted method | 5 | (2) | 7 | — |
| Other operating income/expenses (net) | 129 | 137 | (8) | (6.1) |
| **Gross income** | **(1,392)** | **(1,810)** | **418** | **(23.1)** |
| Operating expenses | (838) | (822) | (16) | 2.0 |
| General administrative expenses | (733) | (689) | (44) | 6.4 |
| *Personnel* | *(285)* | *(268)* | *(16)* | *6.1* |
| *Other general administrative expenses* | *(448)* | *(420)* | *(28)* | *6.6* |
| Depreciation and amortisation | (105) | (133) | 28 | (20.9) |
| **Net operating income** | **(2,230)** | **(2,632)** | **401** | **(15.2)** |
| Net loan-loss provisions | 37 | (111) | 149 | — |
| Other income | (429) | (428) | (2) | 0.4 |
| **Profit before taxes (w/o capital gains)** | **(2,623)** | **(3,171)** | **548** | **(17.3)** |
| Tax on profit | 440 | 867 | (427) | (49.3) |
| **Profit from continuing operations (w/o capital gains)** | **(2,183)** | **(2,304)** | **121** | **(5.3)** |
| Net profit from discontinued operations | — | (13) | 13 | (100.0) |
| **Consolidated profit (w/o capital gains)** | **(2,183)** | **(2,317)** | **134** | **(5.8)** |
| Minority interests | (20) | (25) | 6 | (22.6) |
| **Attributable profit to the Group (w/o capital gains)** | **(2,163)** | **(2,291)** | **128** | **(5.6)** |
| Net extraordinary capital gains and provisions | (1,670) | — | (1,670) | — |
| **Attributable profit to the Group** | **(3,833)** | **(2,291)** | **(1,542)** | **67.3** |
| | | | | |
| **Balance sheet** | | | | |
| Trading portfolio (w/o loans) | 7,727 | 5,123 | 2,605 | 50.8 |
| Available-for-sale financial assets | 23,297 | 21,288 | 2,009 | 9.4 |
| Investments | 908 | 38 | 870 | — |
| Goodwill | 25,089 | 24,622 | 466 | 1.9 |
| Liquidity lent to the Group | 10,440 | 28,265 | (17,825) | (63.1) |
| Capital assigned to Group areas | 67,699 | 63,187 | 4,512 | 7.1 |
| Other assets | 101,749 | 64,806 | 36,943 | 57.0 |
| **Total assets/liabilities & shareholders' equity** | **236,908** | **207,329** | **29,579** | **14.3** |
| Customer deposits (1) | 19,672 | 14,258 | 5,415 | 38.0 |
| Marketable debt securities (1) | 62,253 | 62,812 | (559) | (0.9) |
| Subordinated debt (1) | 5,477 | 12,128 | (6,651) | (54.8) |
| Other liabilities | 72,391 | 47,709 | 24,682 | 51.7 |
| Group capital and reserves (2) | 77,115 | 70,423 | 6,692 | 9.5 |
| **Other customer funds under management** | **—** | **—** | **—** | **—** |
| Mutual funds | — | — | — | — |
| Pension funds | — | — | — | — |
| Managed portfolios | — | — | — | — |
| Savings-insurance policies | — | — | — | — |
| **Customer funds under management** | **87,402** | **89,198** | **(1,796)** | **(2.0)** |

(1).- Including all on-balance sheet amounts for this item
(2).- Not including profit of the year

## Corporate Activities

- This area's results recorded extraordinary provisions net of tax of EUR 3,183 million, of which EUR 1,513 were drawn from capital gains and EUR 1,670 million from the fourth quarter profit.
- Excluding this impact, the area's results were almost the same as in 2010:
  - Higher cost of funding and reduced recovery of taxes increased the losses.
  - This impact was offset by greater gains on financial transactions, mainly hedging of exchange rates.

Corporate Activities covers, on the one hand, a series of centralised activities to manage the structural risks of the Group and of the parent bank. It coordinates and/or executes the necessary activities for managing interest rates, exposure to exchange-rate movements and measures to obtain the required levels of liquidity in the Group. On the other, it acts as the Group's holding, managing global capital as well as that of each of the units.

As regards interest rate management, this activity is conducted on a coordinated basis by all the units, but this business only registers the part relative to the balance sheet of the parent bank, via the ALCO portfolios (at the volume levels and duration considered optimum at each moment).

These portfolios, which normally take the form of sovereign bonds of European countries, aim to mitigate the impact of interest rate movements on the balance sheet of retail banking, structurally sensitive by maturities to these movements and managing to maintain recurrent results reflected as net interest income.

In order to achieve these goals, and in so far as market interest rate movements are envisaged, the Group's financial management area can decide to immunise the net interest income of these portfolios from possible adverse movements in results by hedging interest rates.

Management of the exposure to exchange-rate movements, both from investments in the shareholders' equity of units in currencies other than the euro, as well as that regarding the results generated for the Group by each of the units, also in various currencies, is also conducted on a centralised basis.

This management (dynamic) is carried out by exchange-rate derivative instruments, optimising at each moment the financial cost of hedging.

In this sense, hedging of net investments in the shareholders' equity of businesses abroad aims to neutralise the impact on them of converting to euros the balances of the main consolidated entities whose functional currency is not the euro.

The Group considers it necessary to immunise the impact which, in situations of high volatility in the markets, sharp movements in exchange rates would have on these exposures of a permanent nature. The investments which are currently covered are those of the UK, Poland, Brazil, Mexico and Chile, and the instruments used are spot contracts, FX forwards or tunnel options.

The objective of the hedging is set as part of the shareholders' equity of the unit equivalent to a percentage of risk-weighted assets, which can be changed.

Meanwhile, exposures of a temporary nature (i.e. those regarding the results which the Group's units will contribute over the next 12 months), when they are in currencies other than the euro, are also covered on centralised basis. These results, generated in the local currencies of the units, are hedged with exchange-rate derivatives. The objective is to establish the euros resulting from the exchange rate at the beginning of the year. These policies immunise both the investment in the shareholders' equity as well as the contribution to results of the various units.

The impact of the hedging is in gains/losses on financial transactions, and the hedging of results compensates, in the opposite way, the greater or lesser value in euros from the contribution of businesses.

Management of structural liquidity aims to finance the Group's recurrent activity in optimum conditions of maturity and cost. The decisions regarding whether to go to the wholesale markets to capture funds and cover stable and permanent liquidity needs, the type of instrument used, the structure by maturity dates, as well as management of the associated risks of interest rates and exchange rates of the various financing sources, are also conducted on a centralised basis.

The overriding objective of this activity is to maintain an appropriate liquidity profile by diversifying the sources of financing and controlling short-term financing (diversity in maturities, currencies and markets) and medium-and long-term.

Logically, the objectives that the Group as such wants to cover may or may not coincide with the financing provided to the units and which is based more on their individual needs. The mismatch in maturities, currencies or instruments is a corporate decision and is reflected in this unit in a centralised way.

The financial cost of the various financing sources recorded in the books of the parent bank (although part of them reflects the Group's needs as such) are registered in Corporate Activities and can be issues of commercial paper, senior debt, covered bonds, subordinated debt, preference shares and securitisation of assets.

The Financial Management unit usually covers in new issues the interest rate and exchange rate risks from the start of the operation. It uses financial derivatives for this. The net impact of this hedging is recorded in the gains/loss on financial transactions in Corporate Activities.

The Financial Management area also analyses the strategies for structural management of credit risk where the aim is to reduce concentrations by sectors, which naturally occur as a result of commercial activity. Derivative operations here achieve an effect similar to that of the sale of assets and their compensation through the acquisition of other assets enables us to diversify the credit portfolio as a whole.

Lastly, and separately from the financial management described here, Corporate Activities acts as the Group's holding. It manages all capital and reserves and allocations of capital to each of the units as well as providing the liquidity that some of the business units might need (mainly the Santander Branch Network and corporate in Spain). The price at which these operations are carried out is the market rate (euribor or swap) for each of the maturities of repricing operations, increased by a liquidity premium that varies on the basis of the duration of operations.

Finally, and more marginally, the equity stakes that the Group takes within its policy of optimising investments is reflected in Corporate Activities.

In 2011 the area made a loss of EUR 3,833 million compared to a loss of EUR 2,291 million in 2010.

This was mainly due to the following:

Grupo Santander decided to realise extraordinary provisions net of taxes of EUR 3,183 million, of which EUR 1,513 million were drawn from capital gains and EUR 1,670 million from the fourth quarter profits.

The bank charged EUR 1,812 million pre-tax provisions against the fourth quarter earnings to cover real estate exposure in Spain and EUR 601 million in pre-tax provisions to amortise goodwill related to Santander Totta.

Moreover, net capital gains of EUR 1,513 million generated in 2011 (EUR 872 million arising from the entry of new partners in the capital of Consumer Finance USA and EUR 641 million from the sale of the insurance holding in Latin America) were assigned to the portfolios provisions for EUR 620 million and to the amortisation of intangibles, pensions and other contingencies (EUR 893 million).

Second, and after eliminating the effects already commented on, the losses from the area's ordinary activity were EUR 128 million less than in 2010.

The main developments were:

- Net interest income was EUR 2,172 million negative compared to EUR 1,828 million also negative in 2010. The increase was largely due to the greater cost of wholesale funding. The reasons for this were concentrated in the higher level of market reference interest rates and the rise in the credit spreads of issues, as well as the cost of maintaining in the balance sheet a prudent liquidity position.

  This higher cost also impacted on financing the goodwill of the Group's investments, which by definition have a negative nature, and which increased the cost of their financing proportionately.

  The net interest income of the ALCO portfolios registered here was higher in 2011, while maintaining a similar volume of portfolios than in 2010 thanks to the greater return on them.

- Gains on financial transaction, which are mainly those from the centralised management of interest rate and currency risk of the parent bank and, to a lesser extent, from equities, were EUR 605 million positive compared to losses of EUR 142 million in 2010. The difference was mainly due to hedging.

  In 2011, the impact of hedging the results of subsidiaries was positive (offsetting the lower value in euros of the results of the business units) and more than EUR 500 million above 2010.

  In 2010, there were higher losses from the hedging of the results of subsidiaries and writedowns of financial investments in the portfolio of equity stakes, both of which were partly offset by positive returns from the hedging of interest rates.

- Operating costs were almost flat (+2%). The growth in general costs from the increase in rents was offset by lower amortisations.

- Net loan-loss provisions include a release of EUR 37 million compared to an allowance of EUR 111 million in 2010 to strengthen the balance sheet.

  Other small movements were recorded in this item from normal allocations and releases from portfolios that configure the ALCO strategies, and from others that constitute positions of centralised management.

- Other income, which includes various provisions and provisions, was EUR 429 million negative compared to EUR 428 million negative in 2010.

  This item includes provisions derived from the management and sale of foreclosed properties. These were higher in 2011 because of more entries than in 2010. Other types of provisions are included such as derivatives of goodwill and losses in the value of equity stakes.

- Lastly, the tax line reflects a lower rate arising from the recovery of losses as a result of the different impact that certain one-off items had in both years.

# 2. Secondary segments or by business

## Retail Banking

- Net interest income grew 6.3% and net fee income 10.8%.
- Costs rose 9.9% because of new projects and an increase in installed capacity.
- Risk management reflected in lower specific provisions, offset by the reduced availability of generic provisions.
- Profit hit by the PPI remediation in the UK in the second quarter to cover possible customer remediation.

**Net operating income**
*Million euros*

+3.3% 2011-2010

**Attributable profit**
*Million euros*

-9.1% 2011-2010

Attributable profit was EUR 6,893 million, 9.1% less than 2010 and affected by the provision of EUR 620 million in the second quarter for customer remediation in the UK.

Results were also slightly impacted by the perimeter effect (mainly the incorporation of Poland's Bank Zachodni WBK). The impact was three/four percentage points positive on revenues and costs. The evolution of exchange rates during the period had a negative impact of one/two points.

Gross income increased 6.0% to EUR 39,892 million, due to the 6.3% rise in net interest income, the main component, and strongly backed by fee income (+10.8%).

Operating expenses rose 9.9% (+6.8% without the perimeter and exchange rate effects). As a result, the efficiency ratio was 42.8% and net operating income was 3.3% higher at EUR 22,817 million.

Net loan-loss provisions were only 3.1% higher, reflecting the efforts made in previous years to improve risk management in the Group's units which led to lower specific provisions. This, together with the one-off impact of the provision made in 2010 in Spain because of the change in rules, offset the lower release of generic provisions. Net operating income after provisions increased 3.5%

Both lending and customer deposits increased a little (+2% and +4%, respectively).

## Income statement and business volumes secondary segments

*Million euros*

| | Operating business areas | | Retail Banking | | Global Wholesale Banking | | Asset Management and Insurance | |
|---|---|---|---|---|---|---|---|---|
| | 2011 | Var (%) | 2011 | Var (%) | 2011 | Var (%) | 2011 | Var (%) |
| **Income statement** | | | | | | | | |
| **Net interest income** | **32,993** | **6.3** | **30,273** | **6.3** | **2,458** | **5.2** | **263** | **13.2** |
| Net fees | 10,487 | 7.3 | 8,933 | 10.8 | 1,174 | (8.8) | 380 | (10.5) |
| Gains (losses) on financial transactions | 1,895 | (31.0) | 1,106 | (17.3) | 785 | (42.3) | 4 | (91.3) |
| Other operating income [1] | 278 | (2.6) | (420) | 64.0 | 258 | 55.0 | 440 | 17.3 |
| **Gross income** | **45,655** | **4.1** | **39,892** | **6.0** | **4,675** | **(9.2)** | **1,088** | **0.6** |
| Operating expenses | (19,052) | 9.7 | (17,076) | 9.9 | (1,643) | 10.1 | (333) | (2.8) |
| General administrative expenses | (17,048) | 9.5 | (15,243) | 9.5 | (1,507) | 11.9 | (298) | 0.8 |
| *Personnel* | *(10,041)* | *10.8* | *(8,874)* | *10.8* | *(998)* | *11.6* | *(169)* | *5.1* |
| *Other general administrative expenses* | *(7,007)* | *7.7* | *(6,369)* | *7.6* | *(509)* | *12.5* | *(129)* | *(4.3)* |
| Depreciation and amortisation | (2,004) | 10.9 | (1,832) | 13.5 | (136) | (6.5) | (35) | (25.5) |
| **Net operating income** | **26,603** | **0.4** | **22,817** | **3.3** | **3,032** | **(17.1)** | **754** | **2.2** |
| Net loan-loss provisions | (10,599) | 4.5 | (10,459) | 3.1 | (141) | — | 0 | — |
| Other income | (2,565) | 129.9 | (2,476) | 127.6 | (32) | 192.1 | (57) | 230.8 |
| **Profit before taxes** | **13,439** | **(11.7)** | **9,882** | **(9.0)** | **2,859** | **(21.5)** | **698** | **(3.3)** |
| Tax on profit | (3,376) | (10.9) | (2,382) | (9.0) | (766) | (21.2) | (227) | 13.2 |
| **Profit from continuing operations** | **10,064** | **(12.0)** | **7,500** | **(9.0)** | **2,093** | **(21.7)** | **471** | **(9.6)** |
| Net profit from discontinued operations | (24) | 77.7 | (24) | 77.7 | — | — | — | — |
| **Consolidated profit** | **10,039** | **(12.1)** | **7,475** | **(9.1)** | **2,093** | **(21.7)** | **471** | **(9.6)** |
| Minority interests | 855 | (9.6) | 583 | (9.8) | 221 | (8.2) | 52 | (13.0) |
| **Attributable profit to the Group** | **9,184** | **(12.3)** | **6,893** | **(9.1)** | **1,872** | **(23.0)** | **419** | **(9.2)** |
| **Business volumes** | | | | | | | | |
| Total assets | 1,191,780 | 1.3 | 888,242 | 3.3 | 277,723 | (2.2) | 25,814 | (21.9) |
| Customer loans | 747,297 | 3.6 | 665,875 | 2.4 | 81,000 | 14.8 | 421 | (8.2) |
| Customer deposits | 612,861 | 1.8 | 532,029 | 3.6 | 75,134 | (11.2) | 5,699 | 39.0 |

(1).- Including dividends, income from equity-accounted method and other operating income/expenses

## Retail Banking. Income statement

*Million euros*

| | Gross income | | Net operating income | | Attributable profit to the Group | |
|---|---|---|---|---|---|---|
| | 2011 | Var (%) | 2011 | Var (%) | 2011 | Var (%) |
| **Continental Europe** | **13,531** | **7.9** | **7,772** | **4.3** | **2,302** | **(3.0)** |
| o/w: Spain | 7,143 | (2.3) | 3,745 | (3.0) | 737 | (36.3) |
| Portugal | 785 | (20.8) | 292 | (40.4) | 95 | (72.5) |
| **United Kingdom** | **5,118** | **(8.6)** | **2,812** | **(13.9)** | **889** | **(43.2)** |
| **Latin America** | **19,134** | **9.8** | **11,087** | **8.3** | **3,209** | **(0.9)** |
| o/w: Brazil | 13,660 | 11.9 | 8,147 | 11.5 | 1,588 | (12.1) |
| Mexico | 2,023 | 7.0 | 1,145 | 5.3 | 762 | 64.3 |
| Chile | 1,758 | 2.3 | 1,032 | (3.2) | 438 | (14.5) |
| **Sovereign** | **2,109** | **2.2** | **1,145** | **0.5** | **493** | **21.2** |
| **Total Retail Banking** | **39,892** | **6.0** | **22,817** | **3.3** | **6,893** | **(9.1)** |

Retail banking in continental Europe, despite the recovery in revenues and the positive impact of incorporations to the Group, was conditioned by the higher amount assigned to provisions and writedowns (from the fall in the amount released from generic provisions). Attributable profit declined 3.0%.

Retail banking in the UK was 42.5% lower in sterling as it was hit by the PPI charge. Excluding this impact, attributable profit was almost the same as in 2010. Gross income declined, affected by regulatory changes, but this was offset by flat costs and reduced needs for provisions.

Retail banking revenues in Latin America continued to grow and also costs, compatible with business development. Net operating income was 9.2% higher, excluding the exchange rate impact.

Attributable profit, after loan-loss provisions and writedowns, was 0.8% higher than in 2010 in constant currency.

**Global Private Banking** includes institutions that specialise in financial advice and asset management for high-income clients (Banco Banif in Spain and Santander Private Banking in the UK, Latin America and Italy), as well as the units of domestic private banking in Portugal and Latin America, jointly managed with local retail banks.

The division continued to install and adapt its common business model, the commercial processes of advice, differentiated management of customers, personnel training, standardisation of investment strategies and discretional management and unification of products.

IT platforms for management of clients continued to be adapted so that they will be the same for all units. This platform is currently operating in Spain, Italy and Mexico, and is being installed in Brazil.

All the stock markets in the countries where we operate fell in 2011 (double-digit falls, close to and even higher than 20% in some markets except for the US).

Despite this difficult environment, the total volume of managed assets rose, the fruit of commercial efforts. Of note was the capturing of new business by the Latin American units, especially Brazil. Business grew in Italy because of own activity as well as the acquisition of Banca Privada MeliorBanca.

The volume of managed customer funds was EUR 101,000 million at the end of 2011 (+4%).

Profit before tax was 2.0% higher (+4.7% excluding exchange rate impact) at EUR 370 million, due to the rise in net interest income (+9.2%) and reduced needs for provisions and writedowns, which offset the lower gains on financial transactions and higher operating expenses (+9.1%).

The higher tax charge absorbed almost four points of growth in attributable profit which at EUR 279 million was 1.5% lower than in 2010 (+1.4% excluding the exchange rate impact).

In Europe, the profit generated by Banco Banif grew notably and dropped in the UK and Portugal. Of note in Latin America was the strong growth in Brazil and the higher contribution of Chile. International Private Banking's contribution was lower, due to higher taxes.

Banco Banif in Spain and the private banking unit in Latin America were chosen by the magazine Euromoney as the best private banks in Spain and Latin America.

## Global Banking & Market

- Businesses and results were affected by the economic weakness and tensions in markets, particularly in Europe.
- Attributable profit was 23.0% lower.
- Customer revenues accounted for 87% of total revenues.
- Impact on costs of the investment effort, although the efficiency ratio remained very good.
- Rigorous management of risk, liquidity and capital.

Santander Global Banking & Markets posted an attributable profit of EUR 1,872 million, 23.0% lower than in 2010.

Markets were very unstable, beginning in the spring and intensified in the second half of the year due to the euro zone's sovereign debt crisis. This environment had a significant impact on revenues, particularly those derived from equities and those not related to customers, whose falls explain the larger reduction in profits.

This area contributed 10% of gross income and 20% of attributable profit of the operating areas.

**Strategy**
Santander Global Banking & Markets continued to maintain the key drivers of its business model: centred on clients, the division's global scope and inter connection with local units.

At the strategic level, and in a very complex year, the division focused on maintaining the results of its franchise and on reducing exposure to risk (for example, cutting the risk of trading activity), which helped to improve the Group's capital and liquidity positions, particularly in those countries with the greatest tensions.

**Net operating income**
*Million euros*

-17.1% 2011-2010

**Attributable profit**
*Million euros*

-23.0% 2011-2010

The division also continued to invest in resources to strengthen its operational capacities and distribution of basic treasury products, with a special focus on forex and fixed-income businesses. The generation of recurring revenues and strict management of the cost base is enabling Santander Global Banking to absorb these investments and improve its efficiency ratio to 35.1%, among the best of its peers.

Meanwhile, and with a medium-term view in response to the market's new conditions and the new regulatory framework, Santander Global Banking & Markets took the first steps to develop its business model in order to raise its market share in products that consume little capital and liquidity.

This meant further efforts to improve the area's transactional capacity in a process that will last several years and which, already in 2011, showed signs of its potential: revenues generated by transactional activities continued to increase compared to the decline in wholesale activities.

The same idea is behind the measures taken in Poland and in the north east of the United States to accompany the Group in its international development. The objective is to exploit the revenue synergies and management of clients' current and potential commercial flows in the two countries where the Group has strong business units.

**Results and activity**
Profits declined because of the fall in gross income from the sharp reduction in gains on financial transactions and in fee income, coupled with higher costs and provisions.

Gross income declined 9.2%, following the 42.3% drop in trading gains and after three quarters at their lowest levels since 2007. Basic revenues were virtually unchanged, with net interest income up 5.2% due to adjustments to spreads and larger volumes, while fee income was 8.8% lower due to reduced activity in the markets.

Costs (+10.1%) reflected the investment in equipment and technology. Net operating income was 17.1% lower at EUR 3,032 million. Provisions were higher, partly because of the lower release of generic provisions, as specific ones declined significantly. As a result, attributable profit fell 23.0%.

The results were supported by strong and diversified client revenues, accounting for 87% of total gross income and showing greater stability, although somewhat shaken in the last two quarters of very high stress.

Client revenues were 8.1% lower than in 2010, when they were particularly high because of certain operations and the positive impact on the books of high volatility in some markets.

All countries client revenues fell except Sovereign in the US, which almost doubled them, within a sustained trend to reach its natural share in corporate business. Among the big areas, Latin America only dropped 4%, affected by Mexico (-14%) as Brazil and Chile were more stable. Greater weakness in Europe, particularly Spain (-17%) and the UK (-18%), hit by tensions and falls in markets in the last few months.

The revenues generated by clients in the Global Relation Model, which give the area great stability, were stronger. They were only 4% lower and already account for 70% of total client revenues.

The performance of the business areas was as follows:

### Global Transaction Banking

This area, which includes Cash Management, Trade Finance, Basic Financing and Custody, increased its client revenues 4%.

Cash Management revenues grew 18%, with rises in all countries. Of note were the four large units in Spain, Brazil, Mexico and Chile, particularly the last two which grew higher than the average.

Custody and Settlement registered solid growth (+7%), backed by the positive contribution of Spain and strong rises in Mexico and Chile.

Moderate growth in Basic Financing (+3%) in a context of greater disintermediation and containment of risk assets which was offset by active management of spreads.

Trade Finance dropped 7% after the high levels reached in 2010 in Latin America, particularly in Brazil. Good evolution in Spain, the UK and Sovereign.

### Corporate Finance

In a sluggish market, this area (mergers and acquisitions) reduced its client revenues 29%, but this did not hinder notable participation in important transactions.

Of note was the advice provided for several of the most significant operations in the Group's reference markets, including the acquisition by a consortium led by Iberdrola of electricity and gas distributors from AEI Energy (Ashmore Energy International) in seven Latin American countries; the integration of Vivo and Telesp in Brazil; the entry of Qatar Holding into Iberdrola and the purchase by the French Schneider of Telvent, listed on Nasdaq.

Participation in these operations enabled Santander to maintain leading positions in the advisory rankings (according to Bloomberg and Thomson): second in Spain and Portugal and fourth in Latin America by volumes brokered ($19,947 million and $15,559 million, respectively).

**Gross income breakdown**

*Million euros*

### Credit Markets

Credit Markets, which include origination and distribution of corporate loans or structured finance, bond origination and securitisation teams and asset and capital structuring, reduced client revenues by 3%. The growth in Latin America, strongly backed by Mexico, and in the US was offset by the sharp decline in Europe, particularly in the UK after the exceptional operations in 2010.

In loans, Santander maintained its reference position in Europe and Latin America. Of note was the participation in the $12,500 million loan for Sab Miller to finance the takeover of the Australian beer company Fosters. Santander was the book runner and mandated lead arranger. Of note in Latin America was the loan for Grupo Suramericana to acquire ING's assets in the region.

In project finance, Santander consolidated itself as one of the world's leading banks. Of note was its presence in the operations of Meerwind Offshore Wind Project (a 400 MW wind farm in the German North Sea) and participation in the largest high speed train concession in France (Tours-Bordeaux) amounting to EUR 7,800 million. In Latin America, Santander capitalised on its experience in financing renewable energy and infrastructure and structured projects in Brazil, Mexico and Chile.

In bonds, the area continued to consolidate business. In Europe, Santander maintained an important presence in capital markets throughout the year, despite the sharp fall in the volume issued in the second half. Latin America fared better. Of note was the role in the $6,000 million bond issue of Petrobras, the largest issue ever in Latin America, and the placement of bonds for the Republic of Brazil, with the lowest yield in history and the lowest spread against US Treasuries. Also noteworthy was the second project bond of a Brazilian company, and the second loan structured by Santander ($700 million) for Queiroz Galvão.

Asset and Capital Structuring continued to increase its portfolio of clients in Europe, Latin America and the US, which produced strong growth in revenues and a positive contribution from all countries. Of note were the structured lease operations in Europe for Veolia (electric trains) and Hochtief (ship to install wind turbines offshore) and the structuring and sale of a solar plant to Munich Re in Latin America. A significant structured leasing operation was completed with TAM Linhas Aéreas and two renewable energy operations were structured in Mexico for Grupo Renovalia and Sowitec.

**Rates**
This area, which restructured its businesses into three activities, (Fixed Income sales, Fixed Income Flow and FX) registered a 7% fall in its client revenues. Improved sales were offset by the weakness of the sovereign debt markets and its impact on management of books.

Fixed Income sales (sale and distribution of derivatives) increased its revenue 6%, backed by the UK and Brazil. Of note by client type was the good performance of corporates (+21%). The retail segment repeated the results of 2010 while the focus on the institutional segment produced 9% growth.

Revenues from Fixed Income Flow activity (distribution of corporate and government bonds, interest rate, credit and inflation derivatives) was sharply down (-23%) due to the impact on the markets of the European Union's sovereign debt crisis which countered the solid rise in sales.

Lastly, FX (trading activities and hedging of exchange rates and short-term money markets for the Group's wholesale and retail clients) maintained sustained growth (+9%) firmly backed by the UK and Latin America, particularly Brazil. Good contribution from all client segments (retail, corporate and institutional), as well as a solid performance from activity in the short-term money markets in Europe, in an environment of high volatility.

**Equities**
The fall in revenues from Global Equities (those related to the equity markets) was 44% in 2011. This was due to the weak generation in the second half of the year as against high revenues in 2010.

In addition, the lower volumes and high levels of volatility in the markets in the second half reduced the revenues from equities brokerage, derivatives and structure products revenues, as well as the contribution to the income statement from management of books.

The uncertainty over the economic recovery hit the primary market hard, delaying some key operations in Europe and Latin America.

Lastly, there was a noteworthy increase in Santander's activity in exchange traded derivative markets as access provider to main markets worldwide, boosting revenues.

## Ranking in 2011

| | Activity | Area | Country / Region | Source |
|---|---|---|---|---|
| Award | Best International Trade Bank | GTB | Brazil/Chile | Trade Finance Magazine |
| Award | Best Overall Trade Bank | GTB | Latin America | Trade Finance Magazine |
| Award | World's Best Sub-Custodian Banks | GTB | Spain | Revista Global Finance |
| Award | M&A Latin American deal of the year: Amapola | CIB | Latin America | Euromoney |
| Award | Germany: Meerwind. European Offshore Wind Deal of the Year | CM | Europe | Euromoney |
| Award | Best Quasi-Sovereign Bond - Petrobras $6bn | CM | Latin America / Brazil | Latin Finance |
| Award | Best Infrastructure Bank | CM | Latin America | Latin Finance |
| Award | Best Foreign Exchange Provider | RT | Spain/Chile/Portugal/Uruguay | Global Finance |
| N1.* | Mejor Banco en Derivados de Foreign Exchange | RT | Spain | Risk,net |
| N1.* | Mejor Banco en Derivados de Tipos | RT | Spain | Risk,net |
| N1.* | Equities Research en Iberia | EQ | Iberia | Institutional Investors |
| N1.** | Equity Capital Markets en Iberia | EQ | Iberia | Dealogic |
| N2.** | Equity Capital Markets de Latin America | EQ | Latin America | Bloomberg |

(*).- Ranking depending on the criterion (**).- Ranking by volume

GTB: Global Transaction Banking CIB: Corporate and Investment Banking CM: Credits and Markets RT: Rates EQ: Equity

## Asset Management and Insurance

- Strong growth (+9%) in total revenues, (9.5% of the operating areas' total).
- Mutual and pension funds: lower volumes partly offset by the better mix of products.
- Insurance: faster pace in revenues in Brazil and the rest of Latin America and sustained recovery in Spain and in consumer business.
- The strategic alliance with Zurich was completed and will boost the insurance offer in Latin America.

Total revenues generated by asset management and insurance rose 9.3% to EUR 4,334 million and accounted for 9.5% of the Group's total revenues from its operating areas.

Attributable profit, after deducting distribution and transformation costs, dropped 9.2% to EUR 419 million, largely affected by lower revenues from insurance in the fourth quarter after the global agreement with Zurich materialised.

**Strategy**
Santander Asset Management advanced in developing a global business model based on the Group's management capacities and the market knowledge of local fund managers. The push given to the multimanager team to manage funds of funds, as well as the creation of global teams to manage Latin American and European mandates, underlined the progress.

Santander Insurance also continued to build its global business model by launching units and businesses to respond to the needs of local networks and customers, while preserving a low risk profile model and one very efficient in its operations.

**Net operating income**
*Million euros*

+2.2% 2011-2010

**Attributable profit**
*Million euros*

-9.2% 2011-2010

In Latin America, Santander signed a global agreement in July with the insurer Zurich to bolster business in the region. Under the agreement, which came into effect in the fourth quarter, Zurich has 51% of the holding company which groups Santander's insurers in Argentina, Brazil, Chile, Mexico and Uruguay, as well as a product distribution agreement in these countries.

**Results**
Gross income flat at 0.6%, while net operating income rose 2.2% after the 2.8% fall in operating expenses. The other negative results and a higher tax charge caused attributable profit to be 9.2% lower. These results include a negative impact of EUR 64 million in gross income and EUR 53 million in net operating income from the global agreement with Zurich in the fourth quarter. Excluding this impact, gross income increased 6.6% and net operating income 9.2%.

The area's total revenues contributed to the Group including those recorded by the distribution networks amounted to EUR 4,334 million, 9.3% more than in 2010. The total contribution (profit before tax plus fees paid to the networks) was EUR 3,944 million (+9.4%).

### Asset Management

The global area of Santander Asset Management posted an attributable profit of EUR 53 million. The total contribution (profit before tax and fees paid to the networks was EUR 1,062 million, 4.7% less than in 2010 and due to flat total revenues (-2.1%).

The revenue reduction was the result of a fall in managed volumes, accelerated in the second half, which was partly offset by a better mix of products and, in consequence, in average revenues.

Total mutual and pension funds under management amounted to EUR 112,000 million, 10% less than in December 2010. The preference for liquidity and on-balance sheet funds, together with more unstable markets in the second half of the year and the impact on prices, explain the fall in volumes.

The main developments by units and countries were as follows:

- In **traditional management** of assets, mutual fund business remained resilient in a very demanding environment.

  In this segment, the Group manages EUR 110,000 million in funds, investment companies and pension plans (-8%), of which 90% comes from four large markets (Brazil, the UK, Spain and Mexico).

  Business in Brazil, the main market for the Group by volume (EUR 39,400 million), slowed down in the fourth quarter and ended the year 2% lower in local currency. In this market, where there is pressure for liquidity in certain segments and good capturing of funds that enable the treasury surpluses of companies to be maximised, Santander has a share of around 14%. This is above its natural share in the retail segment, the most profitable one.

The UK continued to increase its retail balances under management (+6% in sterling to EUR 15,700 million), backed by growth in multimanager funds of funds. Our fund management entity achieved the largest net capturing in this type of product according to the Fundscape Pridham Report.

This performance was recognised by the market. The multimanager team in the UK received the award for Best Manager of the Year by Investment Week in the category of funds of funds.

In Spain, large net reimbursements continued throughout the sector, reflecting the preference of banks for liquidity. In this environment, Santander Asset Management focused successfully on mixed and guaranteed funds. Of note was the more than EUR 1,000 million captured by the range of Select funds. Also notable was the awarding to Santander of the first institutional mandate for private fixed income securities outside of Spain (Germany).

All of this helped to consolidate the Group as the market leader in mutual funds (16.6% market share, according to Inverco), and maintain assets under traditional management in Spain, including pension plans, at EUR 34,000 million (-13%).

Mexico benefited from the launch of new mixed and guaranteed funds and increased its volume 3% in pesos to EUR 9,400 million and improved the mix of products.

In the rest of markets, Chile's volume dropped 10% in pesos, because of the push into deposits. In Portugal, the shift into deposits and the impact of markets accelerated the fall in mutual and pension funds (-42%).

- In **non-traditional management** (real estate, alternative management and private equity funds), Santander Asset Management continued to adjust its activity to the scant demand for these products.

  In the first quarter, Grupo Santander decided, for solely commercial reasons, to provide funds to Santander Banif Inmobiliario, by subscribing to new units and granting a two-year liquidity guarantee in order to meet any outstanding redemption claims. This measure ended the suspension of reimbursements and returned the fund to normal.

  Greater stability in alternative funds after the restructuring in previous years, and in the private equity segment, which is aimed at institutional clients who invest long term in unlisted companies.

**Total Group revenues**
*Million euros*

## Insurance

The global area of Santander Insurance posted an attributable profit of EUR 366 million, 3.8% more than in 2010. This result was affected by the sale of 51% of the insurance companies in Latin America completed in the fourth quarter as, without it, growth would have been 4.0%.

Insurance business generated for the Group total revenues (including fee income paid to the commercial networks) of EUR 3,083 million (+14.7%). The total contribution to profits (income before taxes of insurers and brokers plus fee income received by the networks) increased 15.7% to EUR 2,882 million, and 17.9% higher excluding the impact of the sale of the insurance companies.

The total volume of premium income increased 9% due to the good evolution of protection insurance premiums (+13%) as well as the recovery in the distribution of savings insurance whose premium income rose 7% after falling in 2010.

Continental Europe's contribution increased 7%, backed by the solid performance of Santander Consumer Finance and the recovery in Spain.

Excluding consumer business, Spain increased its contribution by 8% due basically to the relaunch of savings-investment products and the competitiveness of protection products. Portugal's contribution continued to decline (-19%) because of the greater pressure from deposits, while the contribution of Poland (BZ WBK) is still small.

Santander Consumer Finance maintained its strong pace of selling, adjusted to each market, which enabled it to increase its total contribution by 11%. The acceleration of the German market and the contribution of new entities offset the decline in some peripheral markets.

The UK's total contribution rose 4% in sterling. The quarterly evolution was better.

### Insurance (breakdown PBT + Fees)

%

Latin America increased its contribution 26%, excluding the exchange rate impact (+31% without the impact of the sale of the insurance companies). This clearly reflected the region's high potential. The greater efficiency in selling via banking networks and other channels, together with the development of simple products independent of loans, pushed up the region's activity and results.

Of note was Brazil, which contributed more than two-thirds of the region's total (+28%), and Mexico (+46%), while Chile only grew 2%. On a like-for-like basis, Brazil's growth would have been 33%, Mexico 49% and Chile 5%, all in local currency.

Sovereign, still installing its insurance model, continued to increase its total contribution (+15% in dollars).

### Asset Management and Insurance. Income statement

*Million euros*

| | Gross income | | Net operating income | | Attributable profit to the Group | |
|---|---|---|---|---|---|---|
| | **2011** | Var (%) | **2011** | Var (%) | **2011** | Var (%) |
| Mutual funds | 266 | (0.3) | 111 | (1.9) | 43 | (38.9) |
| Pension funds | 23 | (8.1) | 15 | (5.7) | 10 | (4.8) |
| Insurance | 799 | 1.1 | 629 | 3.1 | 366 | (3.8) |
| **Total Asset Management and Insurance** | **1,088** | **0.6** | **754** | **2.2** | **419** | **(9.2)** |

# Risk management report

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# Executive summary

## Banco Santander's risk management principles

pages 148 to 151

- Independence of the risk function.
- Involvement of senior management in decision-taking.
- Collegiate decisions that ensure the contrast of opinions.
- Clear definition of attributions.
- Control and management of risk integrated via a corporate structure with all risk, all businesses and all countries scope.

## Credit risk

pages 156 to 177

**Credit to clients (gross)**
*% of operating areas*

## Exposure to real estate sector in Spain

pages 168 to 170

- It accounts for 4% of the Group's gross loans plus foreclosed properties in Spain.

**Exposure to the construction sector and real estate promotion** *Billion euros*

**Total: 32.0**

**Impact on Grupo Santander of the financial reform in Spain** *Million euros*

| **Amount of provisions** | |
|---|---|
| Additional provisions under new rules at 31.12.2011 | 6,100 |
| Against results 2011 | -1,800 |
| Buffer covered with surplus of existing capital | -2,000 |
| Provisions pending | **=2,300** |
| **Financing of new provisions in 2012** | **2,300** |
| Charged to capital gains from the sale of Santander Colombia | 900 |
| Charged to other capital gains and ordinary allowances 2012 | 1,400 |

# Economic capital

pages 200 to 202

**Analysis of the global risk profile**
*By type of risk*

- The Group's economic capital at the end of 2011 was EUR 45,838 million.
- By business units, continental Europe accounts for 39%, Latin America 34%, the UK 10%, Sovereign 6% and financial management and equity stakes 11%.
- The Group's diversification generates economic capital savings.

# Management of funding and liquidity risk

pages 188 to 192

- Santander's subsidiaries are autonomous and self-sufficient in capital and liquidity and are subject to coordination and the Group's corporate policies.
- The portfolio of loans (77% of net assets) is wholly financed by customer deposits and medium- and long-term funding.
- In 2011, EUR 40,000 million of debt was issued, covering 124% of the year's maturities and amortisations.
- Santander has a total discounting capacity in central banks of around EUR 100,000 million.

**Monitoring metrics**

| Metrics | **2011** | 2010 | 2009 |
|---|---|---|---|
| Loans/Net assets | 77% | 75% | 79% |
| Customer deposits, insurance and medium and long-term funding/Lending | 113% | 115% | 106% |
| Customer deposits, insurance and medium and long-term financing, shareholders' funds and other liabilities/ Loans+fixed assets | 114% | 117% | 110% |
| Short-term funding/Net liabilities | 2% | 3% | 5% |
| Loan-to-deposit ratio | 117% | 117% | 135% |

# Market risk

pages 178 to 192

- Santander maintains a moderate exposure to market risk.
- Despite high volatility in financial markets, the average exposure in trading activity was lower than in 2010.
- In 2011, the Group continued to reduce, from an already low level, its exposure related to complex structured assets.

**VaR evolution in 2011**
*Million euros. VaR at 99%. Time frame of one day*

# Corporate principles of risk management, control and appetite

The importance of Grupo Santander's risk policy was underscored again in 2011. The policy is focused on maintaining a medium-low and predictive profile in all risks, which, together with the Group's high degree of diversification, was again the differential element that enabled Santander to maintain a leading position in the market.

For Grupo Santander, quality management of risk is one of its hallmarks and thus a priority in its activity. Throughout its 150 years, Santander has combined prudence in risk management with use of advanced risk management techniques, which have proven to be decisive in generating recurrent and balanced earnings and creating shareholder value.

The risks model is based on the following principles:

- Independent working from the business areas. Mr. Matías Rodríguez Inciarte, the Group's third vice-chairman and chairman of the board's risk committee, reports directly to the executive committee and to the board. The establishment of separate functions between the business areas (risk takers) and the risk areas responsible for measurement, analysis, control and information provides sufficient independence and autonomy to control risks appropriately.
- Involvement of senior management in all decisions taken.
- Collegiate decision-making (including at the branch level), which ensures a variety of opinions and does not make results dependent on decisions solely taken by individuals. Joint responsibility for decisions on credit operations between risk and business areas, with the former having the last word in the event of disagreement.
- Defining functions. Each risk taker unit and, where appropriate, risk manager has clearly defined the types of activities, segments, risks in which they could incur and decisions they might make in the sphere of risks, in accordance with delegated powers. How risk is contracted, managed and where operations are recorded is also defined.
- Centralised control. Risk control and management is conducted on an integrated basis through a corporate structure, with global scope responsibilities (all risk, all businesses, all countries).

Management and control of risk is developed in the following way:

- Formulate the risk appetite. The purpose is to delimit, synthetically and explicitly, the levels and types of risk that the bank is ready to assume in the development of its business.
- Establish risk policies and procedures. They constitute the basic framework for regulating risk activities and processes. At the local level, the risk units incorporate the corporate rules to their internal policies.
- Building, independent validation and approval of the risk models developed in accordance with the corporate methodological guidelines. These models systemise the risk origination processes as well as their monitoring and recovery processes, calculate the expected loss, the capital needed and evaluate the products in the trading portfolio.
- Execute a system to monitor and control risks, which verifies every day and with the corresponding reports the extent to which Santander's risks profile is in line with the risk policies approved and the limits established.

Santander's risk management is fully identified with the Basel principles as it recognises and supports the industry's most advanced practices which the Group has been anticipating and, as a result, it has been using for many years various tools and techniques which will be referred to later in this section. They include:

- Internal rating and scoring models which, by assessing the various qualitative and quantitative components by client and operation, enable the probability of failure to be estimated first and then, on the basis of estimates of loss given default, the expected loss.
- Economic capital, as the homogeneous metric of the risk assumed and the basis for measuring management, using RORAC, for pricing operations (bottom up), and for analysis of portfolios and units (top down), and VaR, as the element of control and setting the market risk limits of the various trading portfolios.
- Analysis of scenarios and stress tests to complement the analysis of market and credit risk, in order to assess the impact of alternative scenarios, including on provisions and on the capital.

Grupo Santander calculates the minimum regulatory capital in accordance with Bank of Spain circular 3/2008 and subsequent changes on determining and controlling the minimum equity of credit institutions. This regulation completed the transfer to Spanish banking legislation of various EU directives.

As a result of the new elements introduced into the regulatory framework, commonly known as BIS III, Grupo Santander took steps to apply with sufficient prevision the future requirements indicated in BIS III. This entails a greater requirement for high quality capital, sufficiency of capital conservation and counter cyclical.

## Grupo Santander's risk appetite

The risk appetite is defined in Santander as the amount and type of risks considered reasonable to assume for implementing its business strategy, so that the Group can maintain its ordinary activity in the event of unexpected events that could have a negative impact on its level of capital, levels of profitability and/or its share price.

The board is responsible for establishing the risk appetite and monitoring the risk profile and ensuring the consistency between both of them. Senior management is responsible for achieving the desired risk profile as well managing risks on a daily basis. The establishment of the risk appetite covers both the risks whose assumption constitutes the strategic objective and for which maximum exposure criteria are set —minimum objectives of return/risk— as well as those whose assumption is not desired but which cannot be avoided in an integral way. The board will ensure that the amount and type of risks relevant for the bank have been taken into account. These derive from the annual budget approved as well as the medium-term strategic plan. It also ensures that sufficient resources have been assigned to manage and control these risks, at both the global and local levels.

The board will regularly revise, at least once a year, the Group's risk appetite and its management framework, analysing the impact of unlikely but plausible tension scenarios and adopting the pertinent measures to ensure the policies set are met.

The risk appetite is formulated for the whole Group as well as for each of its main business units. The boards of the subsidiaries must approve the respective risk appetite proposals adapted to the corporate framework.

### Risk appetite framework

Santander's risk appetite framework has quantitative as well as qualitative elements that are integrated into a series of basic metrics (applicable to both the whole of the Group as well as its main business units) and another series of transversal metrics which because of their nature are directly applied for the whole of the Group's units.

### Qualitative elements of the risk appetite:

The qualitative elements of the risk appetite framework define, both generally and for the main risk factors, the positioning that Santander's senior management wises to adopt or maintain in the development of its business model. Generally, Grupo Santander's risk appetite framework is based on maintaining the following qualitative objectives:

- A general medium-low and predictable risk profile based on a diversified business model, focused on retail banking and with an internationally diversified presence and with significant market shares. Develop a wholesale banking model which attaches importance to the relationship with clients in the Group's core markets.
- Maintain a rating in a range between AA- and A- on the basis of the environment at both Group level as well as in the local units (in local scale), and the evolution of sovereign risk.
- Maintain a stable and recurring policy of profit generation and shareholder remuneration on the foundations of a strong capital base and liquidity and an efficient diversification strategy by sources and maturities.
- Maintain an organisational structure based on autonomous and self-sufficient subsidiaries in terms of capital and liquidity, minimising the use of non-operational or investment companies, and ensuring that no subsidiary has a risk profile that could jeopardise the Group's solvency.
- Maintain an independent risk function and intense involvement by senior management that guarantees a strong risk culture centred on protecting and ensuring an adequate return on capital.
- Maintain a management model that ensure a global vision and one inter-related with all risks, through an environment of control and robust corporate monitoring of risks, with global scope responsibilities: all risk, all businesses, all countries.
- Focus the business model on those products which the Group has sufficient knowledge of and the management capacity (systems, processes and resources).
- The confidence of customers, shareholders, employees and professional counterparts, guaranteeing the development of their activity within its social and reputational commitment, in accordance with the Group's strategic objectives.
- Maintain adequate and sufficient availability of the necessary human resources, systems and tools that guarantee the continuation of a risk profile compatible with the risk appetite established, both at the global and local levels.
- Implement a remuneration policy that contains the necessary incentives to ensure that the individual interests of employees and executives are aligned with the corporate framework of risk appetite and these are consistent with the evolution of the institution's results over the long term.

## Quantitative elements of risk appetite

The quantitative elements that comprise the risk appetite framework are specified in the following basic metrics:

- The maximum losses that the bank has to assume,
- The minimum capital position that the bank wants to maintain, and
- The minimum liquidity position that the bank wishes to have

in the event of unlikely but plausible tension scenarios.

The Group also has a series of transversal metrics to limit the excessive concentration of the Group's risk profile, both by risk factors as well as from the standpoint of customers, businesses, countries and products.

The risk appetite framework distinguishes between:

a) **Risk capacity:** the maximum level of risk that the Group can technically assume in the development of its business plans without compromising its commercial viability;

b) **Risk appetite:** the level, type of risk and geographic distribution that the Group is ready to accept in order to attain the strategic objectives in its business plan;

c) **Objective risk:** the level and type of risk the Group incorporates into its budgets.

**Risk tolerance** is defined as the difference between risk appetite and objective risk. The risk appetite framework includes setting a series of triggers as the risk tolerance is consumed. Once these levels are reached and the board is informed the necessary management measures are adopted so that the risk profile can be reconducted.

### Losses

One of the three basic metrics used to formulate Santander's risk appetite is expressed in terms of the maximum losses it is prepared to assume in the event of unfavourable scenarios —internal and external— whose probability of occurrence is considered low but plausible.

We regularly conduct analysis of the impact, in terms of losses, of submitting the portfolios and other elements that make up the bank's risk profile to stress scenarios that take into account various degrees of the probability of occurring.

The time frame for materialisation of the negative impact for all risks considered will normally be 12 months, except for credit risk where an additional impact analysis is conducted with a three year time frame.

### Capital position

Santander wants to operate with a large capital base that enables it not only to comply with the regulatory requirements but also have a reasonable surplus of capital. Its core capital target is 10%, which is one percentage point above the 9% required by the European Banking Authority (EBA).

The capital target extends to a period of three years, within the capital planning process implemented in the Group.

### Liquidity position

The Group's liquidity management model is based on the following principles:

- Decentralised liquidity model: autonomy of the subsidiaries within management coordinated at the Group level.
- Comfortable structural liquidity position supported by stable funding: mainly customer deposits (principally in the retail segment) and medium- and long-term wholesale funding (with an objective of an average maturity of more than three years).
- Ample access to wholesale markets and diversification by markets, instruments and maturities.
- High discounting capacity in central banks.

Bearing in mind the Group's wish to be structured on the basis of autonomous subsidiaries, liquidity management is executed by each of our subsidiaries. All of them, thus, must be self-sufficient as regards the availability of liquidity.

### Transversal metrics of risk appetite: concentration

Santander wants to maintain a well diversified risk portfolio from the standpoint of its exposure to large risks, certain markets and specific products. In the first instance, this is achieved by virtue of Santander's focus on retail banking business with a high degree of international diversification.

**Concentration risk:** this is measured via three focuses, which include limits set as signs of alert or control:

- **Customer:** individual and aggregate exposure to the 20 largest clients as a proportion of shareholders' funds.
- **Product:** maximum exposure of clients to derivatives.
- **Sector:** maximum percentage of exposure of the portfolio of companies to an economic sector.

## Specific objectives by type of risk

In addition, Grupo Santander's risk appetite framework includes specific objectives for the following types of risk:

### Credit risk

- Complete management of the credit risk cycle with a corporate model based on establishing budgets, structure of limits and management plans for them and on monitoring and control integrated with global reach responsibilities.
- Global and inter-related vision of the credit exposure, with portfolio vision, including, for example, lines committed, guarantees, off-balance sheet, etc.
- Involvement of the risk function in all credit risk admissions, avoiding the taking of discretionary decisions at the personal level, combined with a strict structure of delegation of powers.
- Systematic use of scoring and rating models.
- Centralised control and in real time of the counterparty risk.

### Market risk

- Moderate market risk appetite.
- Business model focused on the customer with scant exposure to own account business activities.
- Independent calculation of the results of market activities by the risk function.
- Daily centralised control of the market risk of trading activity (VaR).
- Strict control ex ante of products, underlying assets, currencies, etc, for which operations are authorised as well as of the corresponding valuation models.

### Structural risks

- Conservative management of balance sheet and of liquidity risk on the basis of the what is stated in the previous sections.
- Active management of exchange rates in relation to the hedging of capital and the results in subsidiaries.
- Reduced sensitivity of margins and capital to changes in interest rates in stress situations.
- Limited assumption of credit risk in managing the Group's balance sheet.
- Limited assumption of cross-border risk.

### Technology and operational risk

- Supervision of technology and operational risk management through approval of the management framework and of the structure of the corresponding limits.
- Management focus centred on risk mitigation, based on monitoring and controlling gross losses/gross income, self-assessment questionnaires/risk maps and management indicators.
- Operational and technology integration model via corporate platforms and tools.
- Systems' architecture with adequate redundancies and controls in order to guarantee a minimum probability of occurrence of high impact events and which, in their case, limit their severity.
- Business Continuity Master Plan with local developments; local plans of contingency coordinated with the corporate area of technology and operational risk.

### Compliance and reputational risk

- Compliance with all the regulatory requirements, ensuring qualifications and substantial recommendations are avoided in audits and supervisors' reviews.
- Maintain the confidence of customers, shareholders and employees, as well as society in general, regarding solvency and reputation.
- Maintain a zero appetite in compliance and reputational risk through corporate policies, with local implementation, backed by risk indicators and the functioning of corporate and local committees that enable risk to be identified, monitored and mitigated in matters of:
  - Prevention of money laundering: (Analysis and resolution Committee);
  - Compliance (committee of compliance with regulations): codes of conduct in the securities market; suspicious operations; abuse of market; institutional relations; Markets in Financial Instruments Directive (MiFid); customers' complaints to supervisors; data protection regulations and code of conduct of employees;
  - Commercialisation of products: reputational risk management office and committees of approval, marketing and monitoring of products, observing operational, conduct and reputational risk criteria.
- Registry and monitoring of disciplinary procedures, total cost by losses including fines and sanctions.
- Continuous monitoring of audits and revisions of the supervisors and of their corresponding recommendations in the sphere of compliance and reputational risk.

## Risk appetite and living will

The Group has an organisational structure based on autonomous and self-sufficient subsidiaries in terms of capital and liquidity, minimising the use of non-operating or investment companies, and ensuring that no subsidiary has a risk profile that could jeopardise the Group's solvency.

Grupo Santander was the first of the international financial institutions considered globally systemic by the Financial Stability Board to present (in 2010) to its consolidated supervisor (the Bank of Spain) its corporate living will including, as required, a viability plan and all the information needed to plan a possible liquidation (resolution plan). Furthermore, and even though not required, in 2010 more summarised individual plans were drawn up for the main geographic units, including Brazil, Mexico, Chile, Portugal and the UK. The second version of the corporate living will was presented in 2011 and also the second version of the main summarised local and voluntary plans, and progress was made in drawing up the local obligatory plans for the Group's entities which must be eventually presented.

Also noteworthy was the significant contribution that the living will exercise made to the conceptual delimitation of the Group's risk appetite and risk profile.

# 1. Corporate governance of the risks function

The risk committee is responsible for proposing to the board the Group's risk policy, approval of which corresponds to the board under its powers of administration and supervision. The committee also ensures that the Group's activities are consistent with its risk tolerance level and establishes the global limits for the main risk exposures, reviewing them systematically and resolving those operations that exceed the powers delegated in bodies lower down the hierarchy.

The committee is of an executive nature and takes decisions in the sphere of the powers delegated in it by the board. It is chaired by the third vice-chairman of Grupo Santander and four other board members are also members of the committee.

The committee met 99 times during 2011, underscoring the importance that Grupo Santander attaches to appropriate management of its risks.

The main responsibilities of the board's risk committee are:

- Propose to the board the risk policy for the Group, which must, in particular, identify:
  - The different types of risk (operational, technological, financial, legal and reputational, among others) facing the Group.
  - The information and internal control systems used to control and manage these risks.
  - Set the level of risk considered acceptable.
  - The measures envisaged to mitigate the impact of identified risks, in the event that they materialise.
- Systematically review exposures with the main customers, economic sectors, geographic areas and types of risk.
- Authorise the management tools and risk models and be familiar with the results of the internal validation.
- Ensure that the Group's actions are consistent with the previously decided risk appetite level.
- Know, assess and monitor the observations and recommendations periodically formulated by the supervisory authorities in the exercise of their function.
- Resolve operations beyond the powers delegated to bodies lower down the hierarchy, as well as the global limits of pre-classification of economic groups or in relation to exposures by classes of risk.

The board's risk committee delegates some of its powers in risk committees which are structured by geographic area, business and types of risk, all of them defined in the corporate governance risk model.

In addition, both the executive committee and the Bank's board pay particular attention to management of the Group's risks.

The Group's third vice-president is the maximum executive in risk management. He is a member of the board and chairman of the risk committee. Two directorates-general of risks, which are independent of the business areas, both from the hierarchical and functional standpoint, report to the third vice-president. The organisational and functional framework is as follows:

- **The general directorate of risk** (GDR) is responsible for the executive functions of credit and financial risk management and is adapted to the business structure, both by customer type as well as by activity and country (global/local vision). The GDR is structured around two fundamental functions, which are replicated locally and globally.

  The GDR is configured in two blocks:

  – A **corporate structure**, with global scope responsibilities ("all risk, all countries"), entrusted with establishing the policies, methodologies and control. In this block, also denominated "intelligence", and Global Control, are the areas/functions of solvency risks, market risk and methodology.

  – A **structure of businesses**, focused on executing and integrating management of the risk functions in the Group's local and global commercial businesses. In this block, also denominated execution and integration in management, the following areas/functions are grouped: management of standardised risks, management of segmented company risks, global recoveries, management of wholesale banking risk, management of Santander Consumer Finance risks and management of global business risks.

  Complementing the three corporate structure areas and the six business areas is a seventh area of global and systemic governance, which supports and advises the GDR, and is responsible for implementing the organisational model, overseeing effective execution of internal control and the systems model.

  These functions have a global action sphere, i.e. they intervene in all the units where the risk division acts and there is a reflection of the same structure in the local units. The main elements through which the global functions are replicated in each of the units are corporate frameworks. These are central elements to communicate and transfer global practices, reflect the criteria and policies for each of the areas and set the Group's compliance standards to be applied in all local units.

  Generally speaking it is possible to distinguish the main functions developed respectively by the GDR's global areas and by the units:

  – The general directorate of risks establishes risk policies and criteria, the global limits and the decision-making and control processes; it generates management frameworks, systems and tools; and adapts the best practices, both the banking industry's as well as those of the different local units, for their implementation in the Group.

  – The local units apply the policies and systems to the local market: they adapt the organisation and the management frameworks to the corporate frameworks; they contribute critical and best practices and lead the local sphere projects.

- **General directorate of integral control and internal validation of risks,** with global reach responsibilities and of corporate nature and support for the Group's governance bodies, which are:

  – Internal validation of credit, market and economic capital risk models in order to assess their suitability for management and regulatory purposes. Validation involves reviewing the model's theoretical foundations, the quality of the data used to build and calibrate it, the use to which it is put and the process of governance associated.

  – Integral control of risks, whose mission is to supervise the quality of the Group's risk management, guaranteeing that the management and control systems of the various risks inherent in its activity comply with the most demanding criteria and best practices observed in the banking industry and/or are required by regulators, and verifying that the profile of effective risk assumed is adjusted to what senior management has established.

# 2. Integral control of risk

Grupo Santander launched in 2008 the function of integral control of risks, anticipating the new regulatory requirements, then being discussed in the main organisations and forums — Basel Committee, CEBS, FSF, etc,— as well as the recommendations on best risk management practices formulated by various public and private bodies.

## Organisation, mission and features of the function

The organisation of this function is part of the directorate general of integral control and internal validation of risk. This function supports the Group's governance bodies in risk management and control.

Particular attention is paid to credit risk (including the risks of concentration and counterparty); market risk (including liquidity risk as well as structural risks of interest rates and exchange rates); operational and technology risks and risk of compliance and reputational risk.

Integral control of risks is based on three complementary activities:

1) Ensure that the management and control systems of the various risks inherent in Grupo Santander's activity meet the most demanding criteria and the best practices observed in the industry and/or required by regulators.

2) Ensure that senior management has at its disposal an integral vision of the profile of the various risks assumed and that these risks are in line with the previously agreed appetite for risks; and

3) Supervise appropriate compliance in time and form with the recommendations drawn up for risk management matters following inspections by internal auditing and by the supervisors to whom Santander is subject.

Internal control of risk supports the work of the risk committee, providing it with the best practices in risk management.

The main features of this function are:

- Global and corporate scope: all risks, all businesses, all countries;
- It is configured as a third layer of control, following the one by the person responsible for managing and controlling each risk in the sphere of each business or functional unit (first layer of control) and the corporate control of each risk (second layer). This ensures the vision and thus integral control of all risks incurred during the year in Santander's activity.
- Special attention is paid to the development of best practices in the sphere of the financial industry, in order to be able to incorporate within Santander and at once any advances deemed opportune.
- Both the information available as well as the resources that Grupo Santander assigns to controlling the various risks are optimised, avoiding overlapping.

## Methodology and tools

This function is backed by an internally developed methodology and a series of tools that support it, in order to systemise the exercise of it and adjust it to Santander's specific needs. This enables application of the methodology to be formalised and traceable. The methodology and the tools of the three activities are articulated through the following modules:

### Module 1

A guide of tests or reviews exists for each risk, divided in spheres of control (for example, corporate governance, organisational structure, management systems, integration in management, technology environment, contingency plans and business continuity, etc).

Applying the tests and obtaining the relevant evidence, which is assessed and enables the parameters of control of the various risks to be homogenised, is done every 12 months. New tests are incorporated where needed. The tests were fully reviewed during 2011, using as a reference the most recent best practices observed in the banking industry and/or required by the regulators, and also taking into account the experience garnered in previous years in this sphere.

The support tool is the risk control monitor (RCM), which is a repository of the results of each test and its work papers. A review of the situation of each risk is also conducted every six months, with monitoring of the recommendations that emanate from the annual report of integral control.

### Module 2

Senior management is able to monitor the integral vision of the various risks assumed and their adjustment to the previously formulated risk appetites.

### Module 3

In order to monitor proactively the recommendations made by internal auditing and by the supervisors regarding risk control and management, there is the SEGRE. This also enables the recommendations arising from integral control to be registered.

The Bank of Spain can access these tools if it so wishes and thus also the work papers used to develop the function of integral control of risks.

## During 2011

(a) The third cycle of reviewing the various risks was completed in close contact with the corporate areas of control, contrasting and assessing the control and management systems of these risks. Improvements were identified and made into recommendations —with their corresponding schedule for implementation agreed with the risk areas—, along with half yearly monitoring of the progress achieved in the recommendations made in 2010.

(b) The board and the executive committee were regularly informed and given an integral vision of all risks, and the risk committee and the audit and compliance committee were also informed of the function.

(c) Work continued on extending the integral control of risks model to the Group's main units, also coordinating the initiatives in this sphere in the various countries; and

(d) There was also participation, in coordination with the public policy and other areas, in representing the Group in forums such as the Financial Stability Board (FSB) and Eurofi in matters such as transparency in information on risks.

***

We will now look at the Group's main risks: credit, market, operational and reputational.

# 3. Credit Risk

## 3.1 Introduction to the treatment of credit risk

Credit risk is the possibility of losses stemming from the failure of clients or counterparties to meet their financial obligations with the Group.

The Group's risks function is organised on the basis of the type of customer in order to distinguish during the risk management process companies under individualised management from standardised customers.

- Those under individualised management are assigned, mainly because of the risk assumed, a risk analyst. This category includes the companies of wholesale banking, financial institutions and some of the companies of retail banking. Risk management is conducted through expert analysis backed up by tools to support decision-making based on internal models of risk assessment.
- Standardised: a customer who has not been specifically assigned a risk analyst. This category generally includes individuals, individual businessmen and retail banking companies that are not segmented. Management of these risks is based on internal models of assessment and automatic decisions, complemented where the model does not go far enough or is not sufficiently precise by teams of analysts specialised in this type of risk.

# 3.2 Main magnitudes and evolution

The Group's credit risk profile is characterised by diversified geographic distribution and predominantly retail banking activity.

## A. Global map of credit risk, 2011

The table below sets out the global credit risk exposure in nominal amounts (except for derivatives and repos exposure which is expressed in equivalent credit) at December 31, 2011.

The year 2011 was characterised by small growth of 0.8% in the credit risk exposure due, on the one hand, to a change in the method for consolidating a Group companies in the US, which mainly reflects a drop in the effective credit amount by customer and, on the other, the combination of two factors: reduction in disbursements by customer (-0.2%), as a result of the lower volume of committed lines in an economic environment of weaker demand for loans in the main units; and growth in the effective amount with credit institutions (13.6%).

Excluding the exchange rate impact during 2011 of the main currencies against the euro, and the change in the aforementioned consolidation method, the increase in the exposure would be 2.8%.

Spain was still the main unit as regards exposure to credit risk, although 1.4% less than at the end of 2010. Of note in the rest of Europe, which accounts for more than one-third of the credit exposure, is the presence in the UK. Overall, Europe, including Spain, accounted for 71% of the total exposure.

In Latin America, which accounted for 22% of the exposure, 97% of the exposure to credit risk is classified as investment-grade.

The US accounted for 6.1% of the Group's total credit exposure at the end of 2011.

**Grupo Santander - Gross exposure to credit risk classified in accordance with legal company criteria**

*Million euros. Data at December 31, 2011.*

| | Outstanding to customers | Commitments to customers | Sovereign fixed income (excluding trading) | Private fixed income (excluding trading) | Outstanding to credit entities | Commitments to credit entities | Derivatives and Repos (REC) | Total |
|---|---|---|---|---|---|---|---|---|
| **Spain** | **252,165** | **55,526** | **32,318** | **8,040** | **33,092** | **3,465** | **36,535** | **421,142** |
| Parent bank | 151,644 | 42,075 | 21,025 | 5,356 | 25,094 | 3,236 | 30,232 | 278,663 |
| Banesto | 73,184 | 7,674 | 7,223 | 1,129 | 6,178 | 218 | 5,658 | 101,264 |
| Others | 27,337 | 5,777 | 4,070 | 1,555 | 1,820 | 10 | 646 | 41,215 |
| **Rest of Europe** | **341,350** | **50,232** | **6,292** | **4,664** | **33,374** | **0** | **11,840** | **447,754** |
| Germany | 30,413 | 536 | 0 | 93 | 2,492 | 0 | 8 | 33,541 |
| Portugal | 25,858 | 6,036 | 3,734 | 1,744 | 1,698 | 0 | 2,171 | 41,241 |
| UK | 248,425 | 39,500 | 0 | 2,679 | 27,757 | 0 | 8,961 | 327,321 |
| Others | 36,655 | 4,161 | 2,558 | 148 | 1,428 | 0 | 700 | 45,651 |
| **Latin America** | **148,579** | **56,992** | **20,079** | **5,879** | **30,849** | **0** | **9,919** | **272,297** |
| Brazil | 88,398 | 40,804 | 13,194 | 4,857 | 23,760 | 0 | 5,305 | 176,317 |
| Chile | 27,888 | 7,103 | 1,948 | 527 | 3,527 | 0 | 2,414 | 43,406 |
| Mexico | 18,101 | 7,501 | 3,376 | 324 | 1,600 | 0 | 1,874 | 32,777 |
| Others | 14,192 | 1,584 | 1,562 | 171 | 1,961 | 0 | 327 | 19,797 |
| **United States** | **43,107** | **15,271** | **1,437** | **10,577** | **2,766** | **0** | **559** | **73,717** |
| **Rest of world** | 774 | 72 | 2 | 1 | 115 | 0 | 0 | 964 |
| **Total group** | **785,975** | **178,094** | **60,129** | **29,160** | **100,196** | **3,465** | **58,854** | **1,215,874** |
| **% of total** | **64.6%** | **14.6%** | **4.9%** | **2.4%** | **8.2%** | **0.3%** | **4.8%** | **100.0%** |
| **% change. s/Dec. 10** | **-0.2%** | **-0.2%** | **-0.2%** | **-1.3%** | **13.6%** | **132.4%** | **-2.8%** | **0.8%** |

ECR (equivalent credit risk: net value of replacement plus the maximum potential value. Includes mitigants)

Balances with customers include contingent risks and exclude repos (EUR 8,467 million) and other customer financial assets (EUR 20,137 million)

The total fixed income excludes the portfolio of trading and investments of third party takers of insurance.

Sovereign fixed income refers to securities issued by public administrations in general, including the state, regional and local administrations and institutions that operate with the guarantee of the state.

Balances with credit entities and central banks include contingent risks and exclude repos, the trading portfolio and other financial assets. Of the total, EUR 81,611 million are deposits in central banks.

## B. Evolution of the magnitudes in 2011

The evolution of non-performing loans reflect the impact of the deterioration of the economic environment, while the reduction in the cost of credit during 2011 underscores the prudent and anticipative management of risk, enabling Santander, in general, to maintain both figures lower than those of its competitors. As a result, the Group maintains a significant level of coverage and available generic provisions.

The NPL ratio was 3.89% at the end of 2011 (+34 b.p). Growth in this ratio slowed down in the last few quarters. NPLs declined in Santander Consumer Finance and Sovereign and rose in the countries most affected by the crisis (Spain and Portugal) and, to a lesser extent, in those with a better situation in the economic cycle, such as the UK. In the whole of Latin America, the rise in the NPL ratio went hand in hand with the growth in lending while maintaining a stable cost of credit. NPL coverage was 61.4% compared to 72.7% at the end of 2010.

Specific provisions for loan losses, net of bad debt recoveries, amounted to EUR 11,137 million, 1.41% of the average credit exposure with customers (the year's average lending plus financial guarantees), down from 1.56% in 2010.

**Grupo Santander - Risk, NPLs, coverage, provisions and cost of credit**
*Million euros*

| | Credit risk with customers(*) (million euros) | | NPL ratio % | | Coverage % | | Spec. prov net of recovered write-offs (**) (million euros) | | Credit cost of risk(3) % | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 | 2011 | 2010 | 2011 | 2010 | 2011(2) | 2010(1) |
| **Continental Europe** | **364,622** | **370,673** | **5.20** | **4.34** | **55.5** | **71.4** | **4,569** | **6,190** | **1.10** | **1.62** |
| Santander Branch Network | 118,060 | 126,705 | 8.47 | 5.52 | 39.9 | 51.8 | 1,735 | 2,454 | 1.42 | 1.89 |
| Banesto | 78,860 | 86,213 | 5.01 | 4.11 | 53.1 | 54.4 | 778 | 1,272 | 0.96 | 1.52 |
| Santander Consumer Finance | 63,093 | 67,820 | 3.77 | 4.95 | 113.0 | 128.4 | 1,503 | 1,884 | 1.43 | 2.85 |
| Portugal | 30,607 | 32,265 | 4.06 | 2.90 | 54.9 | 60.0 | 283 | 105 | 0.90 | 0.30 |
| **United Kingdom** | **255,735** | **244,707** | **1.86** | **1.76** | **38.1** | **45.8** | **779** | **826** | **0.32** | **0.34** |
| **Latin America** | **159,445** | **149,333** | **4.32** | **4.11** | **97.0** | **103.6** | **5,379** | **4,758** | **3.57** | **3.53** |
| Brazil | 91,035 | 84,440 | 5.38 | 4.91 | 95.2 | 100.5 | 4,554 | 3,703 | 5.28 | 4.93 |
| Mexico | 19,446 | 16,432 | 1.82 | 1.84 | 175.7 | 214.9 | 293 | 469 | 1.63 | 3.12 |
| Chile | 28,462 | 28,858 | 3.85 | 3.74 | 73.4 | 88.7 | 395 | 390 | 1.40 | 1.57 |
| Puerto Rico | 4,559 | 4,360 | 8.64 | 10.59 | 51.4 | 57.5 | 95 | 143 | 2.25 | 3.22 |
| Colombia | 2,568 | 2,275 | 1.01 | 1.56 | 299.1 | 199.6 | 14 | 15 | 0.59 | 0.68 |
| Argentina | 4,957 | 4,097 | 1.15 | 1.69 | 206.9 | 149.1 | 29 | 26 | 0.67 | 0.72 |
| **Sovereign** | **43,052** | **40,604** | **2.85** | **4.61** | **96.2** | **75.4** | **416** | **479** | **1.04** | **1.16** |
| **Total Group** | **822,657** | **804,036** | **3.89** | **3.55** | **61.4** | **72.7** | **11,137** | **12,342** | **1.41** | **1.56** |
| Memo item | | | | | | | | | | |
| **Spain** | **271,180** | **283,424** | **5.49** | **4.24** | **45.5** | **57.9** | **2,821** | **4,352** | **1.04** | **1.53** |

(*) Includes gross loans to customers, guarantees and documentary credits (ECR EUR 8,339 million)

(**) Bad debts recovered.

(1) Excludes the incorporation of AIG in Santander Consumer Finance Poland.

(2) Excludes the incorporation of Bank Zachodni WBK.

(3) (Specific provisions-bad debts recovered)/Total average credit risk.

## C. Distribution of credit risk

The charts below show the diversification of Santander's loans by countries and customer segments. The Group is geographically diversified and focused on its main markets.

Grupo Santander's profile is essentially retail (85.6% retail banking), and most portfolios are products with a real guarantee (e.g. mortgages).

### Customer loans (gross)

*% of operating areas*

BY GEOGRAPHIC AREA

### Distribution of credit risk by type of risk

*%*

BY SEGMENT

The distribution by geographic area and product of lending in the segment of standardised risks is set out below.

### Standardised risks

*%*

BY GEOGRAPHIC AREA

BY PRODUCT

# 3.3 Metrics and measurement toools

## A. Rating tools

The Group has been using since 1993 its own models for assigning solvency and internal ratings (known as internal ratings or scoring), which measure the degree of risk of a client or transaction. Each rating or scoring corresponds to a certain probability of default or non-payment, determined on the basis of the entity's past experience, except for some termed low default portfolios, where the probability is assigned using external sources. More than 200 internal rating models used in the admission process and risk monitoring existed in the Group.

Global rating tools are used for the segments of sovereign risk, financial institutions and global wholesale banking. Their management is centralised in the Group, both for determining their rating as well monitoring the risk. These tools assign a rating for each customer resulting from a quantitative or automatic module, based on balance sheet ratios or macroeconomic variables, and supplemented by the expert view of an analyst.

In the case of companies and institutions under individualised management, the parent company of Grupo Santander has defined a single methodology for formulating a rating in each country. The rating is determined by an automatic model which reflects a first intervention by the analyst and which can or not be later complemented. The automatic model determines the rating in two phases, one quantitative and the other qualitative based on a corrective questionnaire which enables the analyst to modify the automatic scoring by a maximum of ±2 points of rating. The quantitative rating is determined by analysing the credit performance of a sample of customers and the correlation with their financial statements. The corrective questionnaire has 24 questions divided into six areas of assessment. The automatic rating (quantitative +corrective questionnaire) can be changed by an analyst by writing over it or by using a manual assessment model.

The ratings accorded to customers are regularly reviewed, incorporating new financial information available and the experience in the development of the banking relation. The regularity of the reviews increases in the case of clients who reach certain levels in the automatic warning systems and in those classified as special watch. The rating tools are also reviewed so that their accuracy can be fine-tuned.

In the case of standardised risks, both for companies as well as individuals, there are scoring tools which automatically assess the operations.

These admission systems are complemented by performance assessment models which enable the risk assumed to be better predicted. They are used for both preventative activities as well as sales and assigning limits

## B. Paramenters of credit risk

The assessment of a customer or operation, through ratings or scorings, constitutes a judgement of the credit quality, which is quantified via probability of default (PD in the terminology of Basel).

As well as the probability of default, quantifying credit risk requires other parameters to be estimated such as exposure at default (EaD) and the percentage of EaD that might not be recovered (loss given default or LGD). Other aspects are also included such as quantifying off-balance sheet exposures, which depend on the type of product, or analysis of expected recoveries, related to the guarantees existing and other features of the operation: type of product, maturity, etc.

These factors comprise the main credit risk parameters. Their combination enables the probable or expected loss (EL) to be calculated. This loss is considered as one more cost of the activity as it reflects the risk premium and should be incorporated into the price of operations.

The following charts show the distribution of failed consumer loans and mortgages since 2001 on the basis of the percentage recovered after discounting all the costs —including the financial —of the recovery process.

**Spain-parent bank. Mortgages**

*Distribution of operations by the percentage recovered*

**Spain- parent bank. Consumer-retail.**

*Distribution of operations by the percentage recovered*

The risk parameters also calculate the regulatory capital in accordance with the rules derived from Circular 3/2008 of the Bank of Spain on determining and control of minimum equity and subsequent changes. The regulatory capital is the difference between the unexpected and the expected loss.

The unexpected loss is the basis for calculating the capital and makes reference to a very high level of loss, but not very probable, not considered recurrent and which must be met with equity.

In portfolios where the internal experience of defaults is scant, such as banks, sovereigns or global wholesale banking, estimates of the parameters come from alternative sources: market prices or studies by external agencies which draw on the shared experience of a sufficient number of institutions. These portfolios are called low default portfolios.

For the rest of portfolios, estimates are based on the institution's internal experience. The PD is calculated by observing NPL entries and putting them in relation to the final rating assigned to the customer or with the scoring assigned to the operations.

The LGD calculation is based on observing the recovery process of operations not fulfilled, taking into account not only the revenues and costs associated with this process, but also the moment when they are produced and the indirect costs incurred in recovery activity.

The estimation of the EaD comes from comparing the use of the lines committed at the moment of default and a normal situation.

The parameters estimated for global portfolios are the same for all the Group's units. A financial institution with a rating of 8.5 will have the same PD regardless of the unit in which its exposure is recorded. On the other hand, retail portfolios have specific scoring systems in each unit of the group. This requires separate estimates and specific assignment in each case.

The parameters are then assigned to the operations present in the balance sheet of units in order to calculate the expected losses and the capital requirements associated with their exposure.

## C. Master scale of global ratings

The following tables are used to calculate regulatory capital. They assign a PD on the basis of the internal rating, with a minimum value of 0.03%.

**Probability of default**

| Wholesale Banking | | Banks | |
|---|---|---|---|
| Internal rating | PD | Internal rating | PD |
| 8.5 to 9.3 | 0.030% | 8.5 to 9.3 | 0.030% |
| 8.0 to 8.5 | 0.033% | 8.0 to 8.5 | 0.039% |
| 7.5 to 8.0 | 0.056% | 7.5 to 8.0 | 0.066% |
| 7.0 to 7.5 | 0.095% | 7.0 to 7.5 | 0.111% |
| 6.5 to 7.0 | 0.161% | 6.5 to 7.0 | 0.186% |
| 6.0 to 6.5 | 0,271% | 6.0 to 6.5 | 0.311% |
| 5.5 to 6.0 | 0.458% | 5.5 to 6.0 | 0.521% |
| 5.0 to 5.5 | 1.104% | 5.0 to 5.5 | 0.874% |
| 4.5 to 5.0 | 2.126% | 4.5 to 5.0 | 1.465% |
| 4.0 to 4.5 | 3.407% | 4.0 to 4.5 | 2.456% |
| 3.5 to 4.0 | 5.462% | 3.5 to 4.0 | 4.117% |
| 3.0 to 3.5 | 8.757% | 3.0 to 3.5 | 6.901% |
| 2.5 to 3.0 | 14.038% | 2.5 to 3.0 | 11.569% |
| 2.0 to 2.5 | 22.504% | 2.0 to 2.5 | 19.393% |
| 1.5 to 2.0 | 36.077% | 1.5 to 2.0 | 32.509% |
| < 1.5 | 57.834% | < 1.5 | 54.496% |

These PDs are applied uniformly throughout the group in accordance with the global management of these portfolios. As can be seen, the PD assigned to the internal rating is not exactly equal for a same rating in both portfolios, although it is very similar in the tranches where most of the exposure is concentrated (i.e. in tranches of rating of more than six).

## D. Distribution of EaD and expected loss (EL) associated

The table below sets out the distribution by segments of the outstanding credit exposure to customers in terms of EaD. PD, LGD and EL. Approximately 78% of total risk with clients (excluding sovereign, counterparty risks and other assets) corresponds to companies, SMEs and loans to individuals, underlining the retail focus of business and of Santander's risks. The expected loss from customer exposure is 1.30% (1.05% for the Group's total credit exposure), which can be considered as a medium-to-low risk profile.

**Segmentation of credit risk exposure**

*Million euros %*

| | EaD[1] | % | PD. Average | LGD Average | EL |
|---|---|---|---|---|---|
| Sovereign debt | 159,775 | 15.2% | 0.14% | 13.9% | 0.02% |
| Counterparty | 51,574 | 4.9% | 0.27% | 59.6% | 0.16% |
| Public sector | 14,654 | 1.4% | 1.44% | 14.8% | 0.21% |
| Corporate | 155,702 | 14.8% | 0.94% | 39.9% | 0.37% |
| SMEs | 163,005 | 15.5% | 5.44% | 30.5% | 1.66% |
| Mortgages (individuals) | 330,435 | 31.5% | 3.10% | 8.9% | 0.28% |
| Consumer loans | 124,913 | 11.9% | 7.94% | 55.1% | 4.38% |
| Credit cards of individuals | 32,374 | 3.1% | 4.74% | 64.8% | 3.07% |
| Other assets | 17,465 | 1.7% | 3.73% | 27.5% | 1.02% |
| Memorandom item customers[2] | *821,083* | *78.2%* | *3.93%* | *33.1%* | *1.30%* |
| **Total** | **1,049,897** | **100%** | **3.17%** | **33.0%** | **1.05%** |

Data at December 2011.
(1) Excluding doubtful loans.
(2) Excluding sovereign debt, banks and other financial entities and other assets.

## 3.4. Loss observed: measurements of credit cost

As well as using these advanced models, other usual measures are employed which provide prudent and effective management of credit risk on the basis of the loss observed.

Grupo Santander's cost of credit is measured by various means: change in net entries (final doubtful loans —initial doubtful loans + write offs —recovered write offs), net loan-loss provisions (net specific provisions – recovered write-offs) and net write-offs (write offs – recovered write-offs).

The three approaches measure the same reality and, consequently, converge in the long term although they represent successive moments in credit cost measurement: flows of non-performing loans (non-performing loans management variation, NPLMV), coverage of doubtful loans (net loan-loss provisions, NLLPs) and becoming write offs (net write-offs), respectively. And this without detriment that in the long term and within the same economic cycle, the three show differences at certain times, particularly significant at the start of a change of cycle. These differences are due to the various moments at which the losses are calculated, which are basically determined by accounting rules. In addition, the analysis can be complicated by changes in the policy of coverage and entry into write offs, composition of the portfolio, doubtful loans of entities acquired, changes in accounting rules, sale of portfolios, etc.

**Grupo Santander´s total cost of credit**
*% of average portfolio*

Note: The data for 2009 reflects the incorporation of A&L and in 2010 Sovereign.
December 2011 does not include the incorporation of Bank Zachodni WBK.

The following charts reflect the cost of Grupo Santander's credit risk in its main areas of activity in 2011 and the comparison with prior years, measured in various ways:

## Net write-offs

*Change in doubtful loans plus net write-offs (% of average balances)*

## Net loan-loss provisions

*Net specific provisions less recovered write offs (% of average balances)*

## Net entries

*Write-offs less recovery of write-offs (% of average balances)*

Note: Data drawn up in accordance with legal company criteria. 2011 does not include Bank Zachodni WBK, and in the case of net provisions also does not include Santander Consumer USA. The figures for 2010 reflect the incorporation of Sovereign.
2008 excludes A&L and 2009 excludes Sovereign and Venezuela.

The general trend over the past few years has been to maintain the cost of Santander's credit at low levels. In 2011, the decline of 15 b.p. in the cost of credit was due to the still significant deterioration of the economic environment and of the mix of retail portfolios which, although with a higher expected loss, have higher levels of direct and indirect profitability and a more predictable nature of risk.

# 3.5 Credit risk cycle

Risk management consists of identifying, measuring, analysing, controlling, negotiating and deciding the risks incurred by the Group's operations. The process involves risk takers and senior management, as well as the risk areas.

The process emanates from senior management, via the board of directors and the risk committee; they set the risk policies and procedures, the limits and delegating of powers, and approve and supervise the framework of the risks function.

The risk cycle has three phases: pre-sale, sale and after sale:

- **Pre-sale:** this includes the planning and setting of objectives, determining the appetite for risk, approving new products, studying the risk and rating loans, and establishing limits.
- **Sale:** this covers the phase of decision-making both for operations under pre-classification as well as one-off transactions.
- **After sale:** monitoring, measurement, control and recovery management.

## A. Planning and setting limits

Setting limits is a dynamic process which identifies the Group's risk appetite by discussing business proposals and the opinion of risks.

The global plan of limits, the document drawn up on the basis of consensus which provides complete management of the balance sheet and of the inherent risks, establishes the risk appetite in the various factors.

The limits are based on two structures: customers/segments and products.

The most basic level in individualised management is the customer and when certain features are present —generally of relative importance— an individual limit (pre-classification) is set.

A pre-classification model based on a system for measuring and monitoring economic capital is used for large corporate groups. A more simplified version is used for those companies who meet certain requirements (high knowledge, rating, etc).

In the sphere of standardised risk, the planning and setting of limits is done through credit management programmes (CMPs), a document reached by consensus between the business and risk areas and approved by the risk committee or committees delegated by it. The CMPs set out the expected results of business in terms of risk and return, as well as the limits to which activity is subject and management of the associated risks.

## B. Risk study and process of credit rating

The study of risk is obviously a prior requirement for authorising customer operations by the Group.

This study consists of analysing the capacity of the customer to meet their contractual obligations with the bank. This entails analysing the customer's credit quality, risk operations, solvency and return in accordance with the risk assumed.

The risk study is carried out every time there is a new customer or operation or with a pre-established regularity, depending on the segment. In addition, the rating is studied and reviewed every time there is an alert or something that affects the customer/operation.

## C. Decisions on operations

The purpose of the decision-making process is to analyse and resolve operations, taking into consideration both the risk appetite as well as those elements of the operation that are relevant in the search for the balance between risk and return.

The Group has been using RORAC methodology (return on risk adjusted capital) since 1993 to analyse and set prices for operations and businesses.

## D. Monitoring

As well as the tasks carried out by the internal auditing division, the directorate general of risks, through local and global teams, controls credit quality by monitoring the risks and has the resources and specific people to do it.

The monitoring is based on a continuous process of permanent observation, which enables incidents to be detected in advance in the evolution of risk, operations, customers, and their environment in order to take steps to mitigate them. The monitoring is conducted on the basis of customer segmentation.

The Group has a system called companies in special watch (FEVE) which identifies four levels on the basis of the degree of concern arising from the circumstances observed (extinguish, secure, reduce, monitor). The inclusion of a company in FEVE does not mean there have been defaults, but rather the advisability of adopting a specific policy toward that company and establishing the person and time frame for it. Clients in FEVE are reviewed at least every six months, and every quarter for the most serious cases. A company can end up in special watch as a result of monitoring, a review conducted by internal auditing, a decision of the person responsible for the company or the entry into functioning of the system established for automatic warnings.

**Ratings of risk balances according to the FEVE monitoring system**
*Million euros at December 2011*

| | Extinguish | Secure | Reduce | Monitor | **Total** |
|---|---|---|---|---|---|
| Retail banking Spain | 4,760 | 485 | 11,250 | 12,649 | **29,143** |
| Banesto | 7,467 | 151 | 2,018 | 11,154 | **20,790** |
| Portugal | 394 | 247 | 987 | 2,221 | **3,848** |
| Poland | 1,112 | N.A.(*) | N.A.(*) | 417 | **1,529** |
| United Kingdom | 235 | 60 | 844 | 1,923 | **3,062** |
| Sovereign | 1,678 | 46 | 1,167 | 2,002 | **4,894** |
| Latin America | 1,339 | 437 | 1,876 | 7,248 | **10,901** |
| **Total** | **16,984** | **1,426** | **18,142** | **37,614** | **74,166** |

Note: 2011 shows the application of the FEVE tool in Poland. The classification of risk in FEVE is independent in each institution and responds to the various criteria for classification of these risks and management of them on the basis of the category in which they are classified.

(*) Not applicable.

Ratings are reviewed at least every year, but if weaknesses are detected, or on the basis of the rating, it is done more regularly.

As regards the risks of standardised clients, the main indicators are monitored in order to detect shifts in the performance of the loan portfolio with respect to the forecasts made in the credit management programmes.

**Payment restructurings and agreements**
The restructuring of debts is part of the continuous management of risks with customers although it is during periods of economic downturn when this practice assumes greater importance. It arises when the customer is not in a condition to comply with the payment obligations contracted with the bank and so the possibility of adjusting the debt to the customer's new payment capacity and/or improve the guarantees is contemplated.

The use of debt restructuring by Grupo Santander's banks makes it necessary to establish common practices, which enable these risks to be overseen. With this in mind, the corporate policy for restructuring the debts of customers was created, approved by the risk committee, which incorporates a series of definitions, general principles and policies that must be applied by all the Group.

Within the activity of continuous monitoring, the risk departments and the business area of recoveries, in coordination with the business areas, carry out centralised actions to identify those customers who might need to restructure their debts. The payment capacity is the central factor of analysis, given that the purpose of restructuring is that the customer continue to pay back their loans. The factors taken into consideration are indicative of the changes in the economic situation and, thus, signify a deterioration in the customer's payment capacity.

The risk departments, in coordination with the business area of recoveries, are entrusted with approving the restructuring operation, modifying the terms of the loan and improving guarantees, if possible, as well as analysing the risks assumed.

Grupo Santander restricts these operations, with rigorous and selective criteria, to:

- viable operations, which in origin do not have a very severe deterioration;
- where the customer wishes to pay;
- that improve the bank's position in terms of expected loss;
- and where restructuring does not discourage additional efforts by the customer.

In standardised customers, the general principles stated below are applied rigorously, tending to exceptional circumstances when necessary. In the case of segmented customers, these principles can be used as an element of reference, but particularly important is individualised analysis of each case.

- The customer's overall risk is assessed.
- The risk with the customer does not increase.
- All the refinancing alternatives are assessed and their impact, ensuring that their results would be better than those likely to be obtained if this process was not carried out.
- Particular attention is paid to guarantees and the possible future evolution of their value.
- Their use is restricted, rewarding the restructuring of risks with additional efforts by customers and avoiding actions that only postpone the problem.
- Monitoring of these operations is carried out in a special way, and maintained until the total extinction of the debt.
- For segmented customers, a very detailed analysis is carried out, case by case, where the expert opinion enables adjustment of the most appropriate conditions.

As well as close monitoring of these portfolios by the Group's risk management teams, both the various supervisory authorities to which Grupo Santander is subject and the internal audit of the Group pay particular attention to control and appropriate assessment of the restructured portfolios.

Depending on the management situation in which operations under restructuring find themselves in, we distinguish two types of operation:

- Those for customers under normal classification (without non-performing loans) who, due to a change in their economic situation, could suffer an eventual deterioration in their payment capacity. This contingency can be resolved by adapting the debt conditions to the customer's new capacity, thereby facilitating compliance with the payment obligation. These operations are not the subject of concern, but a one-off circumstance to tackle within the normal customer relationship. Moreover, as there was no need to anticipate possible losses, it is not necessary to make loan-loss provisions to cover these operations. Once the conditions have changed, there is a certainty that the customer will comply with the payment periods with no problems and continuously.
- Loans classified as non-performing, due to delays in payment or other situations, are known as refinancing.

Refinancings do not signify release of provisions. The classification of the risk as non-performing is maintained unless:

- The criteria envisaged in the regulations based on Bank of Spain circulars (payment of ordinary interest pending and, in any case, contribution of new effective guarantees or a reasonable certainty of payment capacity) are met;
- The cautions under a criterion of prudence in the Group's corporate policy (sustained payment during a period of between 3 and 12 months, on the basis of the features of the operation and the type of guarantees existing) are met.

As for loan-loss provisions, the restructuring must not carry weight in assigning provisions for a particular operation. The fact that the entry into irregularity of a restructured operation is considered substandard entails an increase in provisions for the Group. In restructured operations that return to being non-performing, the applicable coverage percentage will be calculated on the basis of the date when the operation first became non-performing.

The amount of the portfolio refinanced at the end of 2011 was barely 1% of the Group's total lending and its structure was as follows:

**Amount of the refinanced portfolio. Main countries**
*Million euros*

| | |
|---|---|
| Spain | 4,172 |
| Portugal | 914 |
| UK | 1,007 |
| Brazil | 2,844 |
| Latin America | 496 |
| Sovereign | 338 |

The structure by segments of the total refinanced portfolio at the end of 2011 was as follows:

**Structure by segment of the total refinanced portfolio**
*Million euros*

| | |
|---|---|
| Mortgages | 2,037 |
| Consumer | 2,617 |
| Companies | 4,497 |
| Corporate | 1,016 |

**Payment agreements**

These criteria are mainly aimed at situations of low impact on the customer's payment capacity. For situations of serious deterioration, the restructuring of the loan is not considered an option and agreements are sought with the customer to recover all or part of the loan, minimising the losses and assuming sometimes, one or several of the following circumstances:

- There is not a reasonable certainty of payment; delays of 180 days or debts classified as bad.
- Contractual conditions were agreed that do not meet the general principles set out in the corporate policy of restructuring mentioned in the previous section: condonation of the principle and/of interest payments, a quota that does not cover the ordinary interest or there is an increase in the risk.

The logic of normalisation of these operations is based on using as a rule the experience with the customer, setting a graduation in the level of requirement of the observation periods considering both the customer's initial situation before renegotiation, as well as the concessions made by the bank to reach the agreement. The greater the deterioration, the greater the degree of prudence, establishing a longer observation period. When estimating the length of a possible real recovery of the payment capacity a period of between 18 and 24 months is considered for an agreement without a haircut, and between 24 and 36 months for an agreement with a haircut.

## Credit exposure in Spain

### a. General view of the portfolio

At the end of 2011, Santander's total credit exposure (including guarantees and documentary credits) in Spain amounted to EUR 271,180 million, with an appropriate level of diversification, both by product as well as customer segment.

The credit risk of commercial networks of the main businesses in Spain (Santander Branch Network, Banesto, Banif and Santander Consumer) accounted for 23% of the Group's total, distributed as follows:

**Segmentation of the commercial networks in Spain**
*%*

Includes the commercial networks of the main businesses in Spain (Santander Retail Banking, Banesto, Banif and Santander Consumer).

In accordance with Bank of Spain rules, the Group regards as doubtful loans those which have not been serviced for more than 90 days and includes the total debt of the customer when the unpaid part represents more than 25% of it or when pre-judicial actions are taken. Also considered as doubtful loans are those which, without entering into non-compliance, have reasonable doubts of being fully repaid. These criteria are not limited to just credit risk in Spain, but also to all units, where these are combined with the regulations that each local regulator has established.

The NPL ratio in Spain in 2011 was 5.49%, concentrated in those sectors which were most affected by the economic downturn. Although this figure is higher than in 2010, its increase was below the aggregate rise of banks in Spain (according to the regular information published by the Bank of Spain). This underscored the Group's traditionally prudent risk management criteria as well as the fact that the NPL ratios of a large percentage of the credit portfolios in Spain registered lower growth during the year. Santander's positive differential with banking system widened in 2011 by 67 b.p.

Total provisions for covering the possible loss of these risks represent coverage of 45.5%.

In line with the Bank of Spain's rules and indications, loans classified as substandard are those which, while being up to date on payments and with no reason to be classified as doubtful, show some weakness which could lead to non-payments and losses, as they involve the weakest customers from certain collectives or sectors affected by extraordinary circumstances of greater risk.

**Evolution of non-performing loans 2008-2011**
*%*

**b. Analysis of the mortgage portfolio of individual customers**

In line with the Bank of Spain's guidelines for greater transparency in information for the market regarding property, the table below sets out the loans granted to households to buy homes by the main businesses in Spain. This portfolio, one of the main ones in Spain, stood at EUR 59,453 million at the end of 2011 (22% of total credit risk in Spain). Of this, 98% of the loans have mortgage guarantees.

**Lending to households to acquire homes**
*Million euros*

| | Gross amount | Of which: doubtful |
|---|---|---|
| Loans to acquire property | 59,453 | 1,607 |
| Without mortgage guarantee | 918 | 28 |
| With mortgage guarantee | 58,535 | 1,579 |

The NPL ratio of the portfolio with mortgage guarantee, which reflects the evolution of the economic environment during 2011, was 2.7% at the end of the year, 50 b.p. more than in 2010 and well below that of other businesses in Spain.

The portfolio of mortgages for property in Spain has features that maintained its medium-low risk profile and had limited expectations of further deterioration:

- All mortgages pay principal from the very first day of the operation.
- The usual practice is to repay it ahead of time and so the average life of the operation is well below that of the contract.
- The borrower responds with all assets and not just the property.
- Most mortgages have variable interest rates with spreads over Euribor.
- High quality of collateral, almost entirely in mortgages for the first residence.
- 88% of the portfolio has a LTV of less than 80%, calculated as the total risk against the amount of the latest available valuation.
- The average affordability rate remained at close to 29%.

**LTV ranges. Total**
*Million euros*

| | LTV < 40% | 40% < LTV < 60% | 60% < LTV < 80% | 80% < LTV < 100% | LTV > 100% |
|---|---|---|---|---|---|
| Gross amount | 13,020 | 16,503 | 21,940 | 6,474 | 597 |
| Of which: doubtful | 177 | 271 | 598 | 425 | 107 |

## Loan to value

## Affordability rate

*Average 29%*

Note: The affordability rates at Santander and Banesto.
Loan to Value: relation between the amount of the loan and the appraised value of the mortgaged property. On the basis of management criteria, the average LTV of the portfolio of mortgages for individuals to buy homes was 51.6%
Affordability rate: relation between the annual payments and the customer's net income.

Despite the economy's situation and its gradual deterioration during the last three years, the measures taken in admission produced a good evolution of vintages. For new loans between 2008 and 2011 in the Santander network in Spain, the maturity of vintages is shown below.

## Evolution of the default rate by the number of operations by vintages

Note: mortgage vintages of the Santander Branch Network in Spain.

Banco Santander's branch network in Spain offered as of August 1, 2011 a three year moratorium in capital in order to ease the situation of individual customers and the self-employed, with objective causes of economic problems, such as being unemployed or having suffered a fall of more than 25% in their income, and who were having temporary problems in repaying their mortgages on their normal residence. Customers who adhere to this measure have the possibility of extending the maturity of their loan, in order to compensate the grace period, without having to change the loan's financial conditions, neither during the period of grace nor at the end of it.

This measure helped to mitigate the social impact of the economic crisis, while preserving the good culture of payment, one of the differential elements of the Spanish mortgage market. At the end of 2011, 6,000 customers of the Santander Branch Network in Spain had taken advantage of this moratorium for a total amount of close to EUR 1,000 million.

### c. Financing provided for construction and real estate promotion with real estate purpose

Lending to these sectors, in line with the Bank of Spain's guidelines regarding classification by purpose, amounted in Spain to EUR 23,442 million, 25% lower than in 2009 and 14% below 2010 using like-for-like criteria. This represents a market share of around 10% on the basis of the latest information published for June 2011, substantially lower than that of the Group's total businesses in Spain. Including EUR 8,552 million of foreclosed properties, the total amount is EUR 31,994 million (4% of the Group's total lending).

The reduction in risk was largely due to a strict policy in admitting new loans with the consequent amortisation of the credit operations of the portfolio outstanding and proactive management of existing risks.

The non-performing loan ratio of this portfolio at the end of 2011 was 28.6%, underscoring the deterioration in this sector. Of the EUR 10,638 million classified as doubtful and sub-standard loans, 58% were up-to-date with payments, which underscored the Group's conservative policy in anticipating the bad loan classification. Coverage with specific provisions was 32.8%, in accordance with the regulations at the end of the year.

## Financing for construction and real estate development: doubtful and substandard loans

*Million euros*

| | Risk | Coverage | |
|---|---|---|---|
| | Amount | Amount | % |
| Doubtful loans | 6,722 | 2,211 | 33 |
| Substandard | 3,916 | 613 | 16 |
| Coverage with generic provisions | | 327 | |
| **Total** | **10,638** | **3,151** | **30** |

A large part of the exposure to the construction and real estate activity sectors are loans with mortgage guarantee (EUR 18,705 million, 80% of the portfolio compared to 78% in 2010). Their distribution is shown below:

## Credit exposure to the construction and real estate development sector

*Million euros*

**Total: 23,442 million.**

A particularly important product in the real estate promotion portfolio is mortgage loans to real estate developers. At the end of 2011, this amounted to EUR 7,467 million and represented around 0.9% of Grupo Santander's total credit portfolio. The reduction in the exposure to this product accelerated during 2011 (24% compared to 20% in 2010 and 9.3% in 2009).

At the end of 2011, this portfolio of loans had a low degree of concentration and an appropriate level of guarantees and coverage.

The situation was as follows:

- Developments completed and with the final certificate of work: 79.2% of outstanding risk.
- Developments more than 80% completed: 6.4% of outstanding risk.
- Developments between 50% and 80% completed: 5.2% of outstanding risk.
- Developments less than 50% completed: 9.2%.

Furthermore, close to 86% of this financing of real estate developments is totally completed or close to it, having overcome the risk of construction.

***Policies and strategies established for management of these risks***

The policies in force for managing this portfolio, regularly reviewed and approved by the Group's senior management, are currently focused on reducing and securing the exposure, without overlooking new business identified as viable.

In order to manage this credit exposure, Grupo Santander has specialised equipment that not only fits within the risk areas, but also complements its management and covers the whole life cycle of these operations: their commercial management, juridical treatment, eventuality of recovery management, etc.

As already commented on in this same point, anticipative management of these risks enabled the Group to reduce its exposure significantly (-45% in mortgage loans for promoters between 2008 and 2011) and attain a granular portfolio and diversified by territories where the volume of loans for second homes is very low.

Mortgages for land not developed account for only 6% of the mortgage exposure, with the rest already classified as developed land or land that can be developed.

In the event of loans for homes not yet completed, the significant reduction in the exposure of 24% in 2011 was due to various actions. As well as the already existing specialised channels, campaigns were conducted supported by teams of specific managers for this function which, in the case of the Santander Branch Network, were directly supervised by the business area of recoveries, where direct management of them with promoters and buyers applying criteria of sale price reductions and adapting to the financing conditions to the needs of buyers, enabled subrogations of already existing loans to be made. These subrogations diversify risk in a business segment that has a clearly lower NPL ratio.

The admission processes are managed by specialised teams who coordinate directly with commercial teams, and have well defined policies and criteria:

- Promoters with an ample solvency profile and with proven experience in the market.
- Strict criteria of parameters inherent in operations. Exclusive financing for the cost of building, high percentages of sales accredited, financing of the first residence, etc.
- Support for the financing of social housing with accredited percentages of sale.
- Restricted financing of land, reduced to the re-establishment of the appropriate level of coverage in already existing financings or an increase in the guarantees.

As well as the permanent control by teams of monitoring the Group's risks, there is a technical team specialised in monitoring and controlling this portfolio in relation to progress in building, compliance with plans and control of sales, as well as with the validation and control of disbursements through certifications. Santander has specific tools created for this purpose. All the mortgage distributions, disbursements for any type of concept, changes to the grace periods, etc, are authorised on a centralised basis.

In the case of projects under construction with some kind of problems, the criterion to be followed is to guarantee completion in order to have buildings that can be sold. In order to achieve this, each project is analysed individually so that the most effective series of measures can be adopted for each case (payment structures to suppliers that guarantee completion of the work, setting schedules of specific disbursements, etc).

In those cases that require as a result of the analysis some kind of restructuring of the exposure, the restructuring is carried out jointly between risks and the business area of recoveries, anticipating non-payment situations, with criteria centred on providing the projects with a payments structure that produces a good result. These authorisations are conducted on a centralised basis and by expert teams ensuring strict criteria are applied in line with the Group's principles of prudence in risk management. Recognition of the possible losses materialises when they are identified, classifying the positions without waiting for non-payment in accordance with the rules set by the Bank of Spain, with the corresponding provision giving coverage to the expected loss in these positions.

Companies specialised in selling properties (Altamira Santander Real Estate and Promodomus) manage real estate assets, backed up by the commercial network structure. Sales are made with price reduction levels reflecting the market's situation and with the levels of provisions of this portfolio.

### d. Real estate foreclosed

In the last instance, one of the mechanisms used in Spain to manage risk efficiently is the purchase and foreclosure of real estate assets. The net balance of these assets at the end of 2011 was EUR 4,274 million, the result of a gross amount of EUR 8,552 million and provisions of EUR 4,278 million.

In accordance with the Group's usual criteria of prudence and anticipating future regulatory changes regarding coverage of these properties, at the end of 2011 EUR 1,800 million was set aside for real estate risk, of which EUR 1,517 million was used to constitute an additional fund, which raised coverage of all these assets to 50%.

The following table shows the structure at the end of 2011 of properties foreclosed by the main businesses in Spain:

**Spain: Foreclosed properties**
*Million euros*

| | Gross amount | Coverage | Net amount |
|---|---|---|---|
| Finished buildings | 3,753 | 39% | 2,272 |
| Buildings under construction | 521 | 51% | 256 |
| Developed land | 2,661 | 58% | 1,120 |
| Land that can be developed | 1,339 | 61% | 521 |
| Other land | 279 | 62% | 105 |
| **Total** | **8,552** | **50%** | **4,274** |

Of the total amount, 45% corresponds to completed buildings available for sale and of the total land 94% is developed or can be developed.

In the last few years, the Group regarded acquisition/foreclosure as an efficient tool for resolving unpaid loans as against going through systems of legal processes. In both 2010 and 2011, net entries of foreclosed and acquired properties continued to fall, due to a faster pace of sales (+12%) than entries (+8%). In the fourth quarter of 2011, the balance of these assets was slightly lower and this trend was expected to continue in the coming years.

**Spain: Foreclosed properties**
*Billion euros*

| | 2011 | 2010 | |
|---|---|---|---|
| Gross entries | 2.3 | 2.1 | 8% |
| Sales | 1.3 | 1.1 | 12% |
| **Difference** | **1.0** | **1.0** | |

### e. New regulatory requirements

After approval of Royal Decree Law 2/2012, which establishes the new requirements for provisions for real estate assets in the Spanish financial system, the Bank announced that the amount that Grupo Santander needed to cover to meet the requirements was EUR 6,100 million.

These additional needs will be entirely met in 2012 as follows:

- EUR 1,800 million was charged against the Group's fourth quarter 2011 earnings, of which EUR 1,517 million was assigned to an additional fund to the one already existing for coverage of foreclosed properties and which lifted coverage of these assets to 50%.
- EUR 2,000 million are a capital buffer required by the rules and which are covered by capital already held by the Group.
- The remaining EUR 2,300 million will be covered through capital gains which may be obtained during the year— including EUR 900 million from the capital gain on the sale of Banco Santander Colombia— and through ordinary contributions to provisions during 2012.

**Impact on Grupo Santander of the financial reform in Spain**
*Million euros*

| **Amount of provisions** | |
|---|---|
| Additional provisions under new rules at 31.12.2011 | 6,100 |
| Against results 2011 | -1,800 |
| Buffer covered with surplus of existing capital | -2,000 |
| Provisions pending | **=2,300** |
| **Financing of new provisions in 2012** | **2,300** |
| Charged to capital gains from the sale of Santander Colombia | 900 |
| Charged to other capital gains and ordinary allowances 2012 | 1,400 |

**Foreclosed properties**
*Billion euros*

**Foreclosed properties: Coverage ratio**

**Analysis of the mortgage portfolio in the UK**
As well as the risk portfolio in Spain, of note in standardised risks and because of its importance in Grupo Santander's total lending is the UK mortgage portfolio.

This portfolio consists of first home mortgages distributed in UK territory, as there are no operations that entail second or successive charges on mortgaged properties.

Most of the mortgages are in Greater London, where housing prices are more stable even during a period of economic slowdown.

All the properties are assessed by authorised valuers before each operation is approved, in accordance with the principles established by the Group for risk management and in line with the methodology defined by the Royal Institution of Chartered Surveyors.

The portfolio performed favourably during 2011. Its NPL ratio was 1.46% (1.41% in 2010), the result of both the constant monitoring and control as well as the strict credit policies which include, among other measures, maximum loan-to-value criteria in relation to properties in guarantee. On the basis of these policies, since 2009 no mortgages have been granted with LTVs of more than 100%. The average LTV is 53%.

There is no risk appetite for loans considered as high risk (subprime mortgages). The credit risk policies explicitly forbid this type of loan, establishing tough requirements for credit quality, both the operations as well as customers. Buy-to-let mortgages with a higher risk profile account for a small percentage of the total volume of the portfolio (barely 1%).

The following charts give the structure in LTV terms of and the distribution in terms of the income multiple:

**Loan to value**[1] *Average: 52.6%*

**Income multiple** *Average: 3.1*

(1) Indexed
(*) Loan to value: Relation between the amount of the loan and the appraised value of the mortgaged property. Income multiple (opposite of affordability rate): Relation between the total original amount of the mortgage and the borrower's gross annual income. The figures are only for the loans granted in the year.

The following table shows the distribution by type of loan:

**Portfolio of residential mortagages**
*Million euros*

| | December 2011 | |
|---|---|---|
| | Portfolio | % of total UK portfolio |
| Residential mortgages | 198,789 | 82.1 |
| First Time Buyer | 33,010 | 13.6 |
| Mover | 71,295 | 29.4 |
| Remortgage | 94,484 | 39.0 |

First time buyer:customers who buy a home for the first time.
Mover: customers who change home with or without changing the bank that granted the mortgage.
Remortgage: customers who transfer their mortgage from another bank.

An additional indicator of the portfolio's good performance is the small volume of foreclosed homes (EUR 160 million at the end of 2011, only 0.07% of the total mortgage exposure). Efficient management of these cases and the existence of a dynamic market for this type of property which enables sales to take place in a short period contributed to the good results.

## E. Control function

The management process is also aided during the various phases of the risk cycle by the function of control. This provides a global vision of the Group's portfolio of loans with the sufficient level of detail, enabling the current risk position and its evolution to be assessed.

The objective of the control model is to assess the risk of solvency assumed in order to detect focuses of attention and propose measures that tend to correct eventual deterioration. It is therefore vital that to the control activity in the proper sense of the word is added an analysis component that facilitates proactivity regarding early detection of problems and the subsequent recommendation of action plans.

The evolution of risk with regard to budgets, limits and standards of reference is constantly and systematically controlled and the impact in future situations evaluated, both exogenous as well as those arising from strategic decisions, in order to establish measures that put the profile and volume of the portfolio of risks within the parameters set by the Group.

The control function is conducted by assessing risks from various perspectives and establishing as the main elements control by countries, business areas, management models, products and processes. This facilitates the detection of focuses of specific attention for decision-making.

The control processes, which ensure compliance with the Group's corporate criteria in credit risk management, were strengthened in 2011. Meanwhile, the homogeneous nature of the control model enabled standards in the flow of information to be established, their analysis by portfolios and monitoring of the main management metrics, in an exercise of coordination between the global area and the various units in which programmes were created with specific targets that enable the situation of each of the units to converge with the global model.

In 2006, under the corporate framework established in the Group for complying with the Sarbanes-Oxley Act, a tool was created in the Group's intranet to document and certify all sub processes, operational risks and controls that mitigate them. The Risks Division, as part of the Group, evaluates every year the efficiency of internal control of its activities.

### Analysis of scenarios

As part of its management of monitoring and continuous control, the Group conducts simulations of its portfolio using adverse scenarios and stress tests in order to assess the Group's solvency in the face of certain situations in the future. These simulations cover all the Group's most relevant portfolios and are done systematically using a corporate methodology which:

- Determines the sensitivity of risk factors (PD, LGD) to certain macroeconomic variables.
- Defines reference scenarios (at the global level as well as for each of the Group's units).
- Identifies rupture scenarios (levels as of which the sensitivity of risk factors to macroeconomic variables is more accentuated) and the distance of these scenarios from the current situation and the reference scenarios.
- Estimates the expected loss of each scenario and the evolution of the risk profile of each portfolio in the face of movements in certain macroeconomic variables.

The simulation models use the data of a complete economic cycle to measure the performance of risk factors in the face of changes in macroeconomic variables.

The scenarios take into account the vision of each unit as well as the global vision. The macroeconomic variables include:

- The unemployment rate
- Property prices
- GDP
- Interest rates
- Inflation

The analysis of scenarios enables senior management to better understand the foreseeable evolution of the portfolio in the face of market conditions and changing situations, and it is a key tool for assessing the sufficiency of the provisions established for stress scenarios.

The analysis of the baseline and acid scenarios for the whole Group and for each unit, with a time frame of three years, shows the strength of the balance sheet to different market and macroeconomic situations.

### EU Stress test exercises

In order to assess the solvency and resistance of banks to an adverse scenario, the European Banking Authority (EBA), in cooperation with the Bank of Spain, the European Central Bank, the European Commission and the European Systemic Risk Board, conducted in 2011 a stress test on 91 banks representing 65% of the total assets of the European banking system.

The EBA's stress test analysed the level of capital that banks would reach in 2012 and their evolution since the end of 2010 (the starting point) in two types of scenario: a benchmark scenario and an adverse one. The exercise assumed that the balance sheet remained without changes over its starting position, the business model remained constant by countries and product strategies, and there are no acquisitions or disposals. It therefore does not reflect the estimate that the bank's management could have of the development of the Group's results over the next two years. The banks submitted to the test had to have, initially, a Tier 1 core ratio of at least 5% in the most adverse scenario.

In the case of Santander, the stress tests showed the strength and validity of its business model. The results published on July 15, 2011 show that even in the most adverse scenario, the Group is able to generate profits, distribute dividends and continue to generate capital. Santander will end 2012 with a Tier 1 capital of 8.4% in the most adverse scenario and 8.9% including generic provisions.

These results compare very well with those of our competitors. Santander will be the bank that will post the most profits in the most adverse scenario (EUR 8,092 million in 2011 and 2012).

## F. Recovery activity

Recovery management is a strategic element in the bank's risk management.

In order to carry out this function, which is essentially a business activity, the bank has a corporate model of management which sets the guidelines and general rules to be applied in the countries where it operates, with the necessary adjustments on the basis of local business models and the economic situation of the respective environments.

This corporate model basically establishes procedures and management circuits on the basis of customers' features, making a distinction between massive level management with the use of multiple channels and a more personalised or segmented management with specific managers assigned.

As a result, with this segmentation in management, various mechanisms were established to ensure recovery management of customers in non-payment situations from the earliest phases to the writing off of the debt. The sphere of action of the recovery function begins the very first day of non-payment of the loan and ends when it has been paid or reclassified. Preventative management is conducted in some segments before a non-payment situation arises.

**Stress test results. Grupo Santander**

| | Baseline scenario | | Adverse scenario | |
|---|---|---|---|---|
| **Sufficiency of capital (million euros)** | **2011** | **2012** | **2011** | **2012** |
| Risk weighted assets (constant balance sheet assumption) | 613,279 | 622,571 | 626,921 | 650,979 |
| Common equity according to EBA definition | 47,002 | 59,374 | 45,053 | 54,364 |
| *Of which ordinary shares subscribed by the government* | 0 | 0 | 0 | 0 |
| Other existing subscribed government capital (before December 31, 2010) | 0 | 0 | 0 | 0 |
| Core Tier 1 capital (constant balance sheet assumption) | 47,002 | 59,374 | 45,053 | 54,364 |
| Tier 1 ratio (%) | 7.7% | 9.5% | 7.2% | 8.4% |
| **Results (million euros)** | | | | |
| Net interest income | 27,918 | 29,005 | 27,919 | 27,168 |
| Trading income | 895 | 895 | 352 | 352 |
| Other operating income | 1,530 | 1,128 | 2,323 | 2,355 |
| Operating profit before impairments | 21,954 | 22,639 | 22,207 | 21,487 |
| Operating profit after impairments and other losses from the stress test | 11,192 | 14,280 | 7,205 | 6,716 |
| Other income | -1,838 | -1,797 | -2,114 | -1,708 |
| Net profit after tax | 7,246 | 9,545 | 4,088 | 4,004 |

Source: European Banking Authority (EBA).

Recovery activity, understood as an integral business, is supported by constant reviewing of the management processes and methodology. It is backed by all the Group's capacities and with the participation and cooperation of other areas (commercial, resources, technology, human resources) as well as the development of technology solutions to improve effectiveness and efficiency.

In recoveries we have a practical and hands on training plan which deepens knowledge, facilitates the exchange of ideas and best practices and professionally develops teams, while always striving to integrate recovery activity into the Group's ordinary and commercial activity.

During 2011, the indicators for management of loan recoveries underscored the difficult economic situation of some countries where the Group operates, with a change in net entries that was higher than in 2010, mainly due to the local economic conditions and, consequently, greater difficulty in obtaining recovery results in these units. The management capacity has been ensured and new strategies implemented to increase the recovery of non-performing loans.

Nevertheless, the results for the recovery of written-off assets were very good. Action plans were put in place in countries designed to improve this line of activity, with proactive strategies defined at the level of each customer and type of portfolio. This made possible a greater degree of recovery in this line of activity than in previous years, and in relation to the evolution in the declaration of write offs.

As a way of early recognition and rigorous management of problematic loans in the portfolio, Grupo Santander takes into consideration portfolio sales as a possible alternative solution to be assessed. This activity, via a process of evaluation and commercialisation, enables the recovery results with recurrence vocation to be accelerated.

In addition, portfolio sales provide the following advantages:

- Avoid possible future deteriorations from changes in the macroeconomic environment.
- Avoid costs with low return.
- Reduce or adjust structures.
- Improve liquidity for other businesses.
- Ensure revenue recurrence in case of sales flows.

The Bank has specialised teams in this activity. They are responsible for relations with investors, identification of the portfolio, valuation (and subsequent back testing), management of the back office, as well as evaluating the legal and fiscal contingencies. In 2010, the creation of units specialised in this management was strengthened in the Group, particularly in Spain.

## 3.6 Other standpoints of credit risk

There are spheres and/or specific points in credit risk that deserve specialised attention and which complement global management.

### A. Risk of concentration

Control of risk concentration is a vital part of management. The Group continuously tracks the degree of concentration of its credit risk portfolios using various criteria: geographic areas and countries, economic sectors, products and groups of clients.

The board's risk committee establishes the policies and reviews the appropriate exposure limits for appropriate management of the degree of concentration of credit risk portfolios.

The Group is subject to the Bank of Spain regulation on large risks. In accordance with Circular 3/2008 (on determining and control of minimum equity) and subsequent changes, the value of all the risks that a credit institution contracts with the same person, entity or economic group, including that in the part which is non-consolidatable, cannot exceed 25% of its equity. The risks maintained with the same person, whether an individual or a company or an economic group, are considered large risks when their values exceeds 10% of the equity of the credit institution. The exception from this treatment are exposures to OECD governments and central banks.

At December 31, 2011, there were several financial groups that exceeded 10% of shareholders' funds: three EU financial institutions, two US financial entities and an EU central counterparty entity. After applying risk mitigation techniques and the rules for large risks, all of them were below 3.5% of eligible equity.

At December 31, 2011, the 20 largest economic and financial groups, excluding AAA governments and sovereign securities denominated in local currency, represented 5.0% of the outstanding credit risk of the Group's clients (lending plus guarantees), which compares favourably with the 6% in 2010.

The distribution of the portfolio of companies by sectors is adequately diversified. The chart below shows the distribution of the credit exposure in the Group's main units.

## Distribution of risk by sector Grupo Santander

*%*

*Rest includes sectors with concentration below 2%.

The Group's risks division works closely with the financial division to actively manage credit portfolios. Its activities include reducing the concentration of exposures through various techniques such as using credit derivatives and securitisation to optimise the risk-return relation of the whole portfolio.

## OTC derivatives: distribution by equivalent credit risk and market value including mitigation impact

*Million euros at December 31, 2011*

| | Total ECR | | | Total market value including mitigation impact(*) | | |
|---|---|---|---|---|---|---|
| | Trading | Hedging | Total | Trading | Hedging | Total |
| CDS Protection Acquired | 397 | 117 | 515 | 1,627 | 79 | 1,706 |
| CDS Protection Sold | 34 | 0 | 34 | -1,735 | -68 | -1,803 |
| TRS Total Return Swap | 0 | 0 | 0 | 0 | 0 | 0 |
| CDS Options | 0 | 0 | 0 | 0 | 0 | 0 |
| **Total credit derivatives** | **431** | **118** | **549** | **-107** | **10** | **-97** |
| Equity Forwards | 1 | 118 | 119 | 0 | -8 | -8 |
| Equity Options | 512 | 778 | 1,290 | -107 | -245 | -352 |
| Equity Swaps | 0 | 643 | 643 | 0 | 340 | 340 |
| Equity Spot | 0 | 0 | 0 | 0 | 0 | 0 |
| **Total equity derivatives** | **513** | **1,539** | **2,052** | **-107** | **88** | **-19** |
| Fixed-income Forwards | 30 | 99 | 130 | 0 | 75 | 75 |
| Fixed-income Options | 0 | 0 | 0 | 0 | 0 | 0 |
| Fixed-income Spot | 0 | 0 | 0 | 0 | 0 | 0 |
| **Total fixed income derivatives** | **30** | **99** | **130** | **0** | **75** | **75** |
| Asset Swaps | 1,312 | 2,360 | 3,672 | -22 | 311 | 289 |
| Exchange-rate Options | 302 | 264 | 566 | -168 | -24 | -192 |
| Exchange-rate Swaps | 4,346 | 11,655 | 16,001 | 437 | 1,256 | 1,693 |
| Other Exchange-rate Derivatives | 2 | 2 | 4 | -1 | 0 | -1 |
| **Total exchange rates** | **5,962** | **14,281** | **20,243** | **246** | **1,543** | **1,789** |
| Asset Swaps | 0 | 412 | 412 | 0 | 134 | 134 |
| Call Money Swaps | 349 | 52 | 401 | -187 | 14 | -173 |
| IRS | 20,432 | 16,596 | 37,028 | 562 | 5,186 | 5,748 |
| Forward Interest Rates | 16 | 21 | 37 | -25 | -19 | -43 |
| Other Interest-rate Derivatives | 1,215 | 1,574 | 2,789 | 871 | -848 | 23 |
| Interest Rate Structures | **229** | **599** | **828** | **135** | -434 | -298 |
| **Total interest-rate derivatives** | 22,240 | 19,254 | 41,494 | 1,357 | **4,034** | **5,391** |
| Commodities | 287 | 111 | 398 | 235 | 8 | 243 |
| **Total commodity derivatives** | **287** | **111** | **398** | **235** | **8** | **243** |
| **Total otc derivatives** | **29,464** | **35,402** | **64,866** | **1,623** | **5,759** | **7,381** |
| **Collateral** | **0** | **-11,508** | **-11,508** | | | |
| **Total** | **29,464** | **23,894** | **53,358** | | | |

(*) Market value used to take into account the impact of mitigating agreements in order to calculate the exposure by counterparty risk.

## B. Credit risk by activities in financial markets

This section covers credit risk generated in treasury activities with clients, mainly with credit institutions. This is developed through financing products in the money market with different financial institutions, as well as derivatives to provide service to the Group's clients.

Risk is controlled through an integrated system and in real time which enables us to know at any moment the exposure limit available with any counterparty, in any product and maturity and in all of the Group's units.

Risk is measured by its prevailing market as well as potential value (value of risk positions taking into account the future variation of underlying market factors in contracts). The equivalent credit risk (ECR) is the net replacement value plus the maximum potential value of these contracts in the future. The capital at risk or unexpected loss is also calculated (i.e. the loss which, once the expected loss is subtracted, constitutes the economic capital, net of guarantees and recovery).

The total exposure to credit risk from activities in the financial markets was 59.6% with credit institutions. By product type, the exposure to derivatives was 59.4%, mainly products without options, and 40.6% to liquidity products and traditional financing.

Derivative operations are concentrated in high credit quality counterparties; 56.6% of risk with counterparties has a rating equal to or more than A. The total exposure in 2011 in terms of equivalent credit risk amounted to EUR 53,358 million.

### Notional OTC derivative products by maturity

*Million euros at December 31, 2011*

| | 1 year | | | 1-5 years | | | 5-10 years | | | Over 10 years | | | Total REC | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | T | H | Total | T | H | Total | T | H | Total | T | H | Total | T | H | Total |
| CDS Protection Acquired | 19 | 9 | 28 | 226 | 11 | 237 | 27 | 58 | 85 | 126 | 39 | 166 | 397 | 117 | 515 |
| CDS Protection Sold | 8 | 0 | 8 | 17 | 0 | 17 | 9 | 0 | 9 | 0 | 0 | 0 | 34 | 0 | 34 |
| TRS Total Return Swap | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| CDS Options | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| **Total credit derivatives** | **26** | **9** | **35** | **243** | **11** | **254** | **36** | **58** | 94 | **126** | **40** | **166** | **431** | **118** | **549** |
| Equity Forwards | 1 | 118 | 119 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 1 | 118 | 119 |
| Equity Options | 314 | 319 | 633 | 196 | 392 | 588 | 3 | 58 | 61 | 0 | 9 | 9 | 512 | 778 | 1,290 |
| Equity Swaps | 0 | 296 | 296 | 0 | 344 | 344 | 0 | 3 | 3 | 0 | 0 | 0 | 0 | 643 | 643 |
| Equity Spot | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| **Total equity derivatives** | **315** | **733** | **1,048** | **196** | **736** | **931** | **3** | **61** | **64** | **0** | **9** | **9** | **513** | **1,539** | **2,052** |
| Fixed-income Forwards | 30 | 99 | 129 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 30 | 99 | 130 |
| Fixed-income Options | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Fixed-income Spot | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| **Total fixed income derivatives** | **30** | **99** | **129** | 0 | **0** | **0** | **0** | **0** | **0** | **0** | **0** | **0** | **30** | **99** | **130** |
| Asset Swaps | 985 | 1,902 | 2,887 | 323 | 442 | 765 | 4 | 16 | 20 | 0 | 0 | 0 | 1,312 | 2,360 | 3,672 |
| Exchange-rate Options | 211 | 254 | 465 | 90 | 11 | 101 | 0 | 0 | 0 | 0 | 0 | 0 | 302 | 264 | 566 |
| Exchange-rate Swaps | 1,549 | 1,782 | 3,331 | 1,666 | 5,821 | 7,487 | 1,132 | 2,045 | 3,536 | 0 | 1,647 | 1,647 | 4,346 | 11,655 | 16,001 |
| Other exchange-rate Derivatives | 2 | 2 | 4 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 2 | 2 | 4 |
| **Total exchange rates** | **2,747** | **3,941** | **6,688** | **2,079** | **6,274** | **8,353** | **1,136** | **2,421** | **3,556** | **0** | **1,647** | **1,647** | **5,962** | **14,281** | **20,243** |
| Asset Swaps | 0 | 2 | 2 | 0 | 36 | 36 | 0 | 77 | 77 | 0 | 297 | 297 | 0 | 412 | 412 |
| Call Money Swaps | 167 | 27 | 195 | 156 | 12 | 168 | 12 | 12 | 24 | 14 | 0 | 14 | 349 | 52 | 401 |
| IRS | 353 | 636 | 989 | 4,169 | 5,120 | 9,289 | 5,201 | 3,871 | 9,072 | 10,079 | 6,970 | 17,678 | 20,432 | 16,596 | 37,028 |
| Forward Interest Rates | 16 | 21 | 37 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 16 | 21 | 37 |
| Other Interest-rate Derivatives | 1 | 107 | 108 | 21 | 468 | 488 | 117 | 468 | 584 | 1,076 | 531 | 1,608 | 1,215 | 1,574 | 2.789 |
| Interest Rate Structures | 35 | 57 | 92 | 83 | 106 | 189 | 25 | 31 | 56 | 85 | 405 | 490 | 229 | 599 | 828 |
| **Total interest-rate derivatives** | **573** | **850** | **1,422** | **4,429** | **5,742** | **10,171** | **5,354** | **4,460** | **9,814** | **11,884** | **8,202** | **20,087** | **22,240** | **19,254** | **41,494** |
| Commodities | 122 | 45 | 166 | 146 | 66 | 212 | 20 | 0 | 20 | 0 | 0 | 0 | 287 | 111 | 398 |
| **Total Commodity derivatives** | **122** | **45** | **166** | **146** | **66** | **212** | **20** | **0** | **20** | **0** | **0** | **0** | **287** | **111** | **398** |
| **Total OTC derivatives** | **3,813** | **5,676** | **9,489** | **7,092** | **12,829** | **19,921** | **6,548** | **7,000** | **13,549** | **12,011** | **9,897** | **21,908** | **29,464** | **35,402** | **64,866** |
| **Collateral** | | | | | | | | | | | | | **0** | **-11,508** | **-11,508** |
| **Total** | | | | | | | | | | | | | **29,464** | **23,894** | **53,358** |

H = Hedging
T = Trading

**Distribution of risk in OTC derivatives by rating of counterparty**

| Rating | % |
|---|---|
| AAA | 11.7 |
| AA | 9.8 |
| A | 35.1 |
| BBB | 19.4 |
| BB | 21.0 |
| B | 2.3 |
| Rest | 0.7 |

**Distribution of risk in OTC derivatives by type of counterparty**

**Distribution of risk in OTC derivatives by geographic areas**

**Evolution of country-risk subject to provisions and provisions assigned**

*Million euros*

The distribution of risk in derivatives by type of counterparty was 46% with banks, 33% with large companies and 9% with SMEs.

As regards the geographic distribution of risk, 13% is with Spanish counterparties, 18% with UK counterparties (mainly Santander UK's operations), 30% the rest of Europe, 10% the US and 14% Latin America.

### Actividad in credit derivatives

Grupo Santander uses credit derivatives to cover loans, customer business in financial markets and, to a lesser extent, within trading operations. The volume of this activity is small compared to that of our peers and, moreover, is subject to a solid environment of internal controls and minimising operational risk.

The risk of these activities is controlled via a broad series of limits such as VaR, nominal by rating, sensitivity to the spread by rating and name, sensitivity to the rate of recovery and to correlation. Jump-to-default limits are also set by individual name, geographic area, sector and liquidity.

In notional terms, the CDS position incorporates EUR 57,220 million of acquired protection and EUR 51,212 million of sold protection.

At December 31, 2011, for the Group's trading activity, the sensitivity of lending to increases in spreads of one basis point was minus EUR 0.3 million, and the average VaR during the year was EUR 10.6 million. Both were significantly lower than in 2010 (sensitivity of –EUR 1.5 million and average VaR of EUR 17.2 million).

## C. Country risk

Country risk is a credit risk component in all cross-border credit operations for circumstances different to the usual commercial risk. Its main elements are sovereign risk, the risk of transfer and other risks which could affect international financial activity (wars, natural disasters, balance of payments crisis, etc).

The exposure susceptible to country-risk provisions at the end of 2011 was EUR 380 million, of which EUR 19 million corresponded to intragroup operations. At the end of 2010, the total country risk in need of provisions was EUR 435 million. Total provisions in 2011 stood at EUR 55 million compared with EUR 69 million in 2010.

The country risk management principles continued to follow maximum prudence criteria, assuming country risk in a very selective way in operations clearly profitable for the Group, and which strengthen the global relationship with customers.

## D. Sovereign risk

As a general criterion, sovereign risk is that contracted in transactions with a central bank (including the regulatory cash reserve requirement), the issuer risk of the Treasury or the Republic (portfolio of state debt) and that arising from operations with public institutions with the following features: their funds only come from institutions directly integrated into the state sector; and their activities are of a non-commercial nature.

At December 31, 2011, according to Santander's criteria, Europe accounted for 56.3% of total risk, Latin America 35.4%, the US 7.3% and others 1.0%. Of note in Europe were Spain (29.8%), the UK (16.1%) and in Latin America Brazil (24.3%) and Mexico (6.6%). Total risk was higher than in 2010 largely because of the increase in sovereign risk positions with Spain, Germany, the US and Mexico, and the incorporation of the positions of Banco Zachodni (concentrated in Poland) to the perimeter of consolidation, which were partly offset by a reduction of positions with the UK and Switzerland.

As regards the European peripheral countries, their share of the total portfolio is low: Portugal (2.0%), Italy (0.4%), Ireland (0.02%) and Greece (0.04%).

Latin America's exposure to sovereign risk mainly comes from the obligations to which our subsidiary banks are subject for constituting certain deposits in the corresponding central banks as well as from fixed-income portfolios maintained as part of the structural interest rate risk management strategy. These exposures are in local currency and are financed by locally captured customer deposits, also denominated in local currency. The exposures to sovereign risk of Latin American issuers denominated in currencies other than the official one of the country of issue amounted to EUR 2,462 million (3.5% of total sovereign risk with Latin American issuers).

## E. Environmental risk

Analysis of the environmental risk of credit operations is one of the main aspects of the strategic plan of corporate social responsibility. It revolves around the following two large points:

- Equator principles: this is an initiative of the World Bank's International Financial Corporation. It is an international standard for analysing the social and environmental impact of project finance operations. The assumption of these principles represents a commitment to evaluating, on the basis of sequential methodology, the social and environmental risks of the projects financed:
  - For operations with an amount equal to or more than $10 million, an initial questionnaire is filled out, of a generic nature, designed to establish the project's risk in the socio-environmental sphere (according to categories A, B and C or greater to lower risk, respectively) and the operation's degree of compliance with the Equator Principles.
  - For those projects classified within the categories of greater risk (categories A and B), a more detailed questionnaire has to be filled out, adapted according to the sector of activity.
  - According to the category and location of the projects a social and environmental audit is carried out (by independent external auditors). Specific questionnaires have been developed for those sectors where the bank is most active. The bank also gives training courses in social and environmental matters to risk teams as well as to those responsible for business.
- VIDA tool: used since 2004, its main purpose is to assess the environmental risk of corporate clients, both current and potential, through a system that classifies in seven categories each of the companies on the basis of the environmental risk contracted. In 2011, 39,575 companies were assessed by this tool in Spain (total risk of EUR 59,770 million).

**Environmental risk classification**

*Billion euros*

Note: VIDA companies assessed in the retail banking network in Spain.
VB: very low; L: low; M: medium and A: high.

Low or very low environmental risk accounts for 78.3% of total risk. In 2011, there was a sharp fall in medium environmental risk (54.4% less than in 2010).

# 4. Market risk

## 4.1 Activities subject to market risk

The perimeter for measuring, controlling and monitoring the area of market risk covers those operations where equity risk is assumed. This risk comes from the change in interest rates, exchange rates, shares, the spread on loans, raw material prices and from the volatility of each of these elements, as well as the liquidity risk of the various products and markets in which the Group operates.

On the basis of the finality of the risk, activities are segmented in the following way:

a) **Trading:** this includes financial services for customers and the buying and selling and positioning mainly in fixed-income, equity and currency products.

b) **Balance Sheet Management:** Interest rate and liquidity risk arises from mismatches between maturities and repricing of assets and liabilities. It also includes active management of credit risk inherent in the Group's balance sheet.

c) **Structural risks:**

- Structural Exchange-Rate Risk/Hedging of Results: Exchange rate risk, due to the currency in which the investment is made, both in companies that consolidate and do not consolidate (structural exchange rate) and exchange rate risk arising from the hedging of future results generated in currencies other than the euro (hedging of results).
- Structural equity: This covers equity stake investments in financial and non-financial companies that do not consolidate, generating risk in equities.

The Treasury area is responsible for managing the taking of trading activity positions.

The Financial Management area is responsible for the centralised management of these structural risks, applying standardised methodologies, adapted to each market where the Group operates. In the area of convertible currencies, financial management directly manages the parent bank's risks and coordinates management of the rest of the units which operate in these currencies. The management decisions for these risks are taken by each country's ALCO committee and, in the last instance, by the markets committee of the parent bank.

The aim of financial management is to inject stability and recurrence into the net interest margin of commercial activity and the Group's economic value by maintaining appropriate levels of liquidity and solvency.

Each of these activities is measured and analysed with different tools in order to show in the most precise way their risk profile.

## 4.2 Methodologies

### A. Trading Activity

The standard methodology that Grupo Santander applied to trading activities during 2011 was Value at Risk (VaR), which measures the maximum expected loss with a certain confidence level and time frame. The standard for historic simulation is a confidence level of 99% and a time frame of one day. Statistical adjustments are applied enabling the most recent developments that condition the levels of risk assumed to be efficiently and quickly incorporated. A time frame of two years or at least 520 days from the reference date of the VaR calculation is used.[1] Two figures are calculated every day, one applying an exponential decline factor which accords less weight to the observations furthest away in time and another with the same weight for all observations. The reported VaR is the higher of the two.

The VaR is not the only measure used. It is used because it is easy to calculate and is a good reference for the Group's level of risk. There are also other measures that allow greater control of risks in all the markets where the Group operates.

They include analysis of scenarios which define alternatives for the performance of different financial variables and provide the impact on results. These scenarios can replicate critical developments or circumstances that happened in the past (such as a crisis) or determine plausible alternatives that are not concerned with past events. A minimum of three types of scenario are given: plausible, severe and extreme, and a VaR is obtained as well as a much fuller picture of the risk profile.

The market risk area, at the level of each unit and globally and following the principle of independence of the business units, carries out daily monitoring of positions, through an exhaustive control of the changes that take place in the portfolios in order to detect possible new developments for immediate correction. The daily preparation of the income statement is an excellent indicator of risk levels, as it enables us to identify the impact of changes on financial variables in the portfolios.

1. Since October 2011, the stressed VaR began to be calculated with the same methodology as for the usual VaR, but using as a time frame a fixed frame of one year, which covers a representative market crisis period for the trading portfolio of each unit within the perimeter of the internal model .

Lastly, in order to control derivative activities and credit management, because of its atypical nature, specific measures are conducted daily. In the first case, sensitivity to the price movements of the underlying asset (delta and gamma), volatility (vega) and time (theta) is controlled. In the second case, measures such as the spread sensitivity, jump-to-default, and concentration of positions by rating levels, etc, are systematically reviewed.

As regards the credit risk inherent in trading portfolios and in line with the recommendations of the Basel Committee on Banking Supervision and prevailing regulations, an additional measurement began to be calculated (incremental risk charge, IRC), in order to cover the risk of default and rating migration that is not adequately captured in the VaR, via changes in lending spreads. The controlled products are basically fixed-rate bonds, both public and private sector, derivatives on bonds (forwards, options, etc) and credit derivatives (credit default swaps, asset backed securities, etc). The method for calculating the IRC is based on direct measurements of the tails of the distribution of losses to the appropriate percentile (99.9%). The Monte Carlo methodology is used, applying a million simulations.

## B. Balance sheet management

### Interest rate risk

The Group analyzes the sensitivity of net interest margin and market value of equity to changes in interest rates. This sensitivity arises from gaps in maturity dates and the review of interest rates in the different asset and liability items.

On the basis of the positioning of balance sheet interest rates, as well as the situation and outlook for the market, the financial measures are agreed to adjust the positioning to that desired by the bank. These measures range from taking positions in markets to defining the interest rate features of commercial products.

The metrics used by the Group to control interest rate risk in these activities are the interest rate gap, the sensitivity of net interest margin and of net worth to changes in interest rates, Value at Risk (VaR) and analysis of scenarios.

#### a) Interest rate gap of assets and liabilities

Interest rate gap analysis focuses on lags or mismatches between changes in the value of asset, liability and off-balance sheet items. It provides a basic representation of the balance sheet structure and allows for the detection of interest rate risk by concentration of maturities. It is also a useful tool for estimating the impact of eventual interest rate movements on net interest margin or equity.

All on- and off-balance sheet items must be disaggregated by their flows and looked at in terms of repricing/maturity. In the case of those items that do not have a contractual maturity, an internal model of analysis is used and estimates made of the duration and sensitivity of them.

#### b) Net interest margin sensitivity (NIM)

The sensitivity of net interest margin measures the change in the short/medium term in the accruals expected over a particular period (12 months), in response to a shift in the yield curve.

It is calculated by simulating the net interest margin, both for a scenario of a shift in the yield curve as well as for the current situation. The sensitivity is the difference between the two margins calculated.

#### c) Market value of equity sensitivity (MVE)

This is an additional measure to the sensitivity of the net interest margin.

It measures the interest risk implicit in net worth (equity) on the basis of the impact of a change in interest rates on the current values of financial assets and liabilities.

#### d) Value at Risk (VaR)

The Value at Risk for balance sheet activity and investment portfolios is calculated with the same standard as for trading: maximum expected loss under historic simulation with a confidence level of 99% and a time frame of one day. As for the trading portfolios, a time frame of two years, or 520 daily figures, is used, obtained from the reference date of the VaR calculation back in time.

#### e) Analysis of scenarios

Two scenarios for the performance of interest rates are established: maximum volatility and severe crisis. These scenarios are applied to the balance sheet, obtaining the impact on net worth as well as the projections of net interest margin for the year.

### Liquidity risk

Liquidity risk is associated with the Group's capacity to finance its commitments, at reasonable market prices, as well as carry out its business plans with stable sources of funding. The Group permanently monitors maximum gap profiles.

The measures used for liquidity risk control in balance sheet management are the liquidity gap, liquidity ratios, stress scenarios and contingency plans.

#### a) Liquidity gap

The liquidity gap provides information on contractual and expected cash inflows and outflows for a certain period of time, for each of the currencies in which the Group operates. The gap measures the net need or net excess of funds at a particular date, and reflects the level of liquidity maintained under normal market conditions.

Two types of liquidity gap analysis are made, on the basis of the balance sheet item:

**1. Contractual liquidity gap:** All on-and off-balance sheet items are analysed provided they contribute cash flows placed in the point of contractual maturity. For those assets and liabilities without a contractual maturity, an internal analysis model is used, based on statistical research of the historical series of products, and which determines what we call the stability and instability impact for liquidity purposes.

**2. Operational liquidity gap:** This is a scenario in normal conditions of liquidity profile, as the flows of the balance sheet items are placed in the point of probable liquidity and not in the point of contractual maturity. In this analysis defining the behaviour scenario —renewal of liabilities, discounts in sales of portfolios, renewal of assets— is the fundamental point.

### b) Liquidity ratios

The liquidity coefficient compares liquid assets available for sale (after applying the relevant discounts and adjustments) with total liabilities to be settled, including contingencies. This coefficient shows, for currencies that cannot be consolidated, the level of immediate response to firm commitments.

Net accumulated illiquidity is defined as the 30-day accumulated gap obtained from the modified liquidity gap. The modified contractual liquidity gap is drawn up on the basis of the contractual liquidity gap and placing liquid assets in the point of settlement or repos and not in their point of maturity. This indicator is calculated for each of the main currencies.

In addition, other ratios or metrics regarding the structural position of liquidity are followed:

- Loans/net assets.
- Customer deposits, insurance and medium and long-term financing/lending.
- Customer deposits, insurance and medium and long-term financing, shareholders' funds and other liabilities/the sum of credits and fixed assets.
- Short-term financing/net liabilities.
- Survival horizon.

### c) Analysis of scenarios/Contingency plan

The Group's liquidity management focuses on taking all the necessary measures to prevent a crisis. Liquidity crises, and their immediate causes, cannot always be predicted. Consequently, the Group's contingency plans concentrate on creating models of potential crises by analyzing different scenarios, identifying crisis types, internal and external communications and individual responsibilities.

The contingency plan covers the sphere of activity of a local unit and of central headquarters. It specifies clear lines of communication at the first sign of crisis and suggests a wide range of responses to different levels of crisis.

As a crisis can occur locally or globally, each local unit must prepare a contingency financing plan. The contingency plan of each local unit must be communicated to the central unit at least every six months so that it can be reviewed and updated. These plans, however, must be updated more frequently if market circumstances make it advisable.

Lastly, Grupo Santander continues to actively participate in the process opened by the Basel Committee and other international institutions to strengthen the liquidity of banks[2], with a two-pronged approach: on the one hand, participating in calibrating the regulatory changes raised —basically, the introduction of two new ratios: Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR)— and, on the other, being present in the different forums to discuss and make suggestions on the issue (European Banking Federation, etc), maintaining in both cases close co-operation with the Bank of Spain.

2. Basel III: International framework for liquidity risk measurement, standards and monitoring (Basel Committee on Banking Supervision, December 2010).

## C. Structural exchange-rate risk/Hedging of results/Structural equity

These activities are monitored by position measures, VaR and results.

## D. Additional measures

### Back-testing

Back-testing is an a posteriori comparative analysis between Value at Risk (VaR) estimates and the "clean" daily results actually generated (results of the portfolios at the end of the day valued at the next day's prices). The purpose of these tests is to verify and measure the precision of the models used to calculate VaR.

The back-testing analysis carried out by Grupo Santander complies, as a minimum, with the BIS recommendations regarding the verification of the internal systems used to measure and manage market risks. In addition, back-testing includes the hypothesis test: tests of excess, normality, Spearman rank correlation, measures of excess average, etc.

The valuation models are fine-tuned and tested regularly by a specialized unit.

### Analysis of scenarios

The potential impact on results of applying different stress scenarios on all the trading portfolios and using the same suppositions by risk factor is calculated and analysed regularly (at least every month).

In addition, there are triggers for global scenarios, on the basis of the historic results of these scenarios and the capital associated with the portfolio in question. If these triggers are surpassed those in charge of managing the portfolio are notified so that the pertinent measures can be taken. The results of stress exercises at the global level, as well as the possible excesses on the triggers are regularly reviewed by the global committee of market risk, so that, if necessary, senior management can be informed.

### Coordination with other areas

Every day work is carried out jointly with other areas to offset the operational risk. This entails the conciliation of positions, risks and results.

# 4.3. Control system

## A. Definition of limits

The process of setting limits takes place together with the budgetary process, and is the means used by the Group to establish the level of equity that each activity has available. The process of definition of limits is dynamic, and responds to the level of risk appetite considered acceptable by senior management.

## B. Objectives of the structure of limits

The structure of limits require a process that takes into account the following aspects, among others:

- Identify and define, efficiently and comprehensively, the main types of risk incurred so that they are consistent with the management of business and with the strategy drawn up.
- Quantify and inform the business areas of the risk levels and profile that senior management believes can be assumed, in order to avoid undesired risks.
- Give flexibility to the business areas to build risk positions efficiently and opportunely according to changes in the market, and in the business strategies, and always within the risk levels regarded as acceptable by the entity.
- Allow the generators of business to assume prudent risks but sufficient to attain the budgeted results.
- Define the range of products and underlying assets with which each treasury unit can operate, bearing in mind features such as the model and valuation systems, the liquidity of the tools used, etc.

# 4.4. Risks and results in 2011

## A. Trading activity

**Quantitative analysis of VaR in 2011**

The Group's risk performance with regard to trading activity in financial markets during 2011, as measured by VaR, was as follows:

**Evolution of VaR during 2011**

*Million euros. VaR at 99% with a time frame of one day*

VaR during 2011 fluctuated between EUR 12 million and EUR 34 million. It rose as of the end of April to a maximum for the year of EUR 33.2 million on May 24, due to an increase in interest rate and exchange rate risk in Spain and Brazil. The increase in VaR during the first half of July was due to the rise in exchange rate risk and volatility in Brazil. As of then, dynamic management of portfolios, together with a reduction in exchange rate and interest rate risk in the treasuries of Madrid and Brazil, produced a downward path until the end of the year.

The VaR reported as of November 15, 2011 excludes the risk from changes in the credit spreads of securitisations and portfolios affected by credit correlation. For regulatory reasons (BIS 2.5), these exposures are considered as banking book for capital purposes. This change caused a decline in risk in VaR terms, both at the total level as well as by credit spread.

The average VaR of the Group's trading portfolio in 2011 (EUR 22.4 million) was lower than in 2010 (EUR 28.7 million), even though volatility remained high in markets because of Europe's sovereign debt crisis. Meanwhile, in relation to other comparable financial groups, the Group has a low trading risk profile. Dynamic management of it enables the Group to adopt changes of strategy in order to exploit opportunities in an environment of uncertainty.

The histogram below shows the distribution of average risk in terms of VaR during 2011. It was between EUR 16.5 million and EUR 30.5 million on 81.9% of days. The higher values of EUR 30.5 million (3.5%) were concentrated in the central months of the year, mainly due to the increased volatility in the Brazilian the euro zone's sovereign debt crisis.

## VaR risk histogram

*Number of days (%)/ VaR in million euros. VaR at 99% with a time frame of one day*

### Risk by factor

The minimum, average, maximum and year-end 2011 values in VaR terms are shown below:

## VaR statistics by risk factor[3]

*Million euros. VaR at 99% with a time frame of one day*

| | Minimum | Average | Maximum | Year-end |
|---|---|---|---|---|
| **Total Trading Total VaR** | **12.0** | **22.4** | **33.2** | **15.9** |
| *Diversification effect* | *(12.2)* | *(21.8)* | *(34.7)* | *(16.7)* |
| Interest Rate VaR | 8.6 | 14.8 | 21.8 | 14.6 |
| Equity VaR | 2.2 | 4.8 | 22.7 | 3.7 |
| FX VaR | 1.3 | 9.0 | 24.1 | 4.2 |
| Credit Spread VaR | 6.7 | 15.0 | 23.0 | 9.6 |
| Commodities VaR | 0.2 | 0.6 | 3.9 | 0.4 |
| **Latin America Total VaR** | **4.9** | **11.7** | **23.7** | **10.7** |
| *Diversification Effect* | *(2.4)* | *(6.4)* | *(12.5)* | *(8.7)* |
| Interest Rate Var | 5.3 | 11.2 | 18.5 | 10.5 |
| Equity VaR | 1.3 | 3.5 | 9.6 | 2.2 |
| FX VaR | 0.6 | 3.7 | 19.2 | 1.2 |
| **US and Asia Total VaR** | **0.6** | **1.2** | **3.0** | **0.9** |
| *Diversification Effect* | *(0.1)* | *(0.5)* | *(2.4)* | *(0.4)* |
| Interest Rate VaR | 0.5 | 0.9 | 2.2 | 0.9 |
| Equity VaR | 0.0 | 0.1 | 2.9 | 0.1 |
| FX VaR | 0.2 | 0.6 | 1.7 | 0.4 |
| **Europe VaRD Total** | **8.3** | **15.5** | **24.7** | **10.1** |
| *Diversification Effect* | *(8.2)* | *(15.1)* | *(25.0)* | *(13.0)* |
| Interest Rate VaR | 5.9 | 11.5 | 18.9 | 11.9 |
| Equity VaR | 1.5 | 3.9 | 17.4 | 3.6 |
| FX VaR | 0.9 | 8.5 | 15.2 | 3.9 |
| Credit Spread VaR | 2.7 | 6.0 | 11.4 | 3.3 |
| Commodities VaR | 0.2 | 0.6 | 3.9 | 0.4 |
| **Global Activties Total VaR** | **6.5** | **10.5** | **15.9** | **9.7** |
| *Diversification Effect* | *(0.5)* | *(1.1)* | *(4.1)* | *(0.9)* |
| Interest Rate VaR | 0.3 | 0.4 | 0.7 | 0.5 |
| Credit Spread VaR | 6.0 | 10.3 | 17.0 | 8.4 |
| FX VaR | 0.0 | 0.9 | 2.3 | 1.8 |

In Latin America, the US and Asia the credit spread VaR and the commodities VaR are not shown separately because of their scant or zero materiality.

3. The VaR of global activities includes operations that are not assigned to any particular country, such as Active Credit Portfolio Management and Non-core Legacy Portfolio.

The average VaR was EUR 6.3 million lower than in 2010. The reduction was in all risk factors, particularly in the credit spread and equities, which dropped from EUR 20.9 million and EUR 8.0 million to EUR 15.0 million and EUR 4.8 million, respectively.

The evolution of VaR during 2011 highlighted the Group's flexibility and agility in adapting its risk profile on the basis of changes in strategy caused by a perception different to that of expectations in the markets.

### Distribution of economic risks and results

Of note were the transitory balances in VaR by exchange rate, caused by the significant changes in the positions opened in foreign currencies. The drop in VaR by credit spread as of November 15 is explained by the aforementioned exclusion from the risk spread of securitisations and the correlation of credit which as BIS 2.5 are considered as banking book for the purposes of regulatory capital.

## Distribution of economic risks and results in 2011

*Million euros. VaR at 99% with a time frame of one day*

### a) Geographic distribution

Latin America contributed on average 28.3% of the Group's total VaR in trading activity and 34.5% in economic results. Europe, with 49.2% of global risk, contributed 70.8% of results, as most of its treasury activity focused on professional and institutional clients. Global activities, with 22.2% of the Group's total VaR, contributed a negative 6.3% in economic results, hit by the euro zone's sovereign debt crisis and the general rise in financial credit and corporate spreads.

Below is the geographic contribution (by percentage), both in risks, measured in VaR terms, as well as in results (economic terms).

**Risk statistics 2011**

*%. VaR at 99% with a time frame of one day*

### b) Monthly distribution of risks and results

The next chart shows the risk assumption profile, in terms of VaR as opposed to results. The average VaR remained stable until September and then declined, while results evolved in a more irregular way during the year. The first months were positive until March and then negative until November when they were well below the annual average due to the worsening of the euro zone's sovereign debt crisis.

**Distribution of risk by time and results in 2011**

*% of annual total. VaR at 99% with a time frame of one day*

The following histogram of frequencies shows the distribution of daily economic results on the basis of their size. The daily yield[4] was between -EUR 5 and +EUR 15 million on 70% of days when the market was open.

**Histogram of the frequency of daily results MtM**

*Number of days (%)*

4. Yields "clean" of commissions and results of intraday derivative operations.

### Risk management of structured derivatives market

Structured derivatives activity is mainly focused on designing investment products and hedging risks for clients.

These transactions include options on equities, fixed-income and exchange rates.

The units where this activity mainly takes place are: Madrid, Banesto, Santander UK, Brazil and Mexico, and, to a lesser extent, Chile and Portugal.

The chart below shows the VaR Vega[5] performance of structured derivatives business in 2011. It was downward in the first part of the year. In the second, there were two episodes of significant increase in the VaR: the first, during the first half of August, after the increase in volatility in equity markets because of the euro zone's crisis and the second, during the second half of September, because of the increased volatility of Brazil's interest rates.

**Evolution of risk (VaR) of the business of structured derivatives in 2011**

*Million euros. VaR at 99% with a time frame of one day*

The following table shows the average, maximum and minimum values for each of the units where these transactions were carried out.

**Structured derivatives risk (VaR) in 2011 by unit**

*Million euros. VaR at 99% with a time frame of one day*

| | Minimum | Average | Maximum | Year-end |
|---|---|---|---|---|
| **Total VaR Vega** | **2.6** | **4.7** | **9.9** | **4.9** |
| Madrid | 1.4 | 2.9 | 6.9 | 2.8 |
| Banesto | 0.8 | 2.3 | 5.9 | 2.4 |
| Santander UK | 0.5 | 1.4 | 4.4 | 2.7 |
| Brazil | 0.1 | 0.8 | 6.1 | 0.3 |
| Mexico | 0.5 | 1.2 | 3.0 | 1.1 |

The average risk in 2011 (EUR 4.7 million) was lower than in 2010 (EUR 7.9 million), due to the decline in the exposure opened in financial instruments linked to volatility.

Regarding VaR by risk factor, the exposure, on average, was concentrated in equities, followed by interest rates, exchange rates and commodities. This is shown in the following table:

**Structured derivatives risk (VaR) in 2011 by risk factor**

*Million euros. VaR at 99% with a time frame of one day*

| | Minimum | Average | Maximum | Year-end |
|---|---|---|---|---|
| **Total VaR Vega** | **2.6** | **4.7** | **9.9** | **4.9** |
| *Diversification impact* | *(1.6)* | *(2.9)* | *(5.8)* | *(3.7)* |
| Interest rate VaR | 1.1 | 2.0 | 3.2 | 2.0 |
| Equity VaR | 1.9 | 4.1 | 8.7 | 5.2 |
| FX VaR | 0.2 | 1.2 | 8.8 | 1.0 |
| Commodities VaR | 0.1 | 0.3 | 0.7 | 0.4 |

### Gauging and contrasting measures

In accordance with the BIS recommendations on gauging and controlling the effectiveness of internal financial risk measurement and management systems, in 2011 the Group regularly carried out analysis and contrasting measures which confirmed the reliability of the model.

There were three exceptions of VaR at 99% in 2011 (days when the daily loss was higher than the VaR): August 4 and August 8, mainly due to the sharp rise in credit spreads, the abrupt fall in stock markets and the depreciation of most currencies against the US dollar, because of the worsening of the euro zone's sovereign debt crisis and the renewed fears of strong downturn in the global economy, and September 12, due to the significant increase in credit spreads, mainly financial and Greece's.

5. Vega, a Greek term, means here the sensitivity of the value of a portfolio to changes in the price of market volatility.

## Backtesting of business portfolios: daily results versus previous day´s value at risk

*Million euros*

### Analysis of scenarios

Various scenarios were analyzed and calculated regularly in 2011 (at least monthly), at the global and local levels, particularly trading portfolios and using the same suppositions by risk factor.

The chart below shows the results at December 31, 2011 for a scenario of maximum volatility, applying six standard deviations in various market factors for the trading portfolios.

### Maximum volatility scenario

The table below shows, at December 31, 2011, the results by rick factor of (interest rates, equities, exchange rates, spreads on loans, commodities and the volatility of each one of them), in a scenario in which volatility equivalent to six standard deviations in a normal distribution is applied. This scenario is based on taking for each risk factor the movement that represents a greater potential loss in the global portfolio. For the year-end, this scenario involved rises in interest rate in Latin American markets and falls in core markets ("flight into quality"), declines in stock markets, the depreciation of all currencies against the euro, greater volatility and spreads on loans.

## Maximum volatility stress test[9]

*Million euros*

| | Interest rates | Equities | Exchange rates | Credit spread | Commodities | Total |
|---|---|---|---|---|---|---|
| **Total trading** | **-51.4** | **-35.2** | **-19.9** | **-23.4** | **-1.0** | **-130.8** |
| Europe | -5.5 | -26.4 | -16.7 | -5.6 | -1.0 | **-55.2** |
| Latin America | -44.7 | -8.7 | -2.4 | 0.0 | 0.0 | **-55.7** |
| US | -1.4 | -0.1 | -0.8 | 0.0 | 0.0 | **-2.2** |
| Global activities | 0.2 | 0.0 | 0.0 | -17.8 | 0.0 | **-17.7** |

The stress test shows that the economic loss suffered by the Group in its trading portfolios, in terms of the Mark to Market (MtM) result would be, if the stress movements defined in the scenario materialized, EUR 131 million, a loss that would be distributed between Europe (equities, exchange rates and spreads on loans), Latin America (interest rate) and global activities (credit spreads).

## B. Balance sheet management[6]

### B1. Interest rate risk

#### a) Convertible currencies

At the end of 2011, the sensitivity of net interest margin at one year to parallel rises of 100 basis points was concentrated in the sterling interest rate curve, with Santander UK contributing the most (£191 million). In the euro interest rate curve the risk was substantially reduced over the end of 2010 to EUR 96 million, stemming from the greater concentration from the sensitivity of the consumer unit in Germany (EUR 66 million, excluding its subsidiaries in Austria and Belgium). As regards the US dollar curve, the greater concentration comes from the US subsidiary ($76 million). The sensitivity of the rest of convertible currencies was not very significant.

At the same date, the sensitivity of equity to parallel rises in the yield curve of 100 basis points in the euro interest rate curve was EUR 723 million, most of it in the parent bank, although lower than at the end of 2010. As regards the curve in sterling it was £376 million.

In accordance with the current environment of low interest rates, the Bank maintains a positive sensitivity, both in net interest margin (NIM) and to interest rate rises.

#### b) Latin America

*1. Quantitative analysis of risk*

The interest rate risk of Latin America's balance sheet management portfolios, measured in terms of net interest margin (NIM) to a parallel movement of 100 basis points, in the yield curve remained during 2011 at low levels.

In terms of equity sensitivity, interest risk fluctuated in a range of between EUR 753 million and EUR 1,036 million. The sensitivity increased as of April mainly because of growth in lending and the ALCO portfolio in Brazil and the rise in fixed-rate loans in Mexico, after incorporating the portfolio of loans acquired from General Electric.

At the end of 2011, the region's risk consumption, measured by equity sensitivity to 100 basis points, was EUR 957 million (EUR 763 million in 2010), while that of the net interest margin at one year, measured by its sensitivity to 100 basis points, was EUR 79 million (EUR 45 million in 2010).

**Latin American risk profile evolution**

*Sensitivity of NIM and MVE to 100 p.b.*

Interest rate risk profile at the end of 2011

The gap tables show the risk maturity structure in Latin America at the end of 2011.

**Maturity and repricing gaps as of december 31, 2011**

*Structural gap parent bank-holding. Million euros*

| | Not sensitive | Up to 1 year | 1-3 years | 3-5 years | More than 5 years | Total |
|---|---|---|---|---|---|---|
| Money and securities market | | 81,408 | 6,471 | 2,679 | 16,287 | **106,845** |
| Loans | 112 | 106,135 | 8,896 | 1,352 | 1,050 | **117,546** |
| Permanent equity stakes | 86,049 | | | | | **86,049** |
| Other assets | 19,688 | 73,954 | 52 | 54 | 63 | **93,811** |
| **Total assets** | **105,849** | **261,497** | **15,420** | **4,085** | **17,400** | **404,250** |
| Money market | – | 64,325 | 2,585 | 300 | 56 | **67,265** |
| Customer deposits | – | 39,455 | 17,773 | 10,004 | 14,247 | **81,478** |
| Debt issues and securitisations | – | 78,021 | 21,781 | 13,666 | 9,872 | **123,340** |
| Shareholders' equity and other liabilities | 87,606 | 60,906 | 920 | 595 | 935 | **150,962** |
| **Total liabilities** | **87,606** | **242,708** | **43,059** | **24,564** | **25,109** | **423,045** |
| **Balance sheet Gap** | **18,243** | **18,789** | **(27,639)** | **(20,479)** | **(7,709)** | **(18,795)** |
| Off-balance sheet structural Gap | – | (11,451) | 17,952 | 10,663 | 5,416 | **22,579** |
| **Total structural Gap** | **18,243** | **7,337** | **(9.687)** | **(9,816)** | **(2,293)** | **3,785** |
| **Accumulated Gap** | – | **7,337** | **(2,350)** | **(12,165)** | **(14,459)** | – |

6. Includes all the balance sheet except the trading portfolios.

### *2. Geographic distribution*

Financial margin sensitivity

For the whole of Latin America, the consumption at the end of 2011 was EUR 79 million (sensitivity of the financial margin at one year to rises of 100 b.p.). The geographic distribution is shown below.

More than 90% of the risk was concentrated in three countries: Brazil, Chile and Mexico.

**NIM sensitivity by countries**
*%*

(*) Other countries: Argentina, Colombia, Panama, Peru, Puerto Rico, Santander Overseas and Uruguay.

Market Value of equity sensitivity

For the whole of Latin America, the consumption at the end of 2011 was EUR 957 million (sensitivity of MVE to a parallel movement of rises of 100 b.p in interest rates). The geographic distribution is shown below.

About 90% of risk is concentrated in three countries: Brazil, Chile and Mexico.

**MVE sensitivity by countries**
*%*

(*) Other countries: Argentina, Colombia, Panama, Peru, Puerto Rico, Sanander Overseas and Uruguay.

Balance sheet management risk in Latin America, measured in VaR terms at one day and at 99%, amounted to EUR 137.1 million at the end of 2011. The chart shows that most of it was concentrated in Brazil.

**Structural interest rate risk of the balance sheet (VaR)**
*%. VaR at 99% with a time frame of one day*

(*) Other countries: Colombia, Puero Rico, Santander Overseas and Uruguay.

## B2. Structural management of credit risk

The purpose of structural management of credit risk is to reduce the concentrations that can naturally occur as a result of business activity through the sale of assets. These operations are offset by acquiring other assets that diversify the credit portfolio. The financial management area analyses these strategies and makes proposals to the ALCO in order to optimise the exposure to credit risk and help create value.

In 2011 and as part of the Group's liquidity management:

- EUR 73,000 million of assets were securitised, of which around one-third were placed in the market and the rest retained by the Group's various units. These retained securitisations increased the Group's liquidity position through their discounting capacity in central banks.
- Repurchases were made in the secondary market of securitisation bonds of the higher tranches of Group issuers (around EUR 100 million).

**Structural Gap in Latin America**
*Million euros*

| **Local currency** | Not sensitive | 0-6 months | 6-12 months | 1-3 years | More than 3 years | **Total** |
|---|---|---|---|---|---|---|
| Assets | 59,192 | 98,801 | 16,141 | 35,702 | 29,106 | **239,073** |
| Liabilities | 71,196 | 115,340 | 24,017 | 13,731 | 10,833 | **235,117** |
| Off-balance sheet | -2,956 | 115,017 | 253 | 2,406 | -1,622 | **113,099** |
| Gap | -23,083 | 102,782 | -2,541 | 22,485 | 15,674 | **115,317** |
| **Dollar** | | | | | | |
| Assets | 5,295 | 32,182 | 3,887 | 3,695 | 8,397 | **53,455** |
| Liabilities | 5,658 | 30,718 | 4,247 | 5,009 | 10,043 | **55,675** |
| Off-balance sheet | -3,890 | -108,056 | -617 | -847 | 313 | **-113,097** |
| Gap | -4,253 | -106,593 | -976 | -2,162 | -1,333 | **-115,317** |

## B3. Management of financing and liquidity risk

- Strong capacity to capture retail deposits (close to 15,000 branches) and wholesale funding (more than 10 issuing subsidiaries) in the three main currencies.
- Good liquidity situation in 2011 which is reflected in the ratios (loan-to-deposit ratio of 117%), in the scant dependency on short-term wholesale funding (less than 2% of the balance of liquidity) and in the high structural surplus of liquidity (more than EUR 120,000 million).
- Intense activity in medium- and long-term issuance in an unfavourable environment: in 2011, issues covered 124% of maturities and amortisations.
- A high capacity of recourse to central banks is maintained: at the end of 2011, it was around EUR 100,000 million of total capacity.
- The Group faces 2012 in a comfortable liquidity position: without concentration of maturities and with favourable business trends in some countries that generate liquidity.

Banco Santander's business model has enabled it to have a comfortable liquidity position during the financial crisis years. In this environment, the framework of managing financing and liquidity risk continued to function correctly, which gave the Bank a considerable competitive edge.

The great capacity to attract customer deposits, combined with strong issuance activity in institutional markets via subsidiaries with the responsibility and capacity to cover their own needs, has given the Group the necessary liquidity to finance the acquisition of new units in the last few years. It has also helped to bolster the bank's capacity to create value, while at the same time continue to improve the diversification of financing sources.

The Group's liquidity management framework and its situation at the end of 2011 is set out below.

### 1. Management framework

Liquidity management is based on three fundamental pillars:

A) Organisational model: governance and the board.
A solid model of governance that ensures the involvement of senior management and the board in taking decisions and facilitating their integration with the Group's global strategy.

B) Management.
Adapted to each business's liquidity needs, in accordance with the decentralised organisational model.

C) Balance sheet analysis and liquidity risk management.
Profound analysis of the balance sheet and its evolution in order to support decision-taking.

### *A. Organisational and governance model*

Decision-taking regarding structural risks is done by local ALCO committees in coordination with the markets committee. The latter is the highest decision-taking body and coordinates all global decisions that influence measurement, management and control of liquidity risk.

The markets committee is headed by the chairman of the bank and comprises the second vice-chairman and CEO, the third vice-chairman (who is the maximum executive responsible for the Group's risks), the chief financial officer and the senior vice-president of risks and those responsible for the business and analysis units.

There are ALCO committees for convertible currencies (basically, euros, the US dollar and sterling) as well as for the currencies of emerging countries.

**Organisation model**
*Area of decision*

The financial management area is responsible for managing structural risks, including liquidity, while control is the responsibility of the global market risk areas. Both areas support the ALCO committees, providing analysis and management proposals and controlling compliance with the limits set.

In line with the best practices of governance, the Group establishes a clear division between executing the financial management strategy (the responsibility of the financial management area) and monitoring and control (the responsibility of market risks).

### *B. Management*

Structural liquidity management aims to finance the Group's recurring activity in optimum conditions of maturity and cost and avoid assuming undesired liquidity risks.

Liquidity and financing management is based on the following principles:

- Wide and very stable base of customer deposits and funds on the balance sheet (including retail commercial paper): more than 85% of the deposits are retail and are captured in the Group's core markets by various units.
- Financing via medium and long-term issues of the balance sheet's stable liquidity needs (the gap between loans and deposits), establishing a surplus of structural financing in order to be able to meet possible adverse situations.
- Diversification of financing sources to reduce the risk in relation to:

  – instruments/investors

  – markets/currencies

  – maturities
- Strict control of short-term financing needs, within the Group's policy of minimising the degree of recourse to short-term funds.
- Autonomy and responsibility of subsidiaries in managing the financing of liquidity, with no structural support from the parent bank.

In practice, and applying these principles, the Group's liquidity management consists of:

- Drawing up every year the liquidity plan based on the financing needs derived from the budgets of each business and the methodology stated in the risks report of this annual report (market risk-balance sheet management-liquidity risk). On the basis of these needs and bearing in mind prudent limits on recourse to short-term markets, the year's issuance and securitisation plan is established by financial management.
- During the year the evolution of the balance sheet and financing needs is regularly monitored, giving rise to changes to the plan.
- Maintain an active presence in a wide and diversified series of financing markets. The Group has more than 10 significant and independent issuance units, which avoid dependence on a specific market and maintain available a wide capacity of issuance in various markets.
- And backed by all this, the Group has an adequate structure of medium and long-term issues, well diversified by products (senior debt, subordinated, preferred shares, bonds) with an average conservative maturity (4.2 years at the end of 2011), to which are added the securitised bonds placed in the market.
- All of this results in moderate needs of recourse to short-term wholesale financing at the Group level, which, as reflected in the accompanying balance of liquidity, represented less than 2% of net funds in 2011, down from 3% in 2010, and 5% in 2009. This percentage would be below 2% if the retail commercial paper placed by the commercial networks in Spain as products to replace customer deposits is excluded.

The subsidiaries have a large degree of autonomy to manage their liquidity within Grupo Santander's decentralised and coordinated financing model. Each one must budget their liquidity needs and assess their own capacity of recourse to the wholesale markets in order to establish, always in coordination with the parent bank, the issuance and securitisation plan.

Only in the case of Santander Consumer Finance does the parent bank (Banco Santander) supplement the necessary liquidity and always at the market price taking into account the maturity of the finance and the internal rating of the relevant unit. The Group, within the strategy of optimising the use of liquidity in all units, has managed to reduce to one-third (to EUR 5,000 million from EUR 15,000 million in 2009) the recourse of Santander Consumer Finance to the parent bank in the last two years.

### *C. Analysis of the balance sheet and measurement of liquidity risk*

Taking decisions on financing and liquidity is based on a deep understanding of the Group's current situation (environment, strategy, balance sheet and state of liquidity), the future liquidity needs of businesses (projection of liquidity), as well as access to and the situation of financing sources in the wholesale markets.

The objective is to ensure the Group maintains optimum levels of liquidity to cover its short and long-term needs, optimising the impact of its cost on the income statement.

This requires monitoring of the structure of balance sheets, forecasting short and medium-term liquidity and establishing the basic metrics, in line with those reported in the next section.

Various stress tests are also conducted taking into account the additional needs that could arise from various extreme, although possible, events. These could affect the various items of the balance sheet and/or sources of financing differently (degree of renewal of wholesale financing, deposit outflows, deterioration in the value of liquid assets, etc), whether for global market reasons or specific ones of the Group.

All of this enables the Group to respond to a spectrum of potential, adverse circumstances, anticipating the corresponding contingency plans.

**Analysis of the balance sheet and measurement of liquidity risk**

These actions are in line with the practices being fomented from the Basel Committee in order to strengthen the liquidity of banks, whose objective is to define a framework of principles and metrics that is still being analysed and discussed.

## 2. Current state of liquidity

The Group has an excellent structural position, with the capacity to meet the new conditions of stress in the markets. This is underscored by:

A) The robust balance sheet.

B) The dynamics of financing.

### *A. Robust balance sheet*

The balance sheet at the end of 2011 was solid, as befits the Group's retail nature. Lending, which accounted for 77% of the net assets of the balance of liquidity, was entirely financed by customer deposits and medium and long-term financing, including securitised bonds placed in the market. Equally, the structural needs of liquidity, represented by loans and fixed assets, were also totally financed by structural funds (deposits, medium and long-term financing and capital).

As regards financing in wholesale markets, the Group's structure is largely based on medium and long-term instruments (90% of the total).

Together with special financing from the Federal Home Loan Banks in the US and securitised bonds in the market, the bulk of medium- and long-term financing are issues of debt whose outstanding balance at the end of 2011 was around EUR 162,000 million, with an average maturity of more than four years and an adequate distributed profile (no year concentrates more than 20% of the outstanding balance).

Short-term financing is a marginal part of the structure (less than 2% of total funds) and it amply covered by liquid assets. At the end of 2011, the surplus structural liquidity (equivalent to the surplus of structural funds over loans and fixed assets) was EUR 119,000 million.

If within this short-term financing the retail commercial paper placed by the commercial networks in Spain in 2011 to replace deposits is excluded, the structural surplus of liquidity would amount to EUR 125,000 million.

This solid structural position is complemented by the Group's great capacity to obtain immediate liquidity through recourse to the central banks of the countries where the Group has operating subsidiaries. Of note among these central banks are the three institutions that control the three main currencies in which the Group operates: the euro, sterling and the US dollar.

At the end of 2011, total eligible assets which could be discounted in the various central banks to which the Group has access via its subsidiaries amounted to around EUR 100,000 million. This amount, similar to that at the end of 2010, is the result of an active strategy of generating assets that can be discounted, backed by development of customer businesses, which enable both the maturities of the existing assets as well as the increasing cuts in the value of guarantees by central banks when supplying liquidity to be compensated.

We now set out the framework of the balance of liquidity of the consolidated group as well as the main metrics for monitoring the structural position of liquidity:

**Grupo Santander's balance sheet of liquidity at the end of 2011 (*)**

%

(*) Balance sheet for the purposes of liquidity management: total balance sheet net of trading derivatives and interbank balances.

**Monitoring metrics**

%

| Metrics | **2011** | 2010 | 2009 |
|---|---|---|---|
| Loans/net assets | 77% | 75% | 79% |
| Customer deposits, insurance and medium and long-term financing/loans | 113% | 115% | 106% |
| Customer deposits, insurance and medium and long-term financing, shareholders' funds and other liabilities / total loans and fixed assets | 114% | 117% | 110% |
| Liabilities/total loans and fixed assets | 2% | 3% | 5% |
| Short-term financing/net liabilities | 117% | 117% | 135% |

As in the Group, the balance sheets of the units of convertible currencies and of Latin America have the same principles, within the philosophy of independence and responsibility in their financing.

A good example is that in the Group's main units, apart from Santander Consumer Finance, all customer lending is financed by customer deposits plus medium- and long-term wholesale funding.

### *B. Dynamics of financing*

Santander maintained in 2011 the solid structural liquidity position reached in 2010 in an environment of maximum pressure in both the retail and wholesale spheres.

As well as the aggressive competition for retail deposits in the main European markets already begun in 2010, euro zone wholesale markets were closed in the second half of the year due to the crisis of confidence in the solvency of sovereign debt and in the growth capacity of countries on the periphery of Europe. This difficulty in wholesale issuance raised the appetite for retail deposits while complicating access to short-term dollar markets.

In this context of high stress, the Group maintained its liquidity ratios, after absorbing the financing needs derived from the new units incorporated. The Group's loan-to-deposit ratio remained at around 117% in 2011 (including the retail commercial paper), after the sharp reduction from 150% in 2008. The ratio of deposits plus medium- and long-term financing to loans was 113% (115% in 2010), well above the 104% in 2008.

This evolution is the result of managing the two basic drivers of the Santander model: the high capacity to capture customer funds and the wide and diversified access to wholesale finance markets.

As regards the capacity, in 2011 the Group's main units continued to increase their customer deposits as the basis for financing growth in lending. Growth rates in the Latin American units were higher, although without offsetting the strong rise in lending in the region, especially in Brazil and Mexico, which led to the elimination of the traditional surplus of deposits. On the other hand, developed countries undergoing deleveraging generally registered lower growth in deposits although higher than that of lending, which enabled them to keep on reducing their commercial gap.

As an exception, the commercial units in Spain which, after the big effort made in 2010 to capture deposits, reduced the volume of deposits in 2011 after giving priority to recovering spreads by not renewing the most expensive deposits and issuing commercial to attract new funds from retail customers. The fall in the volume of deposits and on-balance sheet funds, however, was less than the reduction in loans, which continued to improve the commercial gap in Spain.

As regards the second driver, the Group maintained a high volume of issuance throughout the year, more continuously in the countries and businesses least affected by the euro zone's issuance difficulties after the summer. The diversity of issuers by markets and currencies, and exploiting the windows offered by the euro markets, particularly in the first half of the year, enabled Santander to capture EUR 40,000 million in medium- and long-term issues in the market (more than in 2010), which covered 124% of the maturities and amortisations envisaged for the year.

Medium- and long-term issues, basically senior debt and mortgage bonds, were concentrated in Spain and the UK (72% of the total between the two), followed by Latin America, led by Brazil, which increased its participation to 24% of the year's total issues.

As regards securitisation, in 2011 the Group's subsidiaries made sales in the market of securitised bonds and structured medium- and long-term operations with customers whose collateral is securitised bonds or mortgage bonds amounting to close to EUR 25,000 million. Of note along with the strong activity in the UK market, which concentrates more than half of the placements, was the growing issuance of Santander Consumer Finance, strongly backed by investor appetite for these securities. This demand increased the number of Santander Consumer Finance units which accessed the wholesale markets and contributed to the opening of new markets. A good example of this was Norway, where the Group made the first securitisation of auto loans in the country.

This high issuance capacity shown by the parent bank and its subsidiaries in various types of debt was backed by the Group's notable credit quality. In February 2012, after the successive downgrading of Spanish sovereign debt by rating agencies, Grupo Santander had the following credit ratings: A from Fitch, A+ from Standard & Poor's and Aa 3 from Moody's.

Also noteworthy was that, in all cases, the Group's issuance capacity was adjusted to investors' appetite for securities at placement prices that recognised the higher credit quality of the Group and its subsidiaries. A good example of this was the parent bank's EUR 2,000 million issue of 3 year mortgage bonds in February 2012, which reopened the Spanish market after almost six months of no activity for these volumes. Its placement, with a high demand (x4) was done at a spread of 210 b.p. over mid swap, below that of the Bank's CDS in the days before and which was close to the levels before the tightening of markets in August 2011.

In short, sustained growth in deposits except in some markets because of the greater focus on spreads, wide access to medium and long-term wholesale markets and generation of liquidity by businesses in economies undergoing deleveraging explain the Group's continued solid structural liquidity position during 2011.

Santander thus begins 2012 with a comfortable liquidity situation and with fewer issuance needs in the medium- and long-term. There are no concentrations of maturities in the coming years, when annual maturities are less than the issues made in 2011 and furthermore the different business dynamics by areas and markets do not make it necessary to cover all issues. This will make the Group develop differentiated strategies in each one of them.

In any case, and while the current environment of uncertainty persists, Santander will continue to pursue a conservative policy in issues, as it did in 2011, in order to bolster its already solid position.

**Group issues and maturities of medium- and long-term debt Grupo Santander (*)**

*Billion euros*

(*) Excludes securitisations

## C) Structural exchange-rate risk/hedging of results

Structural exchange rate risk arises from Group operations in currencies, mainly related to permanent financial investments, and the results and the dividends of these investments.

This management is dynamic and seeks to limit the impact on equity of currency depreciations and optimise the financial cost of hedging.

As regards the exchange-rate risk of permanent investments, the general policy is to finance them in the currency of the investment provided the depth of the market allows it and the cost is justified by the expected depreciation. One-off hedging is also done when a local currency could weaken against the euro beyond what the market estimates.

At the end of 2011, the largest exposures of a permanent nature (with potential impact on net worth) were concentrated in Brazilian reales, followed by sterling, US dollars, Mexican pesos and Polish zloty. The Group covers part of these positions of a permanent nature with exchange-rate derivatives.

In addition, financial management at the consolidated level is responsible for exchange-rate management of the Group's expected results and dividends in those units whose currency is not the euro.

### D) Structured finance operations

Despite the complicated economic environment, Santander achieved growth of 13.2% in this activity in 2011 to a committed exposure of EUR 22,017 million at the end of the year,[7] corresponding to 727 operations, and increased both the diversification by sectors and the internationalisation of business. Leadership in project finance was strengthened with an exposure of EUR 13,528 million among 514 operations, (risk reduced to EUR 12,198 million if we discount the exposure ceded to two CLOs signed in 2008 and 2009), followed by EUR 4,434 million in acquisition finance (50 transactions), of which EUR 1,746 million related to 12 margin calls and, lastly, leveraged buy-outs (LBOs) and other structured financings amounted to EUR 4,055 million (154 transactions).

As a result of integrating Alliance & Leicester into the group in 2008, a portfolio of structured operations is maintained. It is a diversified portfolio of specialised finance operations. The exposure at the end of 2011 was £4,167 million (EUR 4,989 million) corresponding to 214 transactions. This exposure was 15.5% less than at the end of 2010.

### E) Exposures related to complex structured assets

Grupo Santander continues to have a very limited exposure to instruments or complex structured vehicles, reflecting a management culture one of whose hallmarks is prudence in risk management. At the end of 2011, the Group had:

- **CDOs and CLOs:** the position is still very insignificant at EUR 301 million, 38% less than at the end of 2010. A significant part of it is the result of the integration of the Alliance & Leicester portfolio in 2008.
- **Non-Agency CMOs and pass-through with underlying mortgage alt-A[8]:** without exposure. The EUR 818 million of positions at the end of 2010, mainly from the integration of Sovereign Bank in January 2009, were sold in the fourth quarter of 2011.
- **Hedge funds:** the total exposure is not significant (EUR 469 million at the end of 2011) and most of it is through financing these funds (EUR 233 million), as the rest is direct participation in portfolio. This exposure has low levels of loan-to-value of around 30% (EUR 1,552 million of collateral at the end of 2011). The risk with this type of counterparty is analysed case by case, establishing the percentages of collateral on the basis of the features and assets of each fund.
- **Conduits:** No exposure.
- **Monolines:**Santander's exposure to bond insurance companies was EUR 196 million[9] at the end of 2011,mainly indirect exposure, and EUR 173 million by virtue of the guarantee provided by this type of entity to various financing or traditional securitisation operations. The exposure in this case is double default, as the primary underlying assets are of high credit quality (mainly AA). The small remaining amount is direct exposure (for example, via purchase of protection from the risk of non-payment by any of these insurance companies through a credit default swap). The exposure was 29% lower than in 2010.

In short, the exposure to this type of instrument, the result of the Group's usual operations, continued to decline in 2011 and this was mainly due to the integration of positions of institutions acquired in 2011, such as Alliance & Leicester and Sovereign (in 2008 and 2009, respectively). All these positions were known at the time of purchase, having been duly provisioned.

These positions, since their integration in the Group, have been notably reduced, with the ultimate goal of eliminating them from the balance sheet.

Santander's policy for approving new transactions related to these products remains very prudent and conservative; it is subject to strict supervision by the Group's senior management. Before approving a new transaction, product or underlying asset, the risks division verifies:

- The existence of an appropriate valuation model to monitor the value of each exposure: Mark-to-Market, Mark-to-Model or Mark-to-Liquidity.
- The availability in the market of the necessary inputs to be able to apply this valuation model.

And provided these two points are always met:

- The availability of appropriate systems, duly adapted to calculate and monitor every day the results, positions and risks of new operations.
- The degree of liquidity of the product or underlying asset, in order to make possible their coverage when deemed opportune.

## 4.5. Internal model

Grupo Santander had, at the end of 2011, approval from the Bank of Spain for its internal market risk model for calculating regulatory capital in the trading portfolios of units in Spain, Chile and Portugal. The Group's objective is to gradually increase approval to the rest of units.

As a result of this approval, the regulatory capital of trading activity is now calculated via advanced methods, using VaR as the fundamental metric and incorporating new metrics of stressed VaR and incremental risk capital charge, which replaces incremental default risk, in line with the new capital requirements demanded by Basel 2.5.

We closely co-operate with the Bank of Spain in order to advance in the perimeter susceptible of entering into the internal model (at the geographic and operational levels), as well as in analysis of the impact of new requirements, in line with the documents published by the Basel Committee to strengthen the capital of banks.[10]

7. Including the exposure to Banesto.

8. Alternative A-paper: mortgages originated in the US market which for various reasons are considered as having an intermediate risk level between prime and subprime mortgages (not having all the necessary information, loan-to-value levels higher than usual, etc).

9. Guarantees provided by monolines for bonds issued by US states (municipal bonds) are not considered as exposure. As a result of the acquisition of Sovereign Bank, the Group incorporated a portfolio of these bonds which amounted to EUR 1,341 million at the end of 2011.

10. "Basel III: A global regulatory framework for more resilient banks and banking systems" and "Basel III: International framework for liquidity risk measurement, standards and monitoring."

# 5. Operational risk

## Definition and objectives

Grupo Santander defines operational risk (OR) as the risk of losses from defects or failures in its internal processes, employees or systems, or those arising from unforeseen circumstances. They are, in general, purely operational events, which makes them different from market or credit risks, although they also include external risks, such as natural disasters.

The objective in control and management of operational risk is to identify measure/valuate, control/mitigate and monitor this risk.

The Group's priority, is to identify and eliminate risk focuses, regardless of whether they produce losses or not. Measurement also helps to establish priorities in management of operational risk.

Grupo Santander opted, from the beginning, to use the standard method for calculating regulatory capital by operational risk, envisaged in the BIS II rules. The Group is weighing up the best moment to adopt the focus of advanced models (AMs), bearing in mind that a) the short-term priority in management of operational risk centres on its mitigation; and b) most of the regulatory requirements established for being able to adopt the AMs must be incorporated into the standard model (already achieved in the case of Grupo Santander's operational risk management model).

## Management model

The organisational model for controlling and managing risks is the result of adapting to the new BIS II environment, which establishes three levels of control:

- **First level:** control and management functions conducted by the Group's units.
- **Second level:** supervision functions carried out by the corporate areas.
- **Third level:** integral control functions by the risks division-integral control area and internal validation of risk.

This model is constantly reviewed by the internal auditing division.

Control of operational risk in the first and second levels is carried out by the technology and operations division, and is part of the Group's strong risk management culture. Within this division, the corporate area of technological and operational risk, established in 2008, defines policies as well as managing and controlling these risks. The implementation, integration and local adjustment of the policies and guidelines established by this area is the responsibility of local executives in each unit.

This structure for operational risk management is based on the knowledge and experience of executives and professionals of the Group's various units. Particular importance is attached to the role of local executives responsible for operational risk.

Management is based on the following elements:

The different phases of the technological and operational risk management model entail:

- Identify the operational risk inherent in all activities, products,processes and banking systems.
- Measure and assess the operational risk objectively, continuously and in line with the regulatory standards (Basel II, Bank of Spain) and the banking industry, establishing risk tolerance levels.
- Continuously monitor the exposure of operational risk in order to detect the levels of unassumed risk, implement control procedures, improve internal knowledge and mitigate losses.
- Establish mitigation measures that eliminate or minimise operational risk.
- Produce regular reports on the exposure to operational risk and the level of control for senior management and the Group's areas/units, as well as inform the market and regulatory bodies.
- Define and implement systems that enable operational risk exposures to be watched over and controlled and integrated into the Group's daily management, taking advantage of existing technology and seeking the maximum computerisation of applications.

- Define and document operational risk management policies, and introduce methodologies for managing this risk in accordance with regulations and best practices.

Grupo Santander's operational risk management model contributes the following advantages:

- Integral and effective management of operational risk (identification, measurement/assessment, control/mitigation and information).
- Better knowledge of existing and potential operational risks and assigning responsibility for them to the business and support lines.
- Operational risk information helps to improve the processes and controls, reduce losses and the volatility of revenues.
- Facilitates the establishment of operational risk appetite limits.

## Implementing the model: global initiatives and results

The main functions, activities and global initiatives adopted seek to ensure effective management of operational and technological risk are:

- Define and implement the framework for corporate management of technological and operational risk management.
- Designate coordinators and create operational risk departments.
- Training and interchange of experiences: continuation of best practices within the Group.
- Foster mitigation plans: ensure control of implementation of corrective measures as well as ongoing projects.
- Define policies and structures to minimise the impact on the Group of big disasters.
- Maintain adequate control on activities carried out by third parties in order to meet potential critical situations.
- Supply adequate information on this type of risk.

The corporate function enhances management of technological risk, strengthening the following aspects among others:

- The security of the information systems.
- The contingency and business continuity plans.
- Management of risk associated with the use of technologies (development and maintenance of applications, design, implementation and maintenance of technology platforms, output of computer processes, etc).

Almost all the Group's units have been incorporated to the model with a high degree of uniformity. However, due to the different pace of implementation, phases, schedules and the historical depth of the respective data bases, the degree of progress varies from country to country.

On a general basis, all the Group's units continue to improve all aspects related to operational risk management as can be seen in the annual review by the internal auditing unit.

- Data bases of operational incidents that are classified are received every month. The capturing of events related to operational risk are not truncated (i.e. without exclusions for reasons of amount and with both the accounting impact - including positive effects - as well as the non-accounting impact).
- Self-assessment questionnaires filled in by almost all the Group's units are received and analysed.
- A corporate system of operational risk indicators is in place. It is in continuous evolution and coordination with the internal control area.
- The main and most frequent events are identified and analysed, and mitigation measures taken which, in significant cases, are disseminated to the Group's other units as a best practices guide.
- Processes are conducted to conciliate data bases with accounting data.

By consolidating the total information received, the Group's operational risk profile is reflected in the following chart:

### Grupo Santander: distribution of amount and frequency of events by category (2011)

I. Internal fraud
II. External fraud
III. Employment, health and security practices at work
IV. Practices with clients, products and business
V. Damage in physical assets
VI. Interruption of business and failures in systems
VII. Execution, delivery and management of processes

In addition, the Group's units in 2011 continued to advance in conducting self-assessment risk exercises regarding the introduction of estimates of frequency and loss given default and worst case scenarios. Specifically, experts from the various business and support areas assessed the risk associated with processes and activities and estimated the average frequency of occurrence in the materialisation of risks as well as the average loss given default. The exercise also incorporated evaluation of the largest loss in addition to the average loss, as well as assessment of the environment of control.

All of this will enable limits to be established on the basis of the distribution and modelisation of expected/unexpected loss.

The Group completed in 2011 the installation of a new corporate system which supports almost all the operational risk management tools and facilitates the functions and information and reporting needs, both at the local and corporate level. The most noteworthy features are:

- The following modules are available: registry of events, risk map and assessment, indicators and reporting systems.
- Application tool for all the Group's entities.
- All operational risk management processes are automated.
- The following improvements will be incorporated to the platform during 2012:
  - Methodology for analysing scenarios that supplements the current methodologies in the Group and enables potential risks of greater loss to be assessed.
  - Strengthen the procedures for active management of operational risk via implementation and follow up of mitigation measures.

The Group has been exercising supervision and control of technological and operational risk via its governance organs, The board, the executive committee and the Group's management committee have been regularly including treatment of relevant aspects in the management and mitigation of operational risk.

Meanwhile, the Group, through their approval in the risk committee, formalizes every year the operational risk profiles and limits. It establishes a risk appetite, which must be situated in low and medium-low profiles, which are defined on the basis of the level of various ratios. Limits are set by country and limits for the Group on the basis of gross loss/gross income.

Moreover, the areas of local resources hold monitoring committees with the corporate area every month and by country. In February 2011, the anti-fraud corporate committee was created which analyses the situation in the Group and implements the corrective measures for its reduction.

Lastly, ACRTO-CIVIR committees were held every three months. They examined relevant issues of operational risk management and control from the standpoint of integral control of risk.

## Analysis and monitoring of controls in market operations

Due to the specific nature and complexity of financial markets, the Group considers it necessary to strengthen continuously operational control of this activity, thereby enhancing the very demanding and conservative risk and operating principles that Grupo Santander already regularly applied.

Over and above monitoring all aspects related to operational control, in all the Group's units the attention paid to the following aspects is reinforced:

- Review of the valuation models and in general the valuations of portfolios.
- Processes to capture and validation independent of prices.
- Adequate conformation of the operations with counterparties.
- Review of cancellations/modifications of operations.
- Review and monitoring of the effectiveness of guarantees, collateral and risk mitigants.

## Corporate information

The corporate area of technology and operational risk control has an integral management information system for operational risk, which consolidates every quarter the information available in each country/unit in the sphere of operational risk, so that it has a global view with the following features:

- Two levels of information: corporate with consolidated information and the other individualized for each country/unit.
- Dissemination of the best practices between Grupo Santander's countries/units, obtained through a combined study of the results of qualitative and quantitative analysis of operational risk.

Information on the following points is also drawn up:

- Operational risk management model in Grupo Santander.
- Human resources and perimeter of activity.
- Analysis of the database of errors and incidents.
- Operational risk cost and accounting conciliation.
- Self-assessment questionnaire
- Indicators
- Mitigating/active management measures
- Business continuity and contingency plans
- Regulatory framework: BIS II
- Insurance

This information is the basis for complying with the reporting needs to the risk committee, senior management, regulators, rating agencies, etc.

## Insurance in the management of operational risk

Grupo Santander regards insurance as a key element in management of operational risk. The area responsible for operational risk has been closely cooperating with the Group's insurance area since 2004 in all those activities that entail improvements in both areas. For example:

- Cooperation in the exposure of the Group's operational risk control and management model to insurance and reinsurance companies.
- Analysis and monitoring of recommendations and suggestions to improve operational risks made by insurance companies, via prior audits conducted by specialised companies, as well as their subsequent implementation.
- Exchange of information generated in both areas in order to strengthen the quality of the data bases of errors and the perimeter of coverage of the insurance policies for the various operational risks.
- Close cooperation between local operational risk executives and local coordinators of insurance to strengthen mitigation of operational risk.
- Regular meetings on specific activities, states of situation and projects in both areas.
- Active participation of both areas in global sourcing of insurance, the Group's maximum technical body for defining coverage strategies and contracting insurance.

# 6. Reputational risk

Grupo Santander defines reputational risk as that linked to the perception of the bank by its various stakeholders, both internal and external, of its activity, and which could have an adverse impact on results, capital or business development expectations. This risk relates to juridical, economic-financial, ethical, social and environmental aspects, among others.

Various of the Group's governance structures are involved in reputational risk management, depending on where the risk comes from. The audit and compliance committee helps the board to supervise compliance with the Group's code of conduct in the securities markets, the manuals and the procedures to prevent money-laundering and, in general, the Bank's rules of governance and compliance. It formulates the proposals needed for their improvement.

Management of reputational risk which might arise from an inadequate sale of products or an incorrect provision of services by the Group is conducted in accordance with the corporate policies for reputational risk management derived from the commercialisation of products and services.

These policies aim to set a single corporate framework for all countries, all businesses and all entities: (i) strengthening the organisational structures; (ii) ensuring the decision-making committees vouch not only for approval of products and services, but also for monitoring throughout their life; and (iii) establish the guidelines for defining homogeneous criteria and procedures for all the Group for the commercialisation of products and services, covering all the phases (admission, pre-sale, sale and post-sale).

The specific developments and adaptations of these policies to local reality and to local regulatory requirements are handled via local internal rules in the Group's various units, following authorisation from the corporate area of compliance and reputational risk.

The new version of the procedures manual for the commercialisation of financial products (henceforth, the manual) is a specific adaptation of the corporate policies of selling to Spain's reality and to the requirements of local rules (for example, the Markets in Financial Instruments Directive) and, thus, applicable to Banco Santander and to its subsidiaries in Spain as they do not have their own manual.

This manual covers financial products, ranging from securities and other fixed income and variable financial instruments to money market instruments, participations in collective investment institutions, traded derivatives and OTC and untypical financial contracts. The corporate committee of commercialisation can include other products in the manual's sphere of procedures.

The reputational risk management that can arise from the inadequate sale of products or an incorrect provision of services by the Group is carried out by the following organs:

## The risk committee (RC)

This committee is the responsibility of board, as part of its supervisory function. It defines the Group's risk policy.

As the maximum body responsible for global management of risk and of all types of banking operations, the committee assesses, with the support of the division of the secretary general, reputational risk in its sphere of activity and decisions.

## Corporate committee of commercialisation (CCC)

This committee, which is the maximum decision-making body for approving and monitoring products and services, is chaired by the Group's secretary general and integrated by representatives of the divisions of risk, financial management, technology and operations, secretariat general, general intervention and control, internal auditing, retail banking, Santander Global Banking & Markets, private banking, asset management and insurance.

The committee pays particular attention to adjusting the product or service to the framework where it is going to be sold and especially to ensuring that:

- Each product or service is sold by someone who knows how to sell it.
- The customer is given the necessary and adequate information.
- The product or service fits the customer's risk profile.
- Each product or service is assigned to the appropriate market, not only for legal or fiscal reasons, but also to meet the market's financial culture.
- When a product or service is approved the maximum limits for placement are set. They meet the requirements of the corporate policies of commercialisation and, in general, the applicable internal or external rules.

Local commercialisation committees (LCC), in turn, are created, which channel to the CCC new product approval proposals, after issuing a favourable opinion, and approve products that are not new and marketing campaigns.

In the respective approval processes, the marketing committees operate with a risk focus and from the double perspective of bank/customer.

The corporate commercialisation committee held 19 meetings in 2011 and analysed 203 new products/services.

## Global consultative committee (GCC)

The global consultative committee (GCC) is the advisory body for the corporate committee of commercialisation and comprises representatives of areas that contribute vision of regulatory and market risks. This committee meets every quarter and can recommend the review of products affected by changes, in markets, deterioration of solvency (country, sectors and companies) or by changes in the Group's vision of markets in the medium and long term.

## Corporate committee of monitoring (CCM)

A weekly meeting takes place as of 2009 to monitor products presided by the secretary general in which internal auditing, legal advice, compliance, customer attention and the affected business areas (with permanent representation of the commercial network) participate. Specific questions related to the commercialisation of products and services are raised and resolved.

The CCM held 42 meetings in 2011 where it resolved incidents and analysed information on the monitoring of products and services, at both the local level of retail banking in Spain as well as at the consolidated Group level.

## Corporate office of reputational risk management

Integrated in the corporate area of compliance and reputational risk, this office provides the corresponding organs of governance with the necessary information to: (i) adequately analyse the risk to be approved, with a two-pronged purpose: impact on the Bank and on the customer; and (ii) monitoring of products throughout their life cycle.

The office approved during 2011 68 products/services considered as not new and resolved 108 consultations from various areas and countries. The products approved by the office are successive issues of products previously approved by the CCC or the LCC, after having delegated this faculty in this office.

At the local level, reputational risk management offices are created, which are responsible for fostering the culture and ensuring that the functions of approval and monitoring of products are developed in their respective local sphere, in line with the corporate guidelines.

In 2011, the various reputational risk management offices monitored the approved products. The information is coordinated by the corporate office, which reports to the CCM.

In addition, in reputational risk matters, Grupo Santander has a compliance programme which is described in the appendix of this report.

# 7. Adjustment to the new regulatory framework

Grupo Santander participated during 2011 in impact studies promoted by the Basel Committee and the European Banking Authority (EBA), and coordinated at the local level by the Bank of Spain to calibrate the new regulations denominated Basel III and whose implementation involves establishing new standards for capital and liquidity, with stricter criteria and standardised at the international level.

Santander has very solid capital ratios, adjusted to the business model and to its risk profile, putting it in a comfortable position to comfortably meet Basel III. The impact analysis shows no significant affects on the Group's high solvency ratios, which benefit from a considerable organic capital generation capacity. The part of the new regulations known as Basel 2.5 referring to the additional requirements for securitisations and market risk, which came into force on December 31, 2011, did not have any significant impact on the Group's solvency. The new regulations on capital will be gradually implemented between 2013 and 2019.

Grupo Santander has proposed adopting, during the next few years, the advanced internal ratings based (AIRB) models of Basel II for almost all its banks (up to covering more than 90% of net exposure of the credit portfolio under these models). Meeting this objective in the short term will also be conditioned by the acquisition of new entities as well as by the need of coordination between supervisors of the validation processes of internal models. The Group operates in countries where the legal framework among supervisors is the same as in Europe via the capital directive. However, in other jurisdictions, the same process is subject to the collaboration framework between the supervisor in the home country and that in the host country with different legislations. This means, in practice, adapting to different criteria and calendars in order to attain authorisation for the use of advanced models on a consolidated basis.

With this objective, Santander continued during 2011 to gradually install the necessary technology platforms and methodological developments which will make it possible to progressively apply advanced internal models for calculating regulatory capital in the rest of the Group's units. At the moment, Grupo Santander has the supervisory authorisation to use advanced focuses for calculating the regulatory capital requirements by credit risk for the parent bank and the main subsidiaries in Spain, the UK and Portugal, and certain portfolios in Mexico, Brazil, Chile and Santander Consumer Finance Spain (close to two-thirds of its total exposure at the end of 2011). The strategy of implementing Basel in the Group is focused on achieving use of advanced models in the main institutions in the Americas and consumer banking in Europe.

As regards the rest of risks explicitly envisaged in Pillar 1 of Basel, in market risk we have authorisation to use its internal model for the trading activity of Madrid treasury and during 2010 we obtained authorisation for the units in Chile and Portugal, thus continuing the gradual installation for the rest of the units presented to the Bank of Spain.

In operational risk, the Group believes that development of the internal model should be largely based on the accumulated experience of the entity via the corporate guidelines and criteria established after assuming their control and which are very much hallmarks of Santander. The Group has made many acquisitions in the last few years that make necessary a longer period of maturity to develop the internal model based on the management experience of the various entities. However, although for the time being Grupo Santander has decided to adhere to the standard approach for calculating regulatory capital, it envisages the possibility of adopting the advanced management approach (AMA) once it has gathered sufficient information on the basis of its own management model in order to strengthen to the maximum the virtues that characterise the Group.

As regards Pillar II, Grupo Santander uses an economic capital approach to quantify its global risk profile and its solvency position within the process of self-evaluation conducted at the consolidated level (PAC or ICAAP in English). This process, which is supplemented by the qualitative description of the risk management and internal control systems, is revised by the internal audit and internal validation teams, and is subject to a corporate governance framework that culminates with its approval by the board. Furthermore, the board establishes every year the strategic elements regarding risk appetite and solvency objectives. The economic capital model considers features not included in Pillar 1 (concentration, interest rate and business risks). The Group's diversification compensates the additional capital required for these risks.

Grupo Santander, in accordance with the capital requirements set out in the European Directive and the regulations of the Bank of Spain, publishes every year the Report with Prudential Relevance. This report, published for the first time with data at December 31, 2008, clearly shows the transparency requirements requested by the Bank of Spain regarding Pillar III. Grupo Santander regards the requirements of providing the market with information as vital for complementing the minimum capital requirements demanded by Pillar 1, and the supervisory exam process conducted via Pillar II. It is incorporating to its Pillar III report the recommendations of the Committee of European Banking Supervisors (CEBS) in order to become an international benchmark in matters of transparency to the market as already happens in its Annual Report.

As well as the process of implementing the advanced models in various of the Group's units, Santander is carrying out an ambitious training process on Basel at all levels which is reaching a large number of employees in all areas and divisions, with a particular impact on those most affected by the changes resulting from adopting the new international standards in matters of capital.

## Internal validation of internal risk models

As well as a regulatory requirement, internal validation acts as a fundamental support for the risk committee and for the local and corporate risk committees in their responsibilities of authorising the use (management and regulatory) of models and regular revision.

Internal validation of the models involves a specialised unit of the Bank, with sufficient independence, obtaining a technical opinion on the adequacy of the internal models for the purposes used, whether internal management and/or of a regulatory nature (calculation of regulatory capital, levels of provisions, etc), concluding whether they are robust, useful and effective.

Santander's internal validation covers both credit risk and market risk models and those that set the prices of financial assets as well as the economic capital model. The scope of validation includes not only the most theoretical or methodological aspects but also the technology systems and the quality of data that make implementation effective and, in general, all relevant aspects for management of risk (controls, reporting, uses, involvement of senior management, etc).

The function of internal validation is located, at the corporate level, within the area of integral control and internal validation of risk which reports directly to the Group's third vice-chairman and chairman of the board's risk committee. The function is global and corporate in order to ensure homogeneous application. This is done via four regional centres in Madrid, London, Sao Paulo and New York. These centres report to the corporate centre, which ensures uniformity in the development of their activities. This facilitates application of a common methodology supported by a series of tools developed internally in Santander. These provide a robust corporate framework for use in all the Group's units and which automate certain verifications in order to ensure the reviews are conducted efficiently.

Moreover, Grupo Santander's corporate framework of internal validation is fully aligned with the criteria for internal validation of advanced models issued by the Bank of Spain. The criterion of separation of functions is maintained between the units of internal validation and internal auditing which, as the last element of control in the Group, is responsible for reviewing the methodology, tools and work done by internal validation and to give its opinion on its degree of effective independence.

# 8. Economic capital

The concept of economic capital has traditionally been contrasted with that of regulatory capital, as this is the one required for the regulation of solvency. The Basel capital framework clearly brings both concepts together. While Pillar 1 determines the minimum regulatory capital requirements, Pillar II quantifies, via economic capital, the Group's global solvency position.

The Group's model of economic capital quantifies the consolidated risk profile taking into account all the significant risks of activity, as well as the consubstantial diversification effect on a multinational and multi-business group like Santander. This economic capital model serves as the Group's base for preparing its self-assessment of capital report in accordance with Bank of Spain regulations under the Basel II Pillar 2 framework.

The concept of diversification is fundamental for appropriately measuring the risk profile of a global activity group. Although it is an intuitive concept and one present in risk management since banking began, we can also explain diversification as the fact that the correlation between various risks is imperfect and so the largest events of losses do not happen simultaneously in all portfolios or by types of risk. The sum of the economic capital of the different portfolios and types of risk, considered in isolation, is more than the Group's total economic capital. In other words, the Group's overall risk is less than the sum of its parts considered separately.

In addition, within the framework of the model for measurement and aggregation of economic capital, the risk of concentration for wholesale portfolios (large companies, banks and sovereigns) is also considered both in its dimension of exposure as well as concentration by sectors and countries. The existence of concentration in a country or a product in retail portfolios is captured by applying an appropriate model of correlations.

The economic capital is also particularly adapted to internal management of the Group, allowing objectives, prices, business viabilities, etc, to be assessed and helping to maximise the Group's profitability.

## Global risk analysis profile

The Group's risk profile at December 31, 2011, measured in terms of economic capital, is distributed by types of risk and the main business units, is reflected below:

### Distribution of economic capital

*By types of risk*

### Distribution of economic capital

*By business units*

The distribution of economic capital among the main business units reflects the diversification of the Group's activity and risk. This diversification was affected during 2011 by the differentiated growth of countries, the acquisition of SEB's business in Germany, the acquisition of Bank Zachodni WBK in Poland and, to a lesser extent, the partial sale of insurance in Latin America.

Continental Europe accounts for almost 40% of the Group's capital, Latin America including Brazil (21%) more than one-third, the UK 10%, and Sovereign 6%, while the corporate area of financial management and equity stakes, which assumes the risk from the structural exchange-rate position (derived from stakes in subsidiaries abroad denominated in non-euro currencies) and most of the equity stakes, accounts for 11%.

The economic capital at December 31, 2011 was EUR 45,838 million, including minority interests.

The benefit of diversification envisaged in the economic capital model, including both the intra-risks (assimilated to geographic) as well as inter-risks, amounted to around 22% at the end of 2011.

The Group also conducts capital planning with the main objective of obtaining future projections of economic and regulatory capital and so be able to assess situations of capital sufficiency in various scenarios. Each scenario incorporates the forecasts of results in a coherent way, both with their strategic objectives (organic growth, M&A, pay-out ratio, etc) as well as with the evolution of the economic situation and in the face of stress situations. Possible capital management strategies are identified that enable the bank's solvency situation to be optimised as well as the return on capital.

## Return on risk adjusted capital (RORAC) and creation of value

Grupo Santander has been using RORAC methodology in its credit risk management since 1993 in order to:

- Calculate the consumption of economic capital and the return on it of the Group's business units, as well as segments, portfolios and customers, in order to facilitate optimum assigning of economic capital.
- Budget the capital consumption and RORAC of the Group's business units, including them in their remuneration plans.
- Analyze and set prices during the decision-taking process for operations (admission) and clients (monitoring).

RORAC methodology enables one to compare, on a like-for-like basis, the return on operations, customers, portfolios and businesses, identifying those that obtain a risk adjusted return higher than the cost of the Group's capital, aligning risk and business management with the intention of maximising the creation of value, the ultimate aim of the Group's senior management.

The Group regularly assesses the level and evolution of value creation (VC) and the risk adjusted return (RORAC) of its main business units. The VC is the profit generated above the cost of the economic capital (EC) employed, and is calculated as follows:

**Value creation = Profit – (average EC x cost of capital)**

The economic profit is obtained by making the necessary adjustments to attributable profit so as to extract just the recurrent profit that each unit generates in the year of its activity.

The minimum return on capital that an operation must attain is determined by the cost of capital, which is the minimum required by shareholders. It is calculated objectively by adding to the free return of risk the premium that shareholders demand to invest in our Group. This premium depends essentially on the degree of volatility in the price of the Banco Santander share in relation to the market's performance. The cost of capital in 2011 applied to the Group's various units was 13.862%.

A positive return from an operation or portfolio means it is contributing to the Group's profits, but it is not really creating shareholder value unless that return exceeds the cost of capital.

The performance of the business units in 2011 in value creation varied, declining in Europe and maintaining itself in the Americas. The creation of value and the RORAC for the Group's main business areas are shown below:

**Main segments**
*Million euros*

| | *RORAC* (%) | Creation of value |
|---|---|---|
| Continental Europe | 16.2 | 437 |
| UK | 23.0 | 456 |
| Brazil | 31.1 | 1,751 |
| Rest of Latin America | 37.2 | 1,410 |
| Sovereign | 18.3 | 128 |
| **Subtotal of operating areas** | **23.7** | **4,181** |
| Financial management and equity stakes | -37.9 | -3,001 |
| **Group total** | **16.3** | **1,181** |

The Group's RORAC comfortably exceeded the cost of capital estimated for 2011 and stood at 16.3%. The creation of value (i.e. the economic profit less the average cost of capital used to achieve it) amounted to EUR 1,181 million.

# 9. Risk training activities

Santander has a corporate school of risks. Its purpose is to help to consolidate the risk management culture in Santander and ensure that all employees in the risks area are trained and developed with the same criteria.

The school, which gave a total of 31,028 hours of training to 6,195 employees in 2011 in 125 activities, is the base for strengthening Santander's leadership in this sphere and continuously enhancing the skills of its staff.

It also trains staff from other business segments, particularly in the retail banking area, and aligns the requirements of risk management with business goals.

**Hours of training**

# Appendices

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# Grupo Santander's compliance programme

The General Code of Conduct is the central element of the Group's compliance programme. This code, which sets out the ethical principles and rules of conduct governing the behaviour of all Grupo Santander's employees, is supplemented by other rules in codes and sector specific manuals.

The compliance management area is part of the general secretariat division and is responsible, along with other areas or units, for executing the compliance programme and, in general, the Group's compliance policy in order to: (i) minimise the probability of irregularities occurring; and (ii) identify, report and ensure that those irregularities that might occur are quickly resolved.

The compliance area has the following functions:

1. Implement the General Code of Conduct and the Group's other codes and manuals.
2. Supervise the training activity conducted by the human resources area.
3. Manage the investigations made into possible acts of non-compliance, requesting help from internal auditing and proposing to the irregularities committee the relevant sanctions.
4. Cooperate with internal auditing in the regular reviews it makes regarding compliance with the General Code and with the codes and sector specific manuals, without detriment to the regular reviews of regulatory compliance that compliance management makes.
5. Receive and deal with denunciations made by employees and third parties through the channel for this purpose.
6. Advise on resolving doubts that arise from implementing codes and manuals.
7. Draw up an annual report on implementing the compliance programme, which will be submitted to the audit and compliance committee.
8. Regularly inform the general secretary, the audit and compliance committee and the board on the execution of the compliance policy and implementation of the compliance programme; and
9. Annually asses year the changes needed to be introduced into the compliance programme, especially in case of detecting unregulated business areas and procedures susceptible to improvement, and propose these changes to the audit and compliance committee.

Regarding the codes and sector specific manuals, the compliance programme focuses, among others, on the following operational spheres:

- Prevention of money laundering and financing of terrorism.
- Conduct in the securities markets.
- Marketing of products and services.
- Relations with regulators and supervisors.
- Preparing and disseminating the Group's institutional information.

## Governance of the compliance programme

The board, the audit and compliance committee and other bodies of the Group, with varying levels of responsibility and different tasks, supervise the compliance programme in Grupo Santander.

The board approves the Group's general compliance policy and the compliance programme and regularly receives information from the audit and compliance committee on implementation of the programme.

The audit and compliance committee supervises compliance with the General Code of Conduct and the codes and sector specific manuals and, in general, implementation of the programme. It makes the necessary proposals for improvement, and regularly informs the board on the state of the compliance function and implementation of the programme.

The report on the compliance function to the board is permanent and is carried out via the audit and compliance committee. The Group's chief compliance officer participated in 11 of the 12 meetings held by this committee in 2011.

As well as presenting at these meetings monographs on various issues, the chief compliance officer reported in 11 reports on 134 specific regulatory issues that affected the Group's entities throughout the world.

The compliance committee, which is the body responsible for all matters related to the compliance function that are not specific ones of marketing products and services or the prevention of money laundering and of the financing of terrorism, met five times in 2011.

The corporate committee of commercialisation, which develops in the Group the processes related to approval of products and services offered to customers and their monitoring, held 19 meetings in 2011, and the analysis and resolution committee, specialised in prevention of money laundering and financing of terrorism, met four times.

Lastly, as part of its functions of investigation and internal control, internal auditing carried out tests and necessary reviews to ensure that the rules and procedures established in the compliance programme are being fulfilled.

## Prevention of money laundering and of financing of terrorism

It is a strategic objective of Grupo Santander, a socially responsible organisation, to have an advanced and effective system to prevent money laundering and the financing of terrorism, permanently adapted to the latest international regulations and with the capacity to meet the appearance of new techniques by criminal organisations.

Money laundering is participation in any activity whose purpose is to acquire, possess, use, convert, transfer, hide or mask the nature, origin, location, disposition, movement or ownership of goods or rights on goods, knowing that these goods come from criminal activity or participation in criminal activity.

Financing of terrorism is understood as supplying, depositing, distributing or collecting funds, by any means, directly or indirectly, with the intention of using them or with the knowledge that they will be used wholly or partly to commit a crime of terrorism.

The prevention function is articulated around policies that set minimum standards that Grupo Santander's units must observe, formulated in accordance with the principles of the 49 recommendations of the Financial Action Task Force Group and Directive 2005/60/EC of the European parliament and of the Council, of October 26, 2005, regarding prevention of using the financial system to launder money and finance terrorism.

These policies are set out in corporate manuals (universal banking, private banking and correspondent banking). These internal rules have been transposed to all the Group's units throughout the world, with the necessary local adaptations. The various subsidiaries and business areas have manuals and procedures adapted to the type of business and profile of customers.

The central department for the prevention of money laundering (CDPML) carried out actions in 2011 to fully adapt the units to the rules transposed by the third directive of the European Union, mainly regarding the requirement of segmentation by risk of money laundering and financing of terrorism of all customers in the process of contracting, as well as establishment of due diligence differentiated on the basis of the risk assigned (strengthened, standard or simplified). It also promoted a permanent and systematic task of updating the rules in all units abroad.

The organisation to prevent money laundering and the financing of terrorism has three pillars: the analysis and resolution committee, the central department for the prevention of money laundering and executives in charge of prevention at the various levels.

The analysis and resolution committee is a collegiate body of corporate scope chaired by the general secretary of Banco Santander, S.A. and made up of representatives from internal auditing, general secretariat, human resources, as well as the most directly affected business units.

The CDPML is integrated into the corporate area of compliance and reputational risk and its function is to establish, coordinate and supervise the systems and procedures for the prevention of money laundering and of financing of terrorism in all the Group's units. At the end of 2011, the CDPML had 40 employees.

There are also people responsible for prevention of money laundering and of financing of terrorism at four different levels: area, unit, branch and account.

A total of 508 professionals work in the Group in the area of prevention of money laundering and of financing of terrorism. Of them, three-quarters work on this and nothing else. They tend to 195 units in 35 countries.

Grupo Santander has established in all its units and business areas corporate systems based on decentralised IT applications. These enable transactions and customers who because of their risk need to be analysed to be presented to the branches of the account and/or customer relation managers. The tools are complemented by others centralised by teams of analysis from prevention units who, on the basis of certain risk profiles and changes in certain patterns of customer behaviour, enable operations susceptible of being linked to money laundering and/or the financing of terrorism to be analysed, identified early on and monitored.

The Group analysed a total of 24.8 million operations in 2011 (both by the commercial networks as well as money laundering prevention teams), of which more than one million were by the units in Spain.

Procedures have also been established in all units that enable suspicious transactions to be communicated to the authorities, guaranteeing throughout the circuit the strictest confidentiality.

In 2011 the Group opened and investigated 73,942 cases regarding customers and operations with signs of links to criminal activities. As a result of these investigations, 20,162 communications were issued to the relevant authorities in various jurisdictions, as the initial suspicions were firmed up (voluntary communications for suspicion).

One of the Group's priorities in this sphere is to take the necessary steps so that all employees know the requirements resulting from the prevailing regulations. In 2011, 119,976 employees received training on prevention of money laundering (a total of 146,911 hours).

The CDPML and the local departments of prevention conduct annual reviews of all the Group's units throughout the world. In 2011, 172 units were reviewed, 25 in Spain and the rest abroad, issuing reports that state the measures to be taken to improve and strengthen systems. These reports entail in all cases the measures to be taken (recommendations) to improve the systems. In 2011, 338 measures were established, which are being monitored until their full and effective implementation.

Many units are submitted to regular reviews by external auditors. Deloitte carried out in 2011 an integral review of the global system of prevention of money laundering at the parent bank and in the rest of the units in Spain. This review also took into consideration aspects of coordination and global supervision of the rest of the Group's units in the world. The report issued in April 2011 did not find any evidence of material weakening of the system, limiting itself to formulating an eventual recommendation of the rectification arisen and an eventual recommendation of the improvement suggested.

Santander is a founder member of the *Wolfsberg Group* along with 10 other large international banks. The Wolfsberg Group's purpose is to establish international standards that increase the effectiveness of programmes to combat money laundering and the financing of terrorism in the financial community. Various initiatives have been developed on anti-money laundering in private and correspondent banking, the financing of terrorism, among others. Regulatory authorities and experts in this area believe that the principles and guidelines set by the *Wolfsberg Group* represent an important step in the fight against money-laundering, corruption, terrorism and other serious crimes.

During 2011, the *Wolfsberg Group* published the Principles of Action in Foreign Trade Activity and two guides of good practices (to prevent corruption and on prepaid cards). It also maintained working groups to propose best practices regarding various compliance and regulatory issues. As part of the private sector, it cooperated actively in consultations by different regulatory and supervision bodies.

## Conduct in the securities markets

The functions of compliance management with regard to the code of conduct in the securities markets are as follows:

1. Register and control sensitive information known and/or generated by the Group.
2. Keep updated the lists of securities affected and related personnel, and watch the transactions conducted with these securities.
3. Monitor transactions with restricted securities according to the type of activity, portfolios or collectives to whom the restriction is applicable.
4. Receive and deal with communications and requests to carry out own account transactions.
5. Control own account transactions of the personnel subject to the CCSM.
6. Manage failures to comply.
7. Resolve doubts on the Code of Conduct in the Securities Markets (CCSM).
8. Resolve and register, in the sphere of its responsibilities, conflicts of interest and situations that could give rise to them.
9. Assess and manage conflicts arising from the analysis activity.
10. Keep the necessary records to control compliance with the obligations envisaged in the CCSM.
11. Develop ordinary contact with regulators;
12. Organise the training and, in general, conduct the actions needed to apply the code; and
13. Analyse activities suspicious of constituting abuse of the market and, where appropriate, report them to the supervisory authorities.

The compliance management of the parent bank together with the compliance executives of the subsidiaries verifies that the obligations contained in the CCSM are observed by more than 8,000 Group employees throughout the world.

## Marketing of products

The section on reputational risk in the risk management report (pages 196 to 197 of this annual report) describes the composition, functions and activities carried out in 2011 by the corporate committee of marketing. The corporate office for management of reputational risk and the global consultative committee are also dealt with.

## Relations with the supervisory authorities and dissemination of information in markets

Compliance management is responsible for answering the information requirements of the regulatory and supervisory bodies in Spain and in those countries where the Group operates, monitoring the implementation of measures emanating from the reports or inspection activities of these bodies and supervising the way in which the Group disseminates institutional information into markets, ensuring it is done transparently and in accordance with the requirements of regulators.

At each meeting, the audit and compliance committee is informed of the main matters.

The 2011 report of the audit and compliance committee contains more information on relations with supervisors and institutional information on the Group.

## Other compliance activities

Compliance management continued to carry out other activities in 2011 inherent to its sphere, such as, among others, reviewing the Bank's internal rules (circulars and various notes) before their publication, ensuring treasury stock operations are in line with internal and external rules, maintaining the section on regulatory information on the corporate website, reviewing the vote recommendation reports for shareholders' meetings drawn up by the leading proxy agencies in this area and sending periodic regulatory information to the supervisory bodies (treasury stock, significant equity stakes, opening and closing of branches).

## Historical data[1]

*2001 - 2011*

| | | 2011 | 2010 | 2009 | 2008 | 2007 |
|---|---|---|---|---|---|---|
| | Mill. $ | Mill. euros | Mill. euros | Mill. euros | Mill. euros | Mill. euros |
| **Balance sheet** | | | | | | |
| Total assets | 1,619,348 | 1,251,525 | 1,217,501 | 1,110,529 | 1,049,632 | 912,915 |
| Net customer loans | 970,555 | 750,100 | 724,154 | 682,551 | 626,888 | 571,099 |
| Customer deposits | 818,435 | 632,533 | 616,376 | 506,976 | 420,229 | 355,407 |
| Customer funds under management | 1,273,654 | 984,353 | 985,269 | 900,057 | 826,567 | 784,872 |
| Shareholders' equity [2] | 104,326 | 80,629 | 75,273 | 70,006 | 63,768 | 51,945 |
| Total managed funds | 1,789,438 | 1,382,980 | 1,362,289 | 1,245,420 | 1,168,355 | 1,063,892 |
| **Income statement** | | | | | | |
| Net interest income | 42,852 | 30,821 | 29,224 | 26,299 | 20,945 | 14,443 |
| Gross income | 61,539 | 44,262 | 42,049 | 39,381 | 33,489 | 26,441 |
| Net operating income | 33,886 | 24,373 | 23,853 | 22,960 | 18,540 | 14,417 |
| Profit before taxes | 11,038 | 7,939 | 12,052 | 10,588 | 10,849 | 10,970 |
| Attributable profit to the Group | 7,439 | 5,351 | 8,181 | 8,943 | 8,876 | 9,060 |

| | | 2011 | 2010 | 2009 | 2008 | 2007 |
|---|---|---|---|---|---|---|
| | $ | Euros | Euros | Euros | Euros | Euros |
| **Per share data[3]** | | | | | | |
| Attributable profit to the Group | 0.8366 | 0.6018 | 0.9418 | 1.0454 | 1.2207 | 1.3320 |
| Dividend | 0.7763 | 0.6000 | 0.6000 | 0.6000 | 0.6325 | 0.6068 |
| Share price | 7.595 | 5.870 | 7.928 | 11.550 | 6.750 | 13.790 |
| Market capitalisation (million) | 65,070 | 50,290 | 66,033 | 95,043 | 53,960 | 92,501 |

Euro / $ = 1.2939 (balance sheet) and 1.3903 (income statement)

(1) Figures from 2004 on according to IFRS.
(2) In 2011, estimated data of May 2012 scrip dividend.
(3) Figures adjusted to capital increases.
(4) Compound Annual Growth Rate.

## Net customer loans and total managed funds

*Billion euros*

## Profit before provisions (net operating income)

*Billion euros*

| 2006 Mill. euros | 2005 Mill. euros | 2004 Mill. euros | 2003 Mill. euros | 2002 Mill. euros | 2001 Mill. euros | CAGR[4] (%) |
|---|---|---|---|---|---|---|
| 833,873 | 809,107 | 664,486 | 351,791 | 324,208 | 358,138 | 13.3 |
| 523,346 | 435,829 | 369,350 | 172,504 | 162,973 | 173,822 | 15.7 |
| 331,223 | 305,765 | 283,212 | 159,336 | 167,816 | 181,527 | 13.3 |
| 739,223 | 651,360 | 595,380 | 323,901 | 304,893 | 331,379 | 11.5 |
| 40,062 | 35,841 | 32,111 | 18,364 | 17,594 | 19,128 | 15.5 |
| 1,000,996 | 961,953 | 793,001 | 460,693 | 417,546 | 453,384 | 11.8 |
| | | | | | | |
| 12,480 | 10,659 | 7,562 | 7,958 | 9,359 | 10,257 | 11.6 |
| 22,333 | 19,076 | 13,999 | 13,128 | 14,004 | 15,564 | 11.0 |
| 11,218 | 8,765 | 6,431 | 5,721 | 5,566 | 5,944 | 15.2 |
| 8,995 | 7,661 | 4,387 | 4,101 | 3,509 | 4,237 | 6.5 |
| 7,596 | 6,220 | 3,606 | 2,611 | 2,247 | 2,486 | 8.0 |

| 2006 Euros | 2005 Euros | 2004 Euros | 2003 Euros | 2002 Euros | 2001 Euros | CAGR[4] (%) |
|---|---|---|---|---|---|---|
| 1.1334 | 0.9293 | 0.6791 | 0.5105 | 0.4431 | 0.5079 | 1.7 |
| 0.4854 | 0.3883 | 0.3107 | 0.2824 | 0.2690 | 0.2690 | 8.4 |
| 13.183 | 10.396 | 8.512 | 8.755 | 6.098 | 8.773 | (3.9) |
| | | | | | | |
| 88,436 | 69,735 | 57,102 | 44,775 | 31,185 | 43,845 | 1.4 |

## Attributable profit to the Group

*Million euros*

## Dividend per share*

*Euros*

(*).- Figures adjusted to capital increases and stock splits.

# General information

## Banco Santander, S.A.

The parent bank of Grupo Santander was established on March 21, 1857 and incorporated in its present form by a public deed executed in Santander, Spain, on January 14, 1875, recorded in the Mercantile Registry (Finance Section) of the Government of the Province of Santander, on folio 157 and following, entry number 859. The Bank's By-laws were amended to conform with current legislation regarding limited liability companies. The amendment was registered on June 8, 1992, and entered in the Mercantile Registry of Santander (volume 448, general section, folio 1, page 1,960, first inscription of adaptation).

The Bank is also recorded in the Special registry of Banks and Bankers 0049, and its fiscal identification number is A-390000013. It is a member of the Bank Deposit Guarantee Fund.

## Registered Office

The corporate by-laws and additional public information regarding the company may be inspected at its registered office at Paseo de la Pereda, numbers 9 to 12, Santander.

## Operational Headquarters

Santander Group City
Avda. De Cantabria s/n
28660 Boadilla del Monte
Madrid
Spain

## General Information

Telephone: 902 11 2211
Telephone: 91 289 00 00

**www.santander.com**

## Shareholders' Office

Santander Group City
Edificio Marisma, Planta Baja,
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Telephones: 902 11 17 11 and +34 91 276 92 90.

## Relations with investors and analysts

Santander Group City
Edificio Pereda, Planta Primera,
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Telephones: +34 91 259 65 14

## Customer Attention Department

Santander Group City
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Telephone: 91 257 30 80
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atenclie@gruposantander.com

## Ombudsman

Mr. José Luis Gómez-Dégano,
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