
# 2013

## ANNUAL REPORT

Santander

a bank for your ideas

# ANNUAL REPORT 2013

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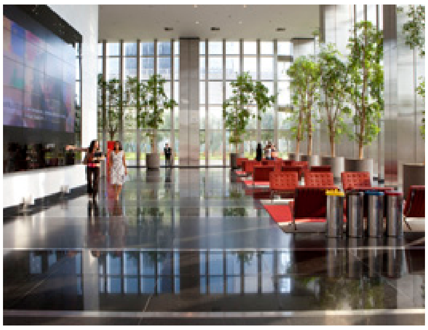
**www.santanderannualreport.com/2013/en/**

AWARD WINNER 2013 ir society BEST PRACTICE AWARDS



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# KEY FIGURES

| BALANCE SHEET AND INCOME STATEMENT (Million euros) | 2013 | 2012 | % 2013/2012 | 2011 |
|---|---|---|---|---|
| Total assets | **1,115,637** | 1,269,598 | (12.1) | 1,251,008 |
| Customer loans (net) | **668,856** | 719,112 | (7.0) | 748,541 |
| Customer deposits | **607,836** | 626,639 | (3.0) | 632,533 |
| Managed customer funds | **924,621** | 968,987 | (4.6) | 984,353 |
| Shareholders' funds[1] | **84,269** | 80,921 | 4.1 | 80,379 |
| Total managed funds | **1,240,806** | 1,387,740 | (10.6) | 1,382,464 |
| Net interest income[2] | **25,935** | 29,923 | (13.3) | 28,883 |
| Gross income[2] | **39,753** | 43,406 | (8.4) | 42,466 |
| Pre-provision profit (net operating income)[2] | **19,909** | 23,422 | (15.0) | 23,055 |
| Profit from continuing operations | **5,539** | 2,993 | 85.1 | 6,103 |
| Attributable profit to the Group[2] | **4,370** | 2,295 | 90.5 | 5,330 |

| RATIOS (%) | 2013 | 2012 | | 2011 |
|---|---|---|---|---|
| Efficiency (with amortisation) | **49.9** | 46.0 | | 45.7 |
| ROE | **5.42** | 2.91 | | 7.12 |
| ROTE | **7.73** | 4.28 | | 10.77 |
| ROA | **0.44** | 0.25 | | 0.50 |
| RoRWA | **1.01** | 0.56 | | 1.05 |
| Core capital (BIS II) | **11.71** | 10.33 | | 10.02 |
| Loan-to-deposit ratio[3] | **109** | 113 | | 117 |
| Non-performing loan (NPL) ratio | **5.64** | 4.54 | | 3.90 |
| NPL coverage | **61.7** | 72.4 | | 61.0 |

| THE SHARE AND CAPITALISATION | 2013 | 2012 | % 2013/2012 | 2011 |
|---|---|---|---|---|
| Number of shares in circulation (millions) | **11,333** | 10,321 | 9.8 | 8,909 |
| Share price (euros) | **6.506** | 6.100 | 6.7 | 5.870 |
| Market capitalisation (million euros) | **73,735** | 62,959 | 17.1 | 50,290 |
| Shareholders' funds per share (euros) | **7.44** | 7.88 | | 8.59 |
| Share price/shareholders' funds per share (times) | **0.88** | 0.77 | | 0.68 |
| PER (share price/attributable profit per share) (times) | **16.13** | 25.96 | | 9.79 |
| Attributable profit per share (euros) | **0.40** | 0.23 | 71.7 | 0.60 |
| Remuneration per share (euro) | **0.60** | 0.60 | | 0.60 |
| Total shareholder remuneration (million euros) | **6,775** | 6,128 | 10.6 | 5,260 |

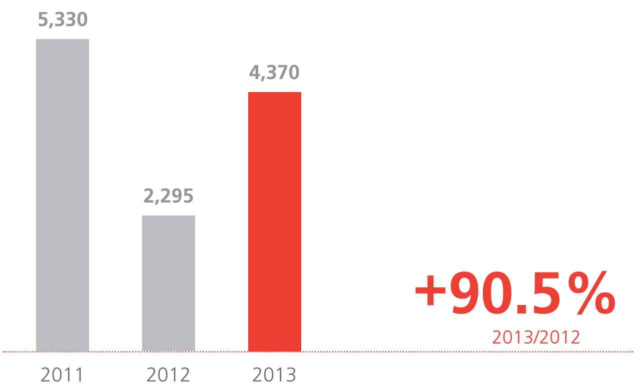
| OTHER FIGURES | 2013 | 2012 | % 2013/2012 | 2011 |
|---|---|---|---|---|
| Number of shareholders | **3,299,026** | 3,296,270 | 0.1 | 3,293,537 |
| Number of employees | **182,958** | 186,763 | (2.0) | 189,766 |
| Number of branches | **13,927** | 14,392 | (3.2) | 14,756 |

| INFORMATION ON ORDINARY PROFIT[4] | 2013 | 2012 | % 2013/2012 | 2011 |
|---|---|---|---|---|
| Attributable profit to the Group[5] | **4,370** | 5,341 | (18.2) | 7,000 |
| Attributable profit per share (euros) | **0.40** | 0.55 | (26.3) | 0.79 |
| ROE | **5.42** | 6.78 | | 9.35 |
| ROTE | **7.73** | 9.97 | | 14.14 |
| ROA | **0.44** | 0.48 | | 0.63 |
| RoRWA | **1.01** | 1.10 | | 1.34 |
| PER (share price/attributable profit per share) (times) | **16.13** | 11.15 | | 7.46 |

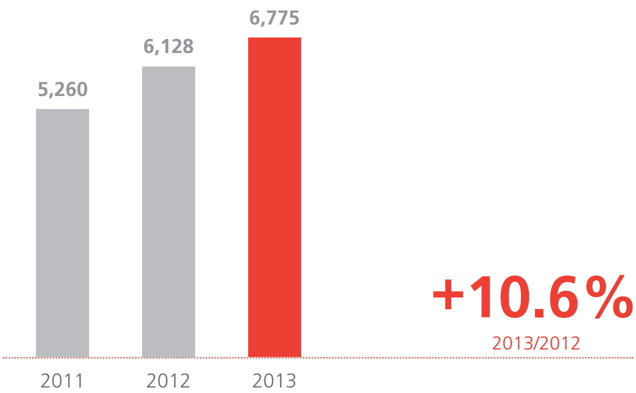
1. In 2013, estimated scrip dividend figure for May 2014.
2. Variations excluding the impact of exchange rates: net interest income -7.0%; gross income -2.2%; pre-provision profit-8.4%; attributable profit +136.8%.
3. Includes retail commercial paper.
4. Excluding the net of capital gains and provisions.
5. Variation excluding exchange rate differences: -10.7%.

In a difficult economic environment, Santander generated a profit of EUR 4,370 million, increased its capital ratios, improved its liquidity position and held its remuneration per share at EUR 0.60 for the fifth year running

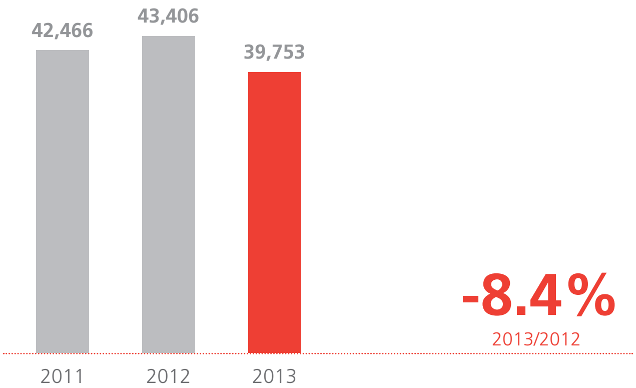
## ATTRIBUTABLE PROFIT
Million euros



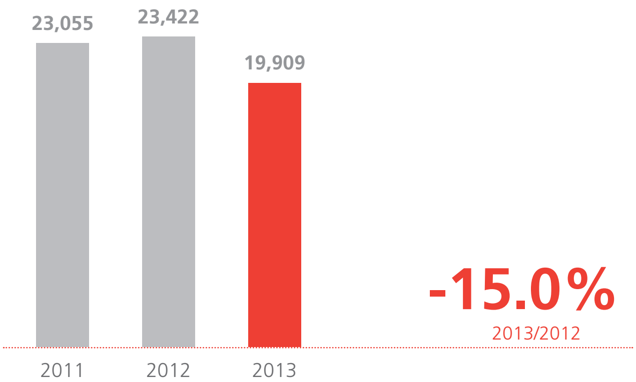

## TOTAL DIVIDEND PAYOUT
Million euros



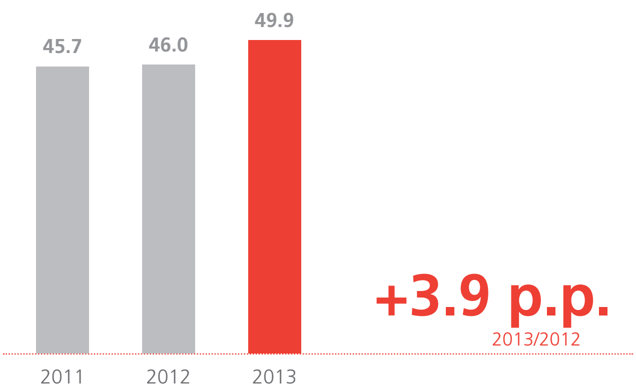

## GROSS INCOME
Million euros



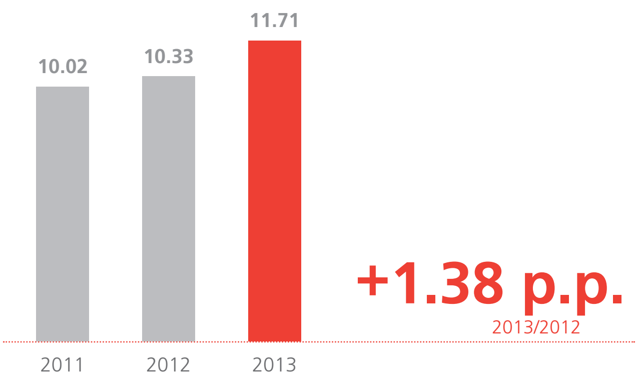

## PRE-PROVISION PROFIT (NET OPERATING INCOME)
Million euros




## EFFICIENCY
%




## CORE CAPITAL
BIS II criteria %



# LETTER FROM THE CHAIRMAN

Dear Shareholders

Banco Santander posted an attributable profit of EUR 4,370 million in 2013, 90.5% more than in 2012. **During the five-year international financial and economic crisis the Bank maintained a substantial degree of recurrence in revenue generation, while also continuing its main priority of strengthening the balance sheet.**

I would like to highlight the following results:

- Pre-provision profit was EUR 19,909 million, one of the highest among our competitors, despite a weak economic environment, interest rates at historic lows, the depreciation of some currencies, strong regulatory pressures and reduced demand for loans in mature markets.

- The effort made to cut costs, which were lower than in 2012 and enabled Banco Santander to remain one of the most efficient international banks.

- The reduction in provisions, which is a trend that will consolidate, as we have completed all the provisions for real estate exposure in Spain. Moreover, the cost of credit declined to 1.53%.

- Lastly, the remuneration per share was held at EUR 0.60 for the fifth year running.

**Read the QR code**
Access the chairman's letter online.

The Bank ended 2013 with a BIS II capital ratio of 11.71%, underscoring its substantial capacity to generate capital organically, and a loan-to-deposit ratio of 109%.

The NPL ratio was 5.64%. It rose in Spain and fell in other core markets such as Brazil, the United Kingdom and the United States.

The **mergers** underway in 2013 in Spain (Santander, Banesto and Banif) and in Poland (Bank Zachodni WBK and Kredyt Bank) have already begun to yield cost synergies, which will increase in the coming years, and bolster our competitive position in these markets.

Banco Santander ended 2013 with **strategic agreements** to spur the asset management business through the alliance with Warburg Pincus and General Atlantic, strengthen consumer finance in Spain with the acquisition of 51% of the finance company of El Corte Inglés and step up its presence in Asia with the purchase of 8% of Bank of Shanghai. The Bank also carried out operations in Brazil and Mexico, enabling it to optimise its capital structure.

In early 2014 the Bank finalised an agreement to sell Apollo Global Management 85% of Altamira Asset Management, which manages the recovery of contentious stage loans in Spain and the sale or rental of foreclosed real estate assets.

**"The Bank ended 2013 with a BIS II capital ratio of 11.71%, underscoring its substantial capacity to generate capital organically"**

# LETTER FROM THE CHAIRMAN

## SHAREHOLDER REMUNERATION

Shareholder remuneration continues to be a priority for Banco Santander. If the shareholders' meeting approves the board's proposal, the remuneration for 2013 will remain at EUR 0.60 per share, which represents a dividend yield of 10%, the highest among international banks. The total dividend payout will be EUR 6,775 million. In the last five years, Banco Santander's shareholders have received more than EUR 28,000 million in dividends.

The *Santander Dividendo Elección* (scrip dividend) programme was launched five years ago and enables 3.3 million shareholders to opt to receive their dividend in cash or in shares. In 2013, 87% of the capital opted to be paid in shares.

The improvement in investors' and analysts' perception of the Bank and the better economic prospects, as well as the easing of uncertainty surrounding Europe and Spain, helped the Santander share end the year up 6.7%. This rise, together with the dividend, **gave a total increase for shareholders of 16.7% in 2013.**

## A SOLID BANKING MODEL

In the international economic and financial crisis of recent years, Banco Santander maintained a high degree of recurrence in revenues. It was one of three large international banks that did not suffer a single quarterly loss between 2007 and 2013. **The strong points that explain the Bank's solid performance and enable us to keep on growing in a stable and sustainable way and with excellent prospects are:**

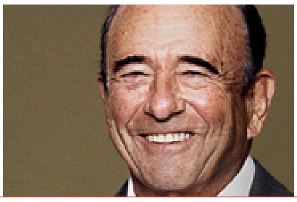
- **Geographic diversification.** Banco Santander operates in 10 main countries, with an appropriate balance between mature and emerging markets (contributing 47% and 53%, respectively, of the Group's profits). This geographic diversification reduces the volatility of earnings and enables the Bank to capitalise on its experience and best practices on a global scale.

- **Focus on retail banking.** Some 87% of our gross income comes from retail banking, which is a key factor for revenue stability.

- **Subsidiaries model.** The Group is made up of subsidiaries that are autonomous in capital and liquidity. This has clear strategic and regulatory advantages, as it limits the risk of contagion between the Group's units, imposes a double layer of global and local supervision and facilitates crisis management and resolution. The Group's goal is to list its main subsidiaries when market circumstances make it advisable.

**" In the last five years, Banco Santander's shareholders have received more than EUR 28,000 million in dividends "**

## // The Bank's strategic position is much better now than at the start of the international financial crisis //



- **Prudence in risks.** The board attaches particular importance to risk management and sets risk appetite at a medium-low level every year. The Bank has a solid balance sheet, thanks to the retail nature of its business, and maintains a limited exposure to sovereign risk, which is mainly used for interest rate hedging.

- **Comfortable liquidity position.** The strength of its commercial franchise enables Santander to finance most of its lending with deposits, while maintaining comfortable access to wholesale funding via many markets and instruments.

- **Solid solvency position.** The Group has ample capacity to generate capital, both organically and through active management of its business portfolio (core capital increased by 138 basis points in 2013).

- **Corporate governance.** The board's composition maintains an adequate balance between non-executive (69%) and executive directors (31%) and constantly promotes compliance with the best international practices in this sphere. The Group also has corporate policies that are implemented in all its banks and global units that supervise and control the whole of it.

  At a board meeting on 29 April 2013, Mr Alfredo Sáenz Abad, who had served as an excellent chief executive officer for 11 years, announced his voluntary resignation. At the same meeting, the board agreed to appoint Mr Javier Marín Romano as chief executive officer. He joined the Group in 1991 and had been a senior executive vice-president since 2007. He has held many senior posts, the most recent was head of the Private Banking, Asset Management and Insurance division.

  There have been other changes to the board during the year. Mr Manuel Soto and Lord Burns have left the board. On its behalf and my own I would like to thank them for their excellent work. Mr Juan Miguel Villar Mir joined the board as did Ms Sheila Bair, former chair of the Federal Deposit Insurance Corporation (FDIC), and I am sure they will make a very positive contribution.

**The Bank's strategic position is much better now than it was at the start of the international financial crisis, both in terms of geographic diversification and balance sheet strength.** During this period, Grupo Santander:

- Boosted its presence in the UK and entered the retail banking business in Poland, Germany and the US, enhancing its international diversification.

- Set aside provisions totalling EUR 65,000 million, covering its real estate exposure in Spain completely.

- Captured EUR 191,000 million of deposits and reduced its liquidity gap by EUR 149,000 million. The loan-to-deposit ratio was 109% for the Group and 87% in Spain at the end of 2013.

Banco Santander is the only bank in the world whose debt is rated above that of its sovereign debt by the three main agencies (S&P, Moody's and Fitch).

And we have achieved all this **without the need for state aid in any of the countries where the Group operates.**

**Today, after a phase in which we concentrated on strengthening the balance sheet, liquidity and strategic positioning, the Bank is ready to begin a new cycle of profitability and improving results.**

# LETTER FROM THE CHAIRMAN

## THE NEW CYCLE OF PROFITABILITY

The latest economic indicators confirm the upturn in the global economy.

Europe, one of the regions that reacted the slowest to the crisis, is progressing solidly and irreversibly toward banking union. This will enable confidence in the financial sector to recover and benefit economic growth.

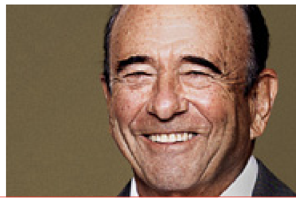
Banco Santander fully supports the establishment of a single supervisory mechanism. In November 2014, the European Central Bank will directly supervise the 130 largest banks in the euro zone, as well as the decisions adopted to achieve a single mechanism for resolving banking crises. Banking union will break the link between banking and sovereign risk and banks' valuations will depend more on their strength and the quality of their management than on their country of origin.

This improvement in the environment is already beginning to be perceived in the core countries where the Group operates, making us optimistic about the coming years.

- In **Brazil (23% of the Group's profits in 2013)**, non-performing loans have already begun to decline and the Bank is recovering its market share in lending. The country's medium-term outlook is excellent and Santander is very well placed to take advantage of this.
- In **Continental Europe (26%)**, business is picking up in Portugal and our banks are performing remarkably well in Poland and Germany.
- In **the United Kingdom (17%)**, there has been a change of trend in revenues and results have improved. Santander UK signed up 1.1 million new customers for the *1|2|3 World* product range in 2013, boosting current account balances. In corporate banking, we continued to support SMEs with 13% growth in lending.
- In **Mexico (10%)**, Banco Santander consolidated its position as the leader in the SME segment, with growth of 26%. As a result of this and the acquisition of ING's mortgage business, the Bank will reinforce its position as the second largest player by market share in this business. The objective is to continue to grow with the country and strengthen our commercial franchise by expanding our branch network.
- In **the United States (10%)**, at the end of 2013 we changed the Sovereign brand to Santander and began the Bank's commercial relaunch. Furthermore, our auto finance unit continues to grow strongly, spurred in recent months by the agreement reached with Chrysler. The recent flotation of Santander Consumer USA, with a market value of USD 8,300 million, underscored the success of this project and its potential for the Group.
- **As for Spain (7% of the Group's profits in 2013),** I would like to highlight the perceived improvement in the economy. The reforms are beginning to bear fruit; the recession is over and the risk premium has fallen significantly. Growth in foreign investment in the last few months confirms the enhanced credibility and international confidence in the country. However, and although some

**// The Bank is ready to begin a new cycle of profitability and higher earnings //**

**" In the next three years, we expect to regain our pre-crisis profit levels "**



progress is beginning to be made, the objective must continue to be to reduce the high unemployment rate. By integrating the three commercial networks under the Santander brand, we are in a privileged position to keep on growing in Spain and generate value.

The chief executive officer will set out in greater detail the business performance and outlook in the core countries where the Group operates.

## FUTURE VISION

Banco Santander is closely involved in building a more stable, solid and efficient financial sector, focused on financing sustainable economic growth. Our business model, based on lasting and profitable relations with customers, increasing their linkage with the Bank and maintaining prudence in risks and discipline in the financial and capital sphere, has been vindicated by the crisis and is very well regarded by regulators and rating agencies.

**Banco Santander is in a unique position to face the new cycle of growth in the global economy.** We have a potential market of 600 million people in our 10 core markets. Our challenge is to generate greater value by focusing on our customers and attracting those who are not yet clients. Meanwhile, we will continue to help social development in the countries where we do business via Santander Universities, a programme that has enabled us to create a unique alliance with more than 1,000 universities.

**In the next three years, we expect to regain our pre-crisis profit levels, which would enable us to maintain an adequate remuneration for shareholders,** while at the same time comfortably meeting the new regulations for capital and liquidity.

**At the Bank's general shareholders' meeting on 28 March 2014, the board will propose** continuing to pay four scrip dividends, under the *Santander Dividendo Elección* programme, well as **maintaining the 2014 dividend at EUR 0.60 per share for the sixth year running.**

I am sure that the ambitious business plans recently announced by the chief executive officer will be achieved successfully.

The board, the chief executive officer and I personally are fully committed to keep on managing the Bank in a way that rewards the confidence placed in it by its shareholders.

Thank you very much for your confidence.

**EMILIO BOTÍN**
Chairman

# LETTER FROM THE CHIEF EXECUTIVE OFFICER

Dear Shareholder,

Banco Santander made an attributable profit of EUR 4,370 million in 2013, 90.5% more than in 2012.

As the chairman explains in his letter to shareholders, profit growth in 2013 was based on stable gross income (net interest income and fee income), efficient cost management and lower provisions, all of it against a backdrop of a still very complicated economic environment in some of the countries where the Group operates.

Our results enabled us to maintain the remuneration per share at EUR 0.60 for yet another year.

At the same time, **Santander continued to intensify its focus on customers, improve efficiency and boost profitability**. In order to achieve this:

- The Retail & Commercial Banking division was created to develop, design and integrate the commercial models of the various countries, exchange best practices and reduce the time taken to develop business initiatives.
- The Human Resources, Organisation and Costs division was given a new focus, with a greater emphasis on management of customer-oriented talent and on identifying synergies within the Group.
- A global division for Recoveries and Asset Restructuring was created.

Our performance in 2013 reinforces the merits of our diversified business model, centred on retail banking activities and focused on ten core markets where we have a significant share. **Banco Santander's model brings a significant level of recurrence and stability to the Group's results.**

**Read the QR code**
Access the CEO's letter online.

## INTERNATIONAL BANKING ENVIRONMENT

The forecasts for 2014 and 2015 point to an upswing in the international economic cycle, particularly in the markets hardest hit by the crisis.

However, **the economic recovery will not be sufficient for the banking sector to return to the pre-2008 levels of profitability.** The new regulations introduced as a result of the international financial crisis are having and will have a structural impact on banks' profitability. This is particularly the case with the higher capital requirements, new short- and long-term liquidity and leverage ratios, the higher cost of deposits as a result of the new bank resolution mechanisms, as well as the cost of compliance itself in the new regulatory environment.

Banco Santander comfortably meets all the new regulatory requirements:

- Its core capital ratio has risen by 413 b.p. since the start of the crisis and it has strengthened its balance sheet, which is well provisioned and has high levels of coverage.
- The loan-to-deposit ratio improved to 109%.
- It successfully passed the various stress tests conducted on European and Spanish banks and is very well prepared for the balance sheet analysis that the ECB will carry out as a prior step to setting up the Single Supervisory Mechanism.

**Santander has completed a cycle whose objective was to bolster the balance sheet. Our management is now concentrating on attaining higher levels of profits,** while bear-

# LETTER FROM THE CHIEF EXECUTIVE OFFICER

ing in mind other important trends that will define the sector's future, such as:

- The expansion of the middle classes in emerging markets, while the affluent segment gains importance globally;
- The recovery in companies' productivity and profitability in a context of globalization that offers growing investment opportunities; and
- An increasingly demanding consumer with greater access to new technologies.

## GRUPO SANTANDER'S MANAGEMENT DRIVERS

In the context I have described, and bearing in mind the structural impact of the new financial regulations on business profitability, Banco Santander's management drivers are:

**1. Capital management**
Banco Santander is analysing its markets and segments in order to ensure the correct allocation of capital to the businesses that are most profitable and have the highest growth potential, all with a clear long-term vision.

In order to guarantee that capital investment is in line with the levels of risk and expected profitability of each of our businesses, we are establishing common management metrics throughout the Group, based on the rate of return on risk-weighted assets (RoRWA).

**2. Increasing the focus on the customer**
Banco Santander will continue to develop its retail banking strategy, based on forging lasting and value-added relationships with customers.

Our priority is to know our customers better and adapt the service and value proposition we offer them because different customer segments require different solutions. This will enable us to continue to make progress in linking customers so that Santander is their main bank, which is undoubtedly a key element in recurrent revenue generation.

Consequently, we are striving to:

- Transform our commercial processes, which have to be simpler and more efficient and accessible for customers.
- Have the best business intelligence tools and better management of information.
- And establish a more agile risk management system and one with models tailored more to each customer segment, while maintaining our hallmark of prudence.

Our branch network will continue to be the main channel for high value relationships with customers. At the same time, as an increasing percentage of our clients are operating via online and mobile telephone banking and the contact centre, we are strengthening our multi-channel distribution model so as to provide a more integral, complete and accessible service.

**3. Improve efficiency**
Banco Santander is one of the world's most efficient banks: our objective is to continue enhancing our efficiency and productivity in order to put them at the service of our customers.

During 2013, **we designed a global plan to create synergies of up to 2016. This is already being implemented and will generate EUR 1,500 million of savings,** half of them in 2014. Our objective is not only to reduce costs, but also to manage our resources in a more efficient, agile and productive way.

**4. Management of human resources**
Banco Santander realises that the key to success lies in our professionals. We are developing our human resources management model in order to align it with the Bank's objective of intensifying our vocation to serve our customers.

**" In 2013, Santander continued to intensify its focus on customers, improve efficiency and boost profitability "**

We are reviewing the processes for selecting, training and rewarding our employees to align them with the specialised and differentiated management of our customers. The Bank attaches great importance to managing talent and developing professional careers.

Implementation of these management drivers is already underway, through various plans and projects, and is reinforced by Grupo Santander's global capacities, which enable it to identify, develop and share the best practices of international banking among its different markets. For example:

- On the basis of the good practices in Mexico and Argentina, we have established a new commercial model in Chile.
- Our Select clients will be able to use their cards free of charge in the Bank's cashpoints throughout the world.
- A project is underway which will enable the corporate clients of our retail networks to access wholesale banking products and services.

## MANAGEMENT PRIORITIES FOR 2014 BY UNITS

The management priorities in our ten core markets are:

**Brazil**

**We remain very positive about the medium- and long-term potential of the Brazilian economy.** After a period of adjustment in 2013 and 2014, with growth rates of close to 2%, Brazil's solid macroeconomic, institutional and political fundamentals will create the right conditions for a new phase of expansion on a firmer footing.

In the last few years, the Brazilian economy has made decisive progress in key areas, becoming the world's seventh largest economy and creating a large middle class that includes 50% of the population and which represents an enormous potential for "bankarisation".

- In this environment, Santander Brazil starts from a solid situation in a well-capitalised financial market, where we have growth opportunities in segments such as high income, SMEs or agriculture. This will enable us to boost our market share at the same time as we reinforce customer linkage.
- We launched projects to increase commercial productivity, based on best practices identified in other Group units. We drew up efficiency improvement measures that will keep cost increases below the expected inflation rate and help profits grow in a decisive way.

**United Kingdom**

The UK's macroeconomic outlook is solid for 2014 and the financial market outlook is equally positive for all business segments.

During the crisis years, Santander consolidated itself as one of the leading banks. It is particularly worth noting the progress made in the SME market, while maintaining our leadership in mortgages and deposits.

We are re-defining our customer relationship model in order to make it simpler, more personal and balanced. This strategy includes the range of *1|2|3 World* products, which are already enjoyed by 2.4 million customers and have increased their linkage and satisfaction with the Bank.

- We will continue in 2014 to improve our customer segmentation and quality of service, and are strongly committed to developing segments such as companies, SMEs and high income, where we have a lot of potential.
- In the personal banking segment, we will remain focused on developing *1|2|3*. This attractive and differentiated range of products will enable us capture a larger number of customers at a time of greater market rotation.

# LETTER FROM THE CHIEF EXECUTIVE OFFICER

**Mexico**
Mexico's economic outlook is very good thanks to the structural reforms approved under the Mexico Plan and consolidation of the recovery in the US.

Santander Mexico continued to contribute to the country's growth in 2013, developing its branch network in the various business lines, both general and specialised, and completing the integration of ING's mortgage business, acquired in 2012.

In 2014, we expect to continue to gain market share in all segments and concentrate on companies, SMEs and medium and high incomes. We also expect loan-loss provisions to normalise, following the impact in 2013 of implementing the new provisioning criteria for loans to companies, as well as the provisions for homebuilders (*viviendera*s).

**United States**
The US economy will continue to strengthen in 2014 and the employment outlook is good. The US is a key market for Santander; its size gives us significant long-term growth opportunities.

The brand was changed in 2013 to Santander and our retail banking unit was re-launched with a very innovative product. This year we are focusing on developing a full franchise, with the capacity to grow in the most attractive segments.

Santander Consumer USA continues to grow at a brisk pace, the fruit of its agreements with major auto producers. Following its flotation at the beginning of 2014, we expect further strong growth.

**Spain**
**It is highly likely that the Spanish economy will consolidate its recovery in 2014.** This upturn is firmly anchored in competitiveness gains.

The structural reforms undertaken in the last few years have laid the foundations for more sustainable growth and contributed to reactivating the solvent demand for loans that is beginning to be seen in SMEs and companies.

The commercial networks of Santander, Banesto and Banif were successfully merged during 2013. The personal banking, companies and corporate banking businesses in the country were re-grouped under the new Santander Spain unit in June, enabling us to develop the business strategy and strengthen efficiency and productivity.

Our main priorities in the coming years are:

- Continue to gain profitable market share in attractive businesses such as companies, SMEs, high income and deposits, for which we will maintain a strategy of segmentation, differentiation and improvement in the quality of service. All this will improve customer linkage.

- Progress in generating synergies, both from the merger as well as from the enhanced efficiency.

- The gradual return to a "normal" level of loan loss provisions will have a positive impact on the income statement in 2014.

**Chile**
The economy continued to grow solidly in an environment of stable inflation and low unemployment.

Santander is market leader and, in 2014, its strategy will focus on boosting retail banking through greater customer linkage and specialization of the value offer, as well as raising efficiency and productivity.

**Poland**
After feeling the impact of the euro zone crisis, Poland will grow more robustly in 2014.

In 2013, our Polish subsidiary Bank Zachodni WBK completed the acquisition of Kredyt Bank, becoming the country's third-largest private sector bank, with a 10% market share, and generating higher-than-envisaged cost savings. We expect our profits in Poland to grow strongly in the medium term.

**// I am very positive about our growth potential in the coming years //**

**Germany**
Santander has more than 6 million customers in the country, is the consumer finance leader and also has retail banking businesses. We expect the contribution to Group profits to rise in the coming years, from EUR 424 million in 2013, underscoring the success of Santander Consumer's business model.

**Argentina**
In an environment of lower growth, Santander Río will focus on improving its efficiency and quality of customer service. The objective is to maintain high levels of profitability, based on leadership in a developed transaction business and on attracting new customers.

**Portugal**
Santander Totta, in a very complicated economic context, continues to be the country's most profitable bank. In 2014, the Bank is focusing on gaining profitable market share, improving costs and reducing non-performing loans.

As for **global businesses**, in the last few years Santander has signed alliances with strategic partners to develop the asset management, global wholesale banking, consumer finance and insurance businesses, among others, in a more global and efficient way.

## CONCLUSIONS

I am very positive about our growth potential in the coming years.

- We start from a solid base of capital and liquidity and a unique geographic position.
- After a cycle of balance sheet strengthening, the Bank is now fully prepared to begin a new phase of profit growth. We have a well-defined strategy that is being implemented to achieve our goals.
- And we have the best team of professionals among international banks.

**I am sure that all of these factors will support Santander's shares and consolidate the Group as one of the leaders of the international financial sector.**

Thank you for your support.

JAVIER MARÍN
Chief executive officer

# CORPORATE GOVERNANCE

## Banco Santander corporate governance model

**Balanced and committed board**

- Of the 16 directors, 11 are non-executive and five executive.

**Equality of shareholders' rights**

- The principle of one share, one dividend, one vote.
- No anti-takeover measures in the corporate Bylaws.
- Encourage informed participation by shareholders in meetings.

**Maximum transparency**

- It is one of the fundamental principles governing the Bank's management in all its spheres and even beyond the legal requirements. This is vital for generating confidence and security in shareholders, customers, employees and society in general.

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

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

The board has 16 directors, five of whom are executive and 11 non-executive. Of the 11 non-executive directors, nine are independent, one proprietary and the other, in the board's view, neither proprietary nor independent.

The non-executive directors are noted for their financial experience. Among them are former chief executives of banks, a former governor of a central bank and professionals with deep knowledge of Latin America, the United States and the United Kingdom, markets where the Group has a substantial part of its businesses.

The board held 15 meetings in 2013 (one of them in Mexico) and devoted two of them to the Group's global strategy.

### Remuneration policy

The remuneration policy for directors and the Bank's senior management is based on the following principles:

1. Remuneration must be consistent with rigorous risk management and must not foster inappropriate assumption of risks.

2. Anticipating and adapting to regulatory changes in remuneration matters.

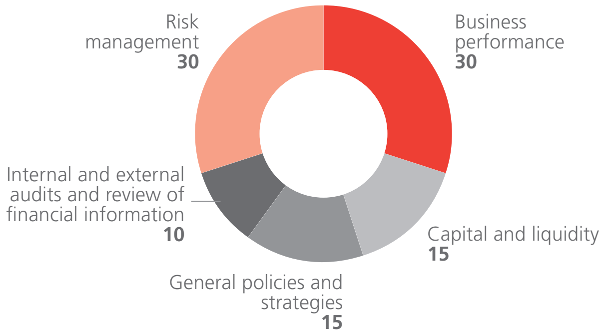
3. Involvement of the board, as, at the proposal of the appointments and remuneration committee, it approves the remuneration policy report for directors and submits it to the general meeting of shareholders on a consultative basis and as a separate item on the agenda. The board approves the remuneration and contracts of the directors and other members of the senior management team and the remuneration of the rest of the supervised collective.


Grupo Santander City, Boadilla del Monte, Madrid, Spain

**4.** Transparent information on remuneration. In 2013, the board agreed a 13% reduction in executive directors' variable remuneration. Full details of the remuneration policy for directors in 2013 are set out in the report of the appointments and remuneration committee, which is part of Banco Santander's corporate documentation.

## APPROXIMATE TIME SPENT BY THE BOARD ON EACH FUNCTION

%




## CHANGES IN THE BOARD'S COMPOSITION

→ At the meeting on 29 April 2013, the following changes were made:

- **Mr Alfredo Sáenz Abad** announced his voluntary resignation as 2nd vice-chairman and chief executive officer, leaving the board on that date.
- The board agreed to name **Mr Javier Marín Romano,** until then senior executive vice-president and head of the Private Banking, Asset Management and Insurance division, as the new chief executive officer.
- The board also agreed the following:
  - Put on record the resignation of **Mr Manuel Soto Serrano** from his responsibilities as director.
  - Appoint **Mr Matías Rodríguez Inciarte** as 2nd vice-chairman.
  - Appoint **Mr Guillermo de la Dehesa Romero** as 3rd vice-chairman and chairman of the audit and compliance committee.
  - Appoint **Mr Juan Miguel Villar Mir** as an independent director.

→ On 31 December 2013, **Lord Burns** announced his voluntary resignation as a director.

→ The board agreed in January 2014 to appoint **Ms Sheila Bair** as an independent director to cover the vacancy left by Lord Burns.

# BOARD OF DIRECTORS OF BANCO SANTANDER

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

**Mr Ángel Jado Becerro de Bengoa**
Director

**Ms Esther Giménez-Salinas**
Director
□

**Mr Abel Matutes Juan**
Director
▲ □

**Mr Fernando de Asúa Álvarez**
1st vice-chairman
● ■ ▲ ● △

**Mr Juan Rodríguez Inciarte**
Director
■

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

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

**Mr Matías Rodríguez Inciarte**
2nd vice-chairman
● ■

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

**Read the QR code**
Access the interactive photo of the board online.

**Mr Javier Marín Romano**
Chief executive officer
● □ △

**Ms Isabel Tocino Biscarolasaga**
Director
● ■ ●

**Lord Burns* (Terence)**
Director

**Mr Vittorio Corbo Lioi**
Director

El Faro, Grupo Santander City, Boadilla del Monte, Madrid, Spain. 21 October 2013.

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

**Mr Guillermo de la Dehesa Romero**
3rd vice-chairman
● ▲ ● □

**Mr Juan Miguel Villar Mir**
Director

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

* With effect from 31 December 2013, Lord Burns announced his voluntary resignation as a director.


Banco Santander's general shareholders' meeting, March 2013, Santander, Spain.

# SANTANDER SHARES

## Performance of Santander's shares

Santander continued to be the largest bank in the euro zone by market capitalisation and the 11th in the world in 2013, with a value of EUR 73,735 million at the end of the year. Santander's shares are also the most liquid in Europe.

In a weak economic environment but with clear signs of improvement, as a result of reduced uncertainty over the European and Spanish economies, Santander's shares ended 2013 at EUR 6.506, up 6.7% from a year earlier. This, combined with a dividend yield of 10%, represents an increase of 16.7%.

## Shareholder remuneration

Banco Santander's total dividend payment charged to 2013 earnings will be EUR 6,775 million, 10.6% more than in 2012, if the general shareholders' meeting approves the board's proposal.

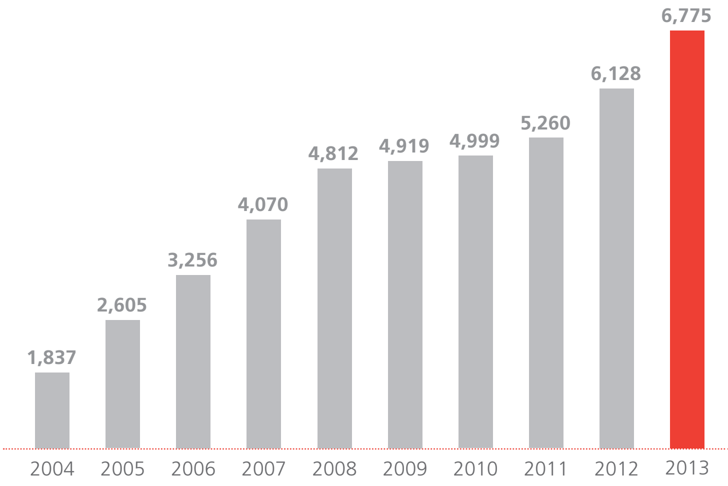
The *Santander Dividendo Elección* (scrip dividend) programme, which enables shareholders to receive the equivalent of the dividend in the form of cash or Santander shares, was applied on the dates when the three interim dividends (of approximately EUR 0.15 each) are traditionally paid in 2013, and it will be applied again for payment of the final dividend. The total dividend payment for 2013 will be EUR 0.60 per share for the fifth year running.

At the Bank's general shareholders' meeting on 28 March 2014, the board will propose the continuation of the four scrip dividends under the *Santander Dividendo Elección* programme, as well as maintaining the 2014 remuneration at EUR 0.60 per share for the sixth year running.

## COMPARATIVE PERFORMANCE OF THE SANTANDER SHARE AND INDEXES DECEMBER 2012 VS DECEMBER 2013


## TOTAL SHAREHOLDER REMUNERATION OVER THE PAST DECADE

Million euros




### REMUNERATION PER SHARE

**0.60 EUR**

For the fifth year running

### MARKET CAPITALISATION

**EUR 73,735 million**

Santander is the largest bank in the euro zone by market value

Santander has distributed more than EUR 28,000 million to shareholders over the last five years

## Shareholder base and capital

The number of Banco Santander shareholders was 3.3 million at the end of 2013, one of the highest among international banks.

At the end of the year, 1.67% of the capital was controlled by the board, 47.35% was held by individual shareholders and rest by institutional investors. Of the total share capital, 87.06% is located in Europe, 12.51% in the Americas and 0.43% in the rest of the world.

The number of Banco Santander shares at the end of 2013 stood at 11,333,420,488 following the capital increases carried out to cover the *Santander Dividendo Elección* programme (February, May, August and November). A total of 1,012,240,738 new shares were issued (8.9% of the capital).

Banco Santander continued to strengthen its shareholder information channels in Spain, the United Kingdom, the United States, Brazil, Argentina, Mexico, Portugal and Chile. These offices dealt with 251,812 phone consultations, 30,977 e-mails, 544,259 letters and sent 784,483 SMS. A total of 15,659 people attended 279 corporate events held in various countries.

**Read the QR code**
Access the shareholders' area in the corporate website.

### THE SUCCESS OF *SANTANDER DIVIDENDO ELECCIÓN*

- With the *Santander Dividendo Elección* programme, which enables shareholders to receive the equivalent of the traditional dividend in the form of cash or Santander shares, the Bank offers flexible remuneration so that its shareholders can benefit from tax advantages.
- Since its launch five years ago, 83% of the Bank's capital has opted to receive shares. This percentage reached 87% in 2013.
- These figures underscore shareholder confidence in the Bank's performance, despite the volatility of financial markets and the impact of the crisis on household income, which increased the attractiveness of receiving the dividend in cash.

*European banking union is vital to break the vicious circle between sovereign and banking risk and reduce market fragmentation. This will benefit the strongest banks and boost lending to the private sector*

**Guillermo de la Dehesa**
3rd vice-chairman
Non-executive director (independent)

# REGULATORY CONTEXT

The regulatory response to the international financial crisis advanced during 2013. The new rules on capital and liquidity, known as Basel III and agreed internationally by the Basel Committee in December 2010, were transposed in the main jurisdictions where the Bank operates in 2013 and came into force on January 1, 2014. They will be gradually implemented over the next 10 years.

There was progress at global and European level in drawing up banking crisis management frameworks, which aim to make it possible to intervene, resolve and liquidate banks without affecting financial stability or resorting to state funds.

The euro zone made progress in creating a European Banking Union in 2013.

- The **European Banking Authority (EBA)** has been operating since January 2011 and is developing a series of technical standards to harmonise implementation of prudential rules in Europe.
- The **Single Supervisory Mechanism (SSM)**, whose regulations were approved in October, establishes that the European Central Bank (ECB) will assume direct supervision of the euro zone's main banks, including Banco Santander, as of October 30, 2014. As a preparatory step to taking on these functions, the ECB will carry out an exhaustive analysis of banks' balance sheets in order to enhance transparency, implement the necessary corrective measures and recover confidence in the European financial system. The results of this exercise will be published in October 2014.
- At the end of December, European Union economy ministers (Ecofin) finalized a political agreement that represents a commitment to mutualise the cost of resolving banking crises. This agreement will serve to break the vicious circle between banking and sovereign risk in Europe and includes:
  - The launch of a **Single Resolution Mechanism (SRM)** as of January 1, 2015, which will be applied to all banks participating in the SSM, and which, in its first year of operation, will deal with approving viability and resolution plans.
  - A **single resolution fund** that will come into force in 2016 and will be fully established in 2026.

Banco Santander has played a very active role in the debates and consultations on new regulations and comfortably meets the various regulatory requirements.

# MANAGEMENT PRIORITIES

## GRUPO SANTANDER MANAGEMENT PRIORITIES IN 2013

### Strengthen the capital base and improve the liquidity position

**Organic generation of capital** and active management of the Group's business portfolio enabled the Group to raise its core capital ratio by 138 b.p. in 2013.

Brazil and Mexico carried out operations to optimise their capital base by issuing debt instruments.

The Group's retail franchise strategy, together with deleveraging in mature markets, led to a **further improvement in the loan-to-deposit ratio to 109%.**

### Progress in the mergers underway in Spain and Poland

**Both mergers are ahead of schedule** and are generating higher-than-expected cost synergies.

In Spain, the rebranding and absorption of the Banesto and Banif branches was practically completed by the end of 2013.

### Signing of agreements, strategic alliances and acquisition of new businesses

**Alliance with Warburg Pincus and General Atlantic** to boost the asset management business, which generated a capital gain of EUR 669 million.

Investment of EUR 470 million in **Bank of Shanghai,** which involves the acquisition of an 8% stake in the Chinese bank.

**Acquisition in Spain of 51% of Financiera El Corte Inglés,** which bolsters the Group's leading position in the consumer finance business.

### Internal organisation

**Creation of new corporate divisions and reorganisation of functions** in order to increase the focus on customers, take better advantage of the Group's global scope and improve efficiency: Retail & Commercial Banking; Human Resources; Organisation and Costs; and Recoveries and Asset Restructuring.

**Reinforcement of the internal governance framework,** which regulates relations between the Group parent and its subsidiaries.

# 1

# BANCO SANTANDER'S BUSINESS MODEL


**Read the QR code**
Access the business model online version.

Santander Select office, São Paulo, Brazil.


## ■ Highlights

- → Banco Santander's business model produces substantial recurrence in revenues.
- → Santander focuses on retail banking. It offers its 106.6 million customers innovative solutions, tailored to each segment and customer profile.
- → Santander provides services to its customers through the largest international branch network and a full range of alternative channels.
- → The Group operates in 10 core countries with high market shares and the right balance between mature and emerging markets.
- → Santander has a medium-low level of risk and high credit quality.
- → Santander's balance sheet strength is reflected in solid capital ratios and a comfortable liquidity position. It has not required state aid in any of the countries in which it operates.
- → Santander's subsidiaries are autonomous in capital and liquidity, which encourages good local management, provides financial flexibility and limits the possibility of contagion between Group units.
- → With a cost-to-income ratio of 49.9%, Santander is one of the most efficient banks among its competitors.
- → Santander runs its business in a sustainable way, protecting the environment, supporting the community in the countries where it operates and investing in higher education.
- → Santander has 182,958 employees, who are focused on the customer and on results.

# BANCO SANTANDER'S COMMITMENT TO ITS CUSTOMERS

Customers are the focal point of Banco Santander's business model. Understanding their needs, responding with innovative solutions and building long-term relationships based on confidence are the foundations of Santander's commitment to its customers.

The Bank's corporate claim, ***Santander, a bank for your ideas,*** aims to transmit the idea that all the Bank's strength, leadership, capacity for innovation as well as its 183,000 professionals are at customers' service to help them carry out their projects.

This claim reflects a corporate and daily working culture that aims to ensure that the customer has a unique brand experience and perceives tangible benefits in all of its dealings with the Bank, through all channels and in all countries. This brand experience is based on the following principles:

- Meet customers' needs through a simple, transparent and easy-to-understand range of products and services.
- The customer-bank relationship has to provide a differential value for both the Bank and the client.
- Develop relationships based on confidence between the Bank and the customer that make customers proud to work with the Bank and increases their loyalty to the Santander brand.

The Group launched various initiatives in 2013 to improve the customer's brand experience:

- In the UK, *Simple, personal & fair* is a three-year programme that will transform systems, processes and products to make them simpler, personalized and fair for its customers.
- In Brazil, *Trabalhar bem* was put into effect at the end of the year. It involves all the Bank's employees working to improve customer satisfaction and efficiency.

## Our customers

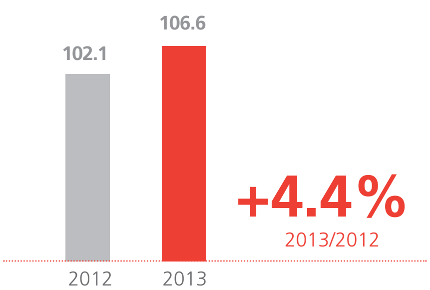
The Group has 106.6 million customers in the world who recognize Santander as an institution that is solid, solvent and strong to face the future. The three countries with the most customers are Brazil (28% of the total), the UK (24%) and Spain (15%).

In 2013, more than four million new customers decided to put their trust in Banco Santander. The increase in the number of customers was particularly significant in Brazil and Mexico, as a result of Santander's commitment to grow in these countries; in Poland, due to inclusion of Kredyt Bank's customers; and in Spain, because of the perception of Santander's financial soundness in an environment that posed difficulties for some of its competitors.

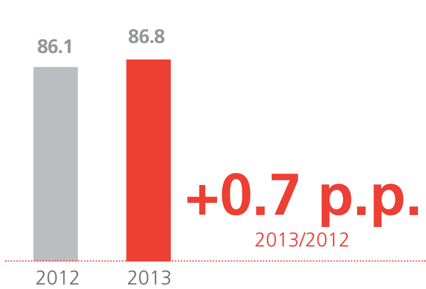
One of Banco Santander's main objectives is to improve customer satisfaction. The Bank's research shows that satisfied customers use the Bank's products more, have higher average savings balances and are significantly less likely to move their accounts to another bank than dissatisfied customers.

In 2013, 86.8% of Grupo Santander's active individual customers were satisfied (0.7 percentage points more than in 2012). Of note were the improvements in the UK, Spain, the US, Mexico and Chile.

CUSTOMERS
Million




CUSTOMER SATISFACTION
% of active individual customers who are satisfied



*Banco Santander strives every day to be a better bank for our customers: through more specialised attention, more streamlined processes and by improving our channels of communication with clients. The Retail & Commercial Banking division, with global corporate scope, was created in 2013 in order to strengthen all of these elements*

**Javier Marín**
Chief executive officer

# COMMERCIAL FOCUS

Banco Santander's retail banking model focuses on satisfying the needs of all sorts of customers: individuals with different income levels, companies of all sizes in every sector and private and public corporations.

Retail banking, which includes individuals, companies and consumer finance, accounted for 87% of the Group's revenues in 2013.

## Retail & Commercial Banking division

The Retail Banking division was created in 2013 to develop the Group's global strategy for retail banking, exploiting the opportunities generated by Grupo Santander's international positioning.

This new division aims to achieve a business model that revolves around customers, with a greater focus on business segments, more specialization, a customer vision of processes and systems, and a stronger and integrated multi-channel strategy. The objective of all this is to promote lasting relationships that strengthen customer linkage and loyalty. The division's global corporate nature enables it to have a broad view of business, foster the exchange of best practices and exploit synergies between the different countries where the Group operates.

## Specialisation by segments

The Bank is deepening its knowledge of customers in order to adapt the way it serves them and the solutions it offers to their demands. It is measuring progress in this area with homogeneous group-wide management metrics, perfecting its commercial tools to manage customers' needs in a more efficient and specialized way and improving operational processes. The objective is to offer every single customer the products and services that are best for them, through suitable channels, and provide a satisfactory customer experience.

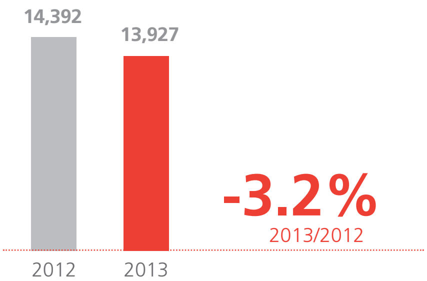
The Bank attaches particular importance to having a differentiated offer in two strategic high profitability segments (affluent and company banking).

- **Strengthen the affluent segment. Santander Select** is Grupo Santander's differentiated value proposition for high-income customers and it involves creating a specialized attention model, with products and services specifically designed for this segment. The Group is able to take advantage of its international franchise, to make global offers to these customers such as a credit card that enables them to make commission-free cash withdrawals at any of the Bank's ATMs around the world. Santander Select was first set up in Spain and is now being established in Mexico, Chile and, recently, Brazil. New countries will be added in the coming months.

### GROUP CUSTOMERS
Million

| | |
|---|---|
| Spain | 14.1 |
| Portugal | 2.0 |
| UK | 25.5 |
| Poland | 4.2 |
| Santander Consumer Finance | 12.1 |
| Rest Europe | 0.1 |
| **Total Europe** | **58.0** |
| Brazil | 29.5 |
| Mexico | 10.5 |
| Chile | 3.5 |
| Argentina | 2.5 |
| Uruguay | 0.5 |
| Puerto Rico | 0.4 |
| **Total Latin America** | **46.9** |
| **United States** | **1.7** |
| **Total customers** | **106.6** |

### BRANCHES
Number



Santander branch, Madrid, Spain.

- **Support for SMEs.** In order to increase its market share in this key segment, the Bank has put in place various initiatives in different countries. These include an agreement signed by Banco Santander and the European Investment Bank (EIB) to launch a EUR 400 million fund for the securitisation of the assets of SMEs and the self-employed to finance long-term investments and cover the working capital needs of SMEs and mid-cap companies. There is also the *Breakthrough* programme in the UK, to identify the best small firms and help them achieve their full potential; the *10,000 Plan* in Spain, which, against a backdrop of low demand for loans, made EUR 10,000 million of financing available to SMEs; and the *Santander Pymes* programmes in Latin America, particularly in Mexico, where Banco Santander received a recognition from the Mexican government for supporting SMEs.

## Solutions for customers

Santander continues to innovate and develop new products and financial services that create value for its customers and respond to the specific needs and circumstances of different countries. Of note in 2013 were:

- The launch of *Santander Trade*, a unique portal in the financial system that helps companies win international business by bringing opportunities closer to the business community.

- The launch in the US, coinciding with the rebranding, of the *Extra20 checking account,* which credits customers with $20 every month if they have $1,500 of income domiciled in their account and have two or more direct debits via Santander's online bank.

- The success of the *1|2|3* range of products in the UK, which won 1.1 million new customers in 2013 to reach a total of 2.4 million people closely linked to the Bank. The *1|2|3* current account reimburses in cash part of household bills and rewards larger balances with higher interest rates. Similar products were launched in Spain and Poland.

## Multi-channel offer

Santander is developing a more efficient multi-channel distribution model that is better adapted to customers' needs and offers segmented and specialised management, tailored to their demands.

The branch network is Santander's main channel for creating and maintaining long-term relationships with customers. The Group has 13,927 branches, the largest network of any international bank. The branch reduction since 2012 is mainly due to the integration of Banesto and Banif under the Santander brand in Spain, which has given rise to a more balanced network in the country, while in other countries, such as Mexico, Argentina and Poland, the number of branches increased.

At the same time, in the knowledge that not all contact with customers requires a branch, Santander continues to strengthen its range of services via online and mobile telephone banking and the contact centre. Santander has 11.6 million online banking customers, 2.6 million mobile banking customers and its telephone banking services tend to 30 million calls a month.

*The financial crisis represented a great challenge to banks' solvency. Banco Santander stands out for having a solid core capital ratio, which is well aligned with its business model, its balance sheet structure and its risk profile, and it comfortably meets all the regulatory requirements*

**Fernando de Asúa**
1st vice-chairman
Non-executive director (independent)

# DISCIPLINED USE OF CAPITAL AND FINANCIAL STRENGTH

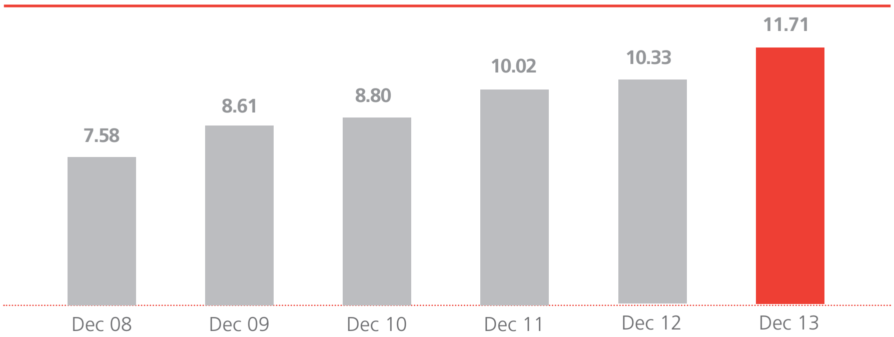
## Capital

Banco Santander has a solid core capital ratio that suits its business model, balance sheet structure, Group risk profile and regulatory requirements. In 2013, it continued to improve its solvency ratios and increased its core capital by 138 b.p. to 11.71% (under Basel II criteria).

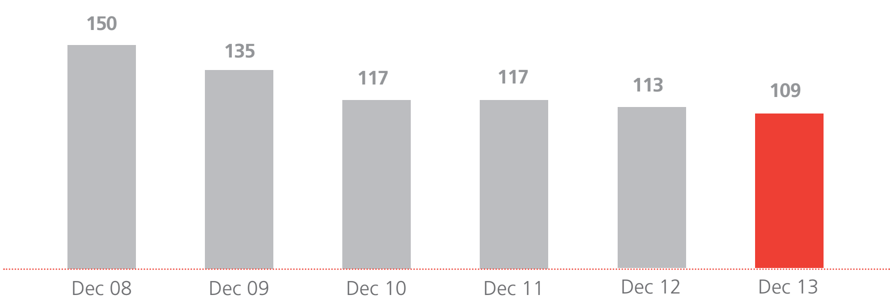
Since the start of the international financial crisis, the Group has generated 413 b.p. of core capital. This increase was achieved largely thanks to the Bank's substantial capacity to generate capital organically and active management of the Group's portfolio of businesses. It was achieved in spite of Santander having a much higher ratio of transforming assets into risk-weighted assets than the average for its competitors. Banco Santander maintained a remuneration per share of EUR 0.60 and did not receive state aid in any of the countries in which it operates.

As proof of its solvency, Santander is the only bank in the world to be rated higher than its home country's sovereign debt by the four main rating agencies (S&P, Fitch, Moody's and DRBS).

CORE CAPITAL RATIO (BIS II)
%




LOAN-TO-DEPOSIT RATIO
%




## Liquidity

Santander funds most of its lending with customer deposits (loan-to-deposit ratio of 109%), maintains comfortable access to wholesale funding and has a wide range of instruments and markets through which to obtain liquidity.

The Group's liquidity management principles are[1]: high contribution and stability of deposits, thanks to the retail nature of its business; a decentralized liquidity model; medium- and long-term liquidity needs must be financed by medium- and long-term instruments; high diversification of funding sources by instruments, investors, markets, currencies and maturities; limited recourse to short-term funding; and availability of a comfortable reserve of liquidity, including discounting capacity at central banks.

1. The section on liquidity risk and funding in the annual report's risk management report sets out in greater detail Grupo Santander's strategy, principles and liquidity management indicators.

# PRUDENT RISK MANAGEMENT

*Banco Santander's risk is very diversified and based on a retail banking model that is predictable and not over complex. The board sets the risk appetite and continuously controls risk management*

**Matías Rodríguez Inciarte**
2nd vice-chairman
Executive director

Prudence in risk management has been a hallmark of Banco Santander for more than 150 years. **The Group has a medium-low risk profile** and its policy is based on the following corporate principles:

- The risk function is independent of the business areas. Matías Rodríguez Inciarte, head of the Group's Risk division and chairman of the board's risk committee, reports directly to the executive committee and to the board.
- Board members and senior management are involved in taking decisions.
- Collegiate decision-making through committees.
- Global/local risk model with scope for all risks, countries and businesses.

The board is responsible for setting and updating the annual risk appetite and for monitoring the risk profile to ensure consistency between the two. The risk appetite is established for the Group as a whole as well as for its main units, in accordance with a corporate methodology that is adapted locally to each market, and includes quantitative as well as qualitative elements[2].

## Balance sheet soundness

The Group's risk profile has three main characteristics:

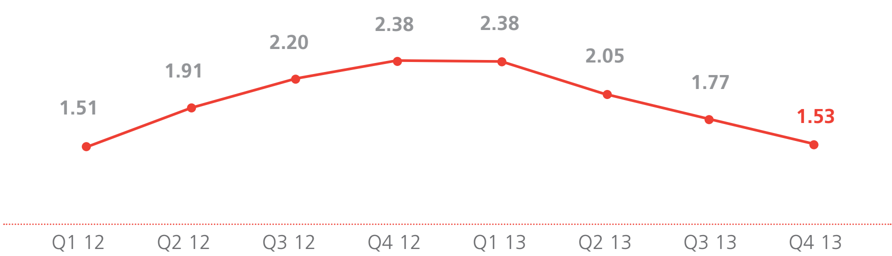
- **Retail banking:** more than 80% of Grupo Santander's credit risk comes from retail banking.
- **Diversification:** the Group has a high degree of risk diversification and limits concentration in terms of customers, business groups, sectors, products and countries.
- **Guarantees:** 64% of the Group's portfolio of loans has real guarantees.

The result of all this is a high loan quality.

The Group's non-performing loan (NPL) ratio was 5.64% in 2013. The fall in NPLs in Brazil, the U.K. and the U.S. partially offset the rise in Spain, where the NPL ratio was 7.49% (below the sector average). The Group's coverage ratio was 62%.

The cost of credit began to return to normal, dropping from 2.38% to 1.53%.

COST OF CREDIT*
%




* Cost of credit = 12 months' loan-loss provisions/average lending.

2. Banco Santander's corporate principles of risk management and risk appetite are set out on pages 168 to 173 of the annual report's risk management report.

# SUBSIDIARIES MODEL


Flotation of Santander Consumer USA, Wall Street, New York.

Grupo Santander's international expansion has been achieved through subsidiaries that are autonomous in capital and liquidity:

- **Capital:** local units have the capital required to carry out their business and comply with regulatory requirements.

- **Liquidity:** each subsidiary draws up its financial plans and liquidity forecasts and calculates its funding needs, without relying on funds or guarantees from the parent bank. The Group's liquidity position is coordinated in asset and liability committees (ALCOs).

In line with this model, each subsidiary's exposure to credit risk is concentrated in the country where it develops its business and in local currency. As a result, the Group's cross-border credit risk exposure is very limited.

The Group's policy is to list some of its main subsidiaries, ensuring their control by maintaining a stake of around 70%. The following are subsidiaries are currently listed: Santander Brazil, Chile and Mexico, Bank Zachodni WBK in Poland, and since January 2014, Santander Consumer USA, which was valued at $8,300 million when it was floated. The value of Banco Santander's stakes in these subsidiaries is EUR 38,000 million.

## Strategic and regulatory advantages

→ The listed subsidiaries :

1. Allow quick access to capital, while being subject to market discipline.
2. Facilitate the funding of acquisitions in local markets and are an alternative to investing capital.
3. Guarantee a high level of transparency and corporate governance and strengthen the brand in the various countries.

→ Subsidiaries are subject to double supervision and internal control: local and global.

→ In times of crisis the autonomy of subsidiaries limits contagion between the Group's different units and reduces systemic risk.

→ This model facilitates management and resolution of crises while generating incentives for good local management.

Santander has an internal governance framework in line with the regulatory requirements of the EBA, BIS and Bank of Spain. This establishes the principles that govern relations between the parent bank and its subsidiaries.

Banco Santander combines the financial autonomy of its subsidiaries with the Group's synergies and has corporate systems and policies in areas such as risks, financial, compliance, human resources, technology, costs, retail banking, communication and marketing and internal auditing, which are implemented in all the Group's units and enable it to:

- **Strengthen the Santander culture,** with particular importance attached to global management of risks and to control of business units.

- **Foster the exchange** of best practices between countries.

- **Greater efficiency in its investments**, through sharing IT systems and operations on a global basis.

- **Attain cost and revenue synergies**, by developing the Santander commercial banking model through global strategies.

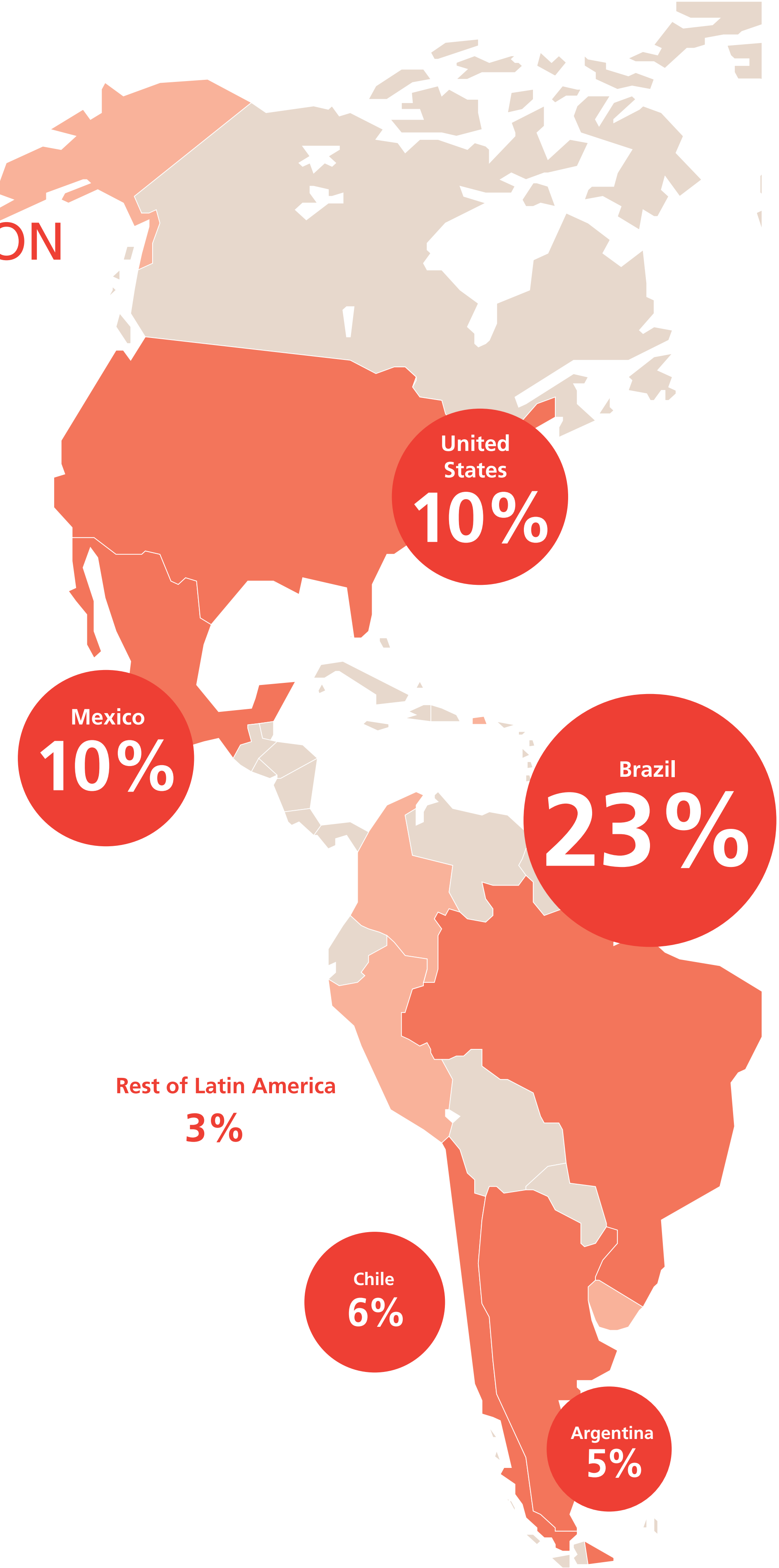
All this enables the Group to obtain better results than those that would come from the sum of each of the local banks.

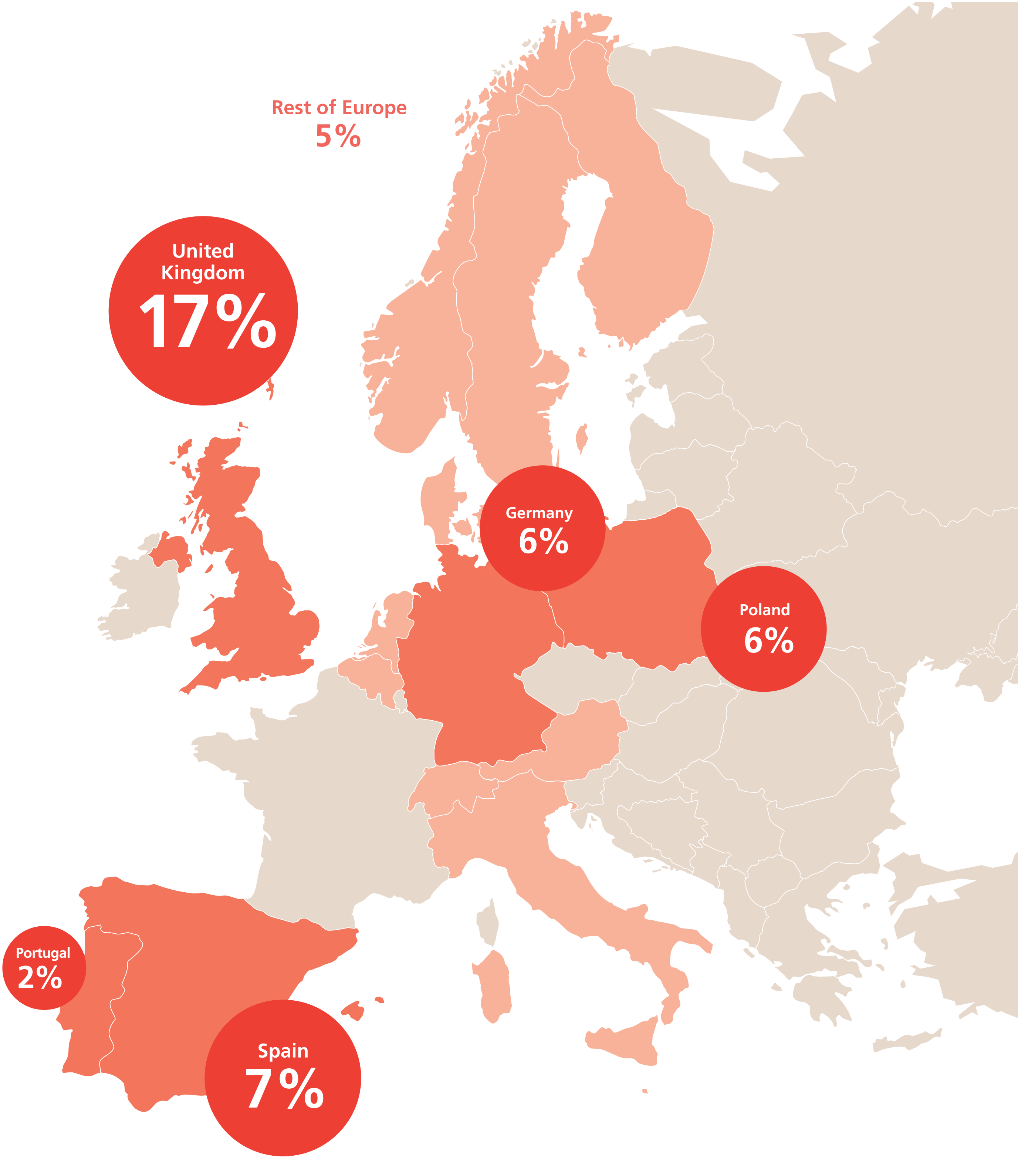
# GEOGRAPHIC DIVERSIFICATION

Grupo Santander's geographic diversification is balanced between mature and emerging markets, which contributed 47% and 53% of profit, respectively, in 2013.

The Bank focuses on 10 core markets: Spain, Germany, Poland, Portugal, the United Kingdom, Brazil, Mexico, Chile, Argentina and the United States. It also has significant market shares in Uruguay and Puerto Rico, consumer finance businesses in other European countries and a presence in China through wholesale banking and consumer finance.

The global business areas develop products that are distributed in the Group's retail networks and provide services to clients globally.





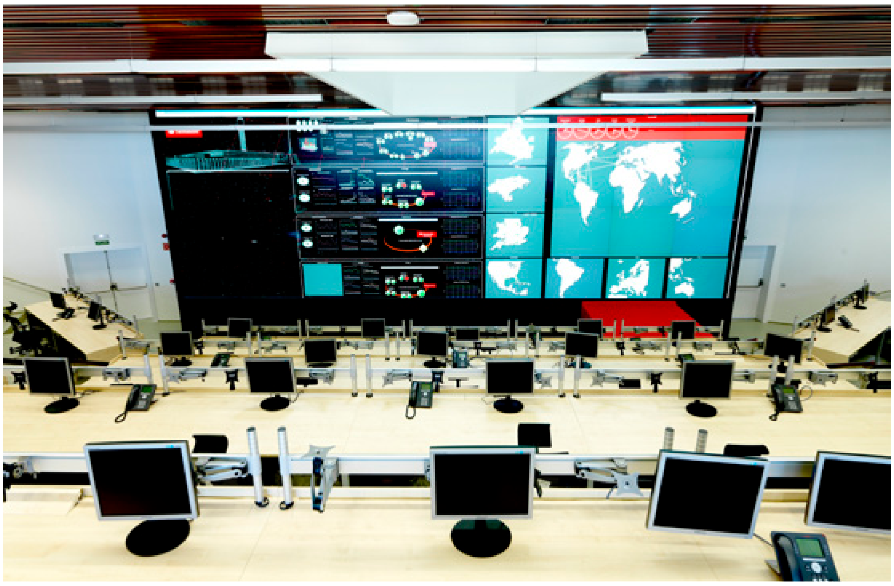

## DISTRIBUTION OF ATTRIBUTABLE PROFIT BY GEOGRAPHIC OPERATING AREA

Main countries

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

**Read the QR code**
Access the interactive map online.

# EFFICIENCY



Data processing centre, Cantabria, Spain.

Santander has a technology and operations platform that provides it with a complete view of customers' financial needs and a high degree of commercial productivity.

Improvements in efficiency translate into value for clients, such as the zero commissions offered in the *We want to be your bank* plan in Spain, the reimbursements and discounts for purchases and direct debits in the *1|2|3* current account in Santander UK, Spain and Poland; and the discounts of the new *extra20 checking* in the United States.

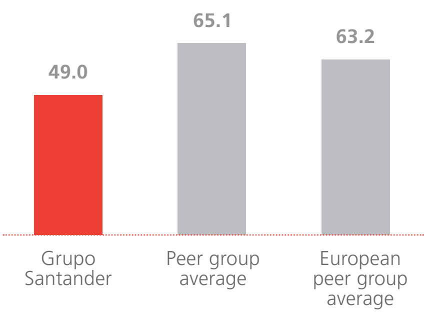
Santander is one of the world's most efficient banks, thanks to strict cost control and the high degree of recurrence in revenue generation. Its cost-to-income ratio was 49.9% in 2013.

The technology and operations model is organised around corporate factories that are subsidiaries of the Group and are responsible for developing software and hardware, operations, maintenance of Internet and intranet and management of purchases and buildings. These factories have a global strategy and local teams in each country. Developing these services as specialised and homogenized units helps to reduce the Group's operational risk.

More progress than expected was made in 2013 in integrating Banesto and Banif into the Santander network in Spain and merging Bank Zachodni WBK and Kredyt Bank in Poland. **The synergies from these mergers, combined with other measures, will enable the Group to achieve EUR 1,500 million of cost savings by 2016 (half of them in 2014).**

## COST-TO-INCOME EFFICIENCY RATIO[1] VERSUS COMPETITORS

September 2013




1. Costs/revenues

Competitors: Banco Itaú, Bank of America, Barclays, BBVA, BNP Paribas, HSBC, ING Group, Intesa Sanpaolo, JP Morgan, Mitsubishi, Nordea, Royal Bank of Canada, Societe Generale, UBS, Unicredito and Wells Fargo.

## COST SAVINGS UNTIL 2016

**EUR 1,500 million**


Left: Rear spoiler of the Ferrari car.
Right: Mr Emilio Botín, chairman, and Mr Michael Bloomberg, at the time mayor of New York, at Santander's brand change ceremony in the United States.

**Read the QR code**
Access a helicopter video of the Ferrari racing car.

# THE SANTANDER BRAND

The Santander brand centralises the Group's identity and values and expresses a unique international positioning that is consistent and coherent throughout the world.

This positioning is reflected in the corporate slogan ***Santander, a bank for your ideas.*** This slogan transmits that Santander is a bank with:

- A clear retail vocation.
- Customer focus: it listens to clients in order to understand their needs and has the capacity, resources and experience to offer them the right solutions.
- It values ideas, as the engine of society, and people who have goals, challenges and dreams.

## Santander brand experience

Santander's objective is to offer its stakeholders a brand experience that is homogeneous, different from others, significant, memorable and aligned with the Bank's corporate values, in all its countries, businesses, channels and communications.

The idea is that everyone who has contact with Santander feels that it is a bank that not only offers the best products and services, but also has a simple and personal way of doing banking, is a trustworthy institution and one that bases its success on helping its customers achieve their goals and projects.

## Centralised management of corporate marketing

The committee of corporate marketing and brand, chaired by the Bank's chief executive officer, approves the marketing plans for countries and global businesses; validates their budgets; and monitors the image of the brand and customer satisfaction. It also oversees the positioning of the single brand and ensures that all the Group's advertising and marketing activities are consistent and create value.

This strategic brand management has yielded significant results and global recognition, as shown by Santander's position in the brand rankings of the world's main consultancies, such as Interbrand, Millward Brown and Brand Finance.

In 2013, the Bank made progress in unifying the brand in key markets:

- In the United States, Sovereign changed its brand to Santander.
- In Spain, Banif completed the change of its brand to Santander Private Banking and the switch from Banesto to Santander is almost done.
- In Poland, Bank Zachodni WBK began its transition to Santander.

Banco Santander maintained its international advertising strategy, which contributes to the Bank being perceived as strong, solid and close to its customers.

Santander has registered its brand in the main markets in which it operates worldwide and attaches great importance to the distinctive sign Santander® and its symbol ®. The Group has set up adequate procedures to ensure the legal protection and custody of its institutional and commercial brands during their life cycle. It manages centrally its more than 5,000 registered brands and 5,700 domain names.

## Corporate sponsorship

Corporate sponsorship is a key element to bring the business closer to the customer, making the brand better known and consolidating Santander's international position.

- In 2013, Santander marked its fourth year of alliance with the Formula 1 Ferrari team, an agreement that will be extended until at least 2017.
- In Latin America, Santander consolidated is positioning as the 'football bank' by sponsoring the region's main international championships, both for clubs and national teams.

*"Santander has 180,000 employees who share the same corporate values and know that keeping customers satisfied and linked with the Bank is the best way of ensuring sustainable and profitable growth for the Group"*

**Isabel Tocino**
Non-executive director (independent)

# THE SANTANDER TEAM

The Human Resources division continued to work with the whole organisation in 2013 in order to improve employees' satisfaction, strengthen their commitment to the brand and enhance their focus on the customer, via all the policies, processes and managing people tools at its disposal.

## Talent and leadership

The main task of Banco Santander's Human Resources division is to attract and win the commitment of the best professionals to ensure the Group's leadership in each market. The external initiative, *Santander could be you*, transmits the Bank's value offer to the best candidates from universities, business schools and professional networks worldwide. This communication is strengthened by media, including social networks such as Linkedin, where it has a global profile with 157,300 followers.

Santander has corporate policies and processes to identify high potential employees, using tools such as development and mobility committees, upward assessment of managers and performance management for employees.

In order to foster the personal growth and development of its employees, Santander launched an international vacancies tool in 2013, which increases transparency for the posts available in the Group's other countries. It was first established in Spain with the idea of extending it gradually to the other countries.

## Excellence in knowledge

The Group is committed to training its professionals and providing them with a wide range of training programmes based on academic excellence and support for the business. Santander invested EUR 111 million in 2013 for 98,4% of the employees to receive an average of 52 hours of training.

Knowledge excellence at Santander was underscored by CLIP certification (Corporate Learning Improvement Process) granted by the European Foundation for Management Development (EFMD).

## Six corporate Human Resources projects to make Santander the best bank

### International mobility

The objective is to further strengthen international mobility as a means of disseminating values and the business model, as well as for exchanging knowledge and best practices.

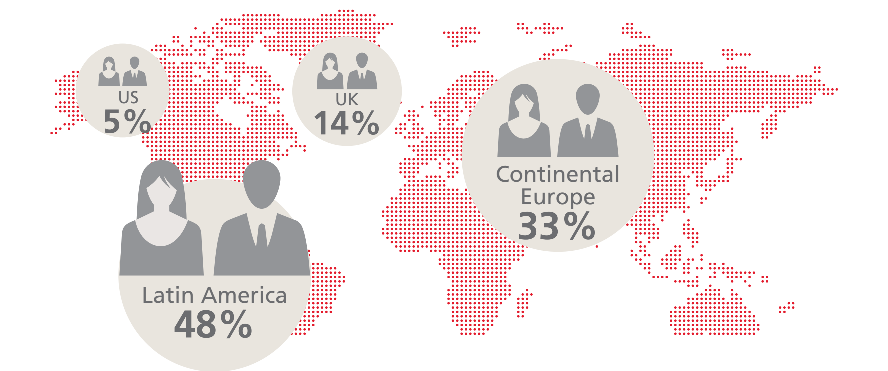
### Businesses 2015

Establish common practices in human resources policy for the international business, Select and SME segments in all countries.

### Talent map

The Bank is enhancing its corporate framework in order to identify and develop the talent needed to guarantee the success of its business.

## GEOGRAPHIC DISTRIBUTION OF PROFESSIONALS




## OTHER KEY FIGURES

| Women | Men |
|---|---|
| 55% | 45% |
| 9 | 11 |

AVERAGE NUMBER OF YEARS WITH SANTANDER

| | |
|---|---|
| 55% | 45% |

GRADUATES

| | |
|---|---|
| 37 | 39 |

AVERAGE AGE (YEARS)

## TOTAL PROFESSIONALS 182,958

| Continental Europe | UK | US | Latin America |
|---|---|---|---|
| 60,780 | 25,368 | 9,741 | 87,069 |

***Santander is you***

The Group's employees share a culture of values, which forms the base of the strength and cohesion that characterise Santander. The *Santander is you* campaign involved many initiatives in 2013 to continue to make Santander one of the best companies to work for, foster pride in belonging to it, promote the integration of all its employees and disseminate its corporate values to all the countries in which the Group operates.

The sixth *Santander is you week,* a global event that aims to foster team work, cooperation and pride in belonging to the Group, was held in June.

The fifth *Santander is you race* was held in September in Portugal, when 57 employees from 17 countries ran from Oporto to Lisbon and participated in corporate volunteer and team activities.

Santander also has an active committed volunteers programme in Spain, in which more than 8,600 people have taken part in two years.

**Prizes**

- *Alliance for Work-Life Progress* (AWLP) awarded the Santander Group City its *Work-Life Innovative Excellence Award 2013* for fostering the work-life balance.

- Santander Totta was chosen by the magazine *Exame* and the consultancy Accenture as the best company to work for in the financial and insurance sector in Portugal in 2013.

- Named best bank to work for in Spain in 2013 by MercoPersonas and Randstad Awards.

- Santander Brazil was chosen as one of the best companies with which to begin a professional career in 2013, according to the survey conducted by the publishing house Abril in cooperation with Cia de Talentos and the Fundación Instituto de Administración (FIA).

- Best company to work for in the financial sector for Spanish university students, according to *Universum 2013.*

- Santander Río, best company to work for in 2013 in Argentina, according to *Great Place to Work.*

## for its customers and employees

### Leadership

Analyse the current leadership style, identifying elements for improvement in order to draw up an action plan and establish measurement and continuous assessment mechanisms.

### Employee value proposition

Review the advantages of working at Santander, adapting them to local conditions, with a strategy of implementation and corporate and global communication, common to all countries.

### Commitment culture

Based on the level of commitment of employees in each country, this project aims to identify areas of improvement and establish a group-wide system of measurement.

# SANTANDER, A SUSTAINABLE BANK

For Banco Santander, being sustainable implies doing business and, at the same time, contributing to the economic and social progress of the communities where it is present, taking into account its environmental impact while fostering stable relationships with its main stakeholders.

**Read the QR code**
See more information in the sustainability section of the corporate website.

## Sustainable business model

Santander has a sustainable business model, which is **customer-focused** and centred on generating recurrent revenues and includes not only economic criteria but also long-term ethical, social and environmental values. This model has enabled Santander to remain a **benchmark among international banks**, anticipating challenges and exploiting the opportunities of the current changing environment.

## Commitment to stakeholders

**Santander has stable and lasting relations** with all its stakeholders, in order to understand their expectations, respond to their demands with innovative solutions and build lasting relationships based on trust.

## The best corporate governance

Principles of transparency, effectiveness and defence of shareholders' interests guide **Banco Santander's corporate governance strategy.**

**The sustainability committee**, chaired by the chief executive officer, is responsible for integrating sustainability into the Group's business model.

## Contribute to social and economic progress

**Santander fosters 'bankarisation' and financial inclusion**, as it knows that access to financial services improves the quality of life and contributes to the social and economic development of the communities in which the Bank operates.

*Banco Santander's commitment to higher education is one of the keys to social and economic development in the countries in which it operates. The third international meeting of Universia's rectors, which will be held in Rio de Janeiro in July 2014, provides a great opportunity to reflect on, strengthen and transform the university system, in accordance with the training and professional needs of today's young people*

**Esther Giménez-Salinas**
Non-executive director (independent)

# Santander Universities

Higher education is the main recipient of the Bank's investment in corporate social responsibility. Santander is convinced that this is the best way to contribute to the economic and social development of the countries in which it does business.

The global Santander Universities division manages Banco Santander's commitment to higher education. Over the past 17 years, it has forged a long-term strategic alliance with universities that is unique in the world. Banco Santander contributed EUR 142 million to university cooperation projects in 2013.

These included launching projects to improve education, the internationalisation and modernisation of universities, the mobility of students and teachers, innovation and projects to foster job creation for students and an entrepreneurial culture in universities.

This cooperation is carried out through agreements; support for international cooperation agreements between universities; promoting cooperation with international academic networks and backing global projects.

## Santander Universities in 2013

- Ninety-five cooperation agreements were signed, with a particular focus on the United States, Poland and Germany.

- Launch of the third edition of the work experience in SMEs programme in Spain (5,000 grants) and the first edition in Argentina, the United Kingdom and Puerto Rico.

- Consolidation of the Santander Latin America scholarships programme, first presented at the Second Meeting of University Rectors in Guadalajara, Mexico, in 2010.

- The plan for supporting US and UK universities was presented, with the assistance of rectors and chairmen of the main universities.

- The ninth series of Santander Universities prizes for innovation and entrepreneurship were awarded in Brazil, where 16,130 projects were presented, and prizes were also given in Mexico, Argentina, Chile and Puerto Rico.

- Prize of the decade for the best social commitment programme in Argentina. The Stanford Prize for Innovation in Research Libraries (SPIRL) went to the Miguel de Cervantes Virtual Library.

- Roadshow of the Financial Culture and Education Programme in various Spanish cities.

- Universia published a total of 2,935,904 job offers in 2013 and registered 15,179,017 employment requests through its labour market portals.

**142 million**
euros for universities

**1,115 cooperation**
agreements with universities in 20 countries on four continents

**22,422 scholarships**
and grants for studies in 2013

**Universia**
**1,262 universities**
form part of Universia

# 2

## 2013 RESULTS


**Read the QR code**
Full information on the 2013 results is available at the corporate website.

Headquarters of Santander UK, London, UK.

## ■ Highlights

- ➔ Grupo Santander carried out its business in 2013 in an environment of low economic growth, historically low interest rates, strong regulatory pressure in some of its markets and depreciation against the euro of the main currencies in which it operates.
- ➔ Grupo Santander posted attributable profit of EUR 4,370 million, 90% more than in 2012.
- ➔ The Group continued to generate around EUR 10,000 million of revenues each quarter (at constant exchange rates).
- ➔ Costs have been flat for the last two years.
- ➔ The capital and liquidity ratios are at very comfortable levels with core capital of 11.71% and a loan-to-deposit ratio of 109%.

# GRUPO SANTANDER RESULTS

Santander made a profit of EUR 4,370 million in 2013. Lower provisions, once those for real estate exposure in Spain were completed, led to a surge in profit compared with 2012.

## Economic environment

The economic backdrop for Banco Santander's business remained weak in 2013. As the year advanced, the gradual upturn in the global economy became more widespread. Developed economies, in particular, began to show a broadly better tone in their growth and inflation remained low, which helped keep interest rates at exceptionally low levels across the yield curve. At the same time, the foundations were laid for a recovery in lending, although, with the exception of the US economy, this will not show up in the actual numbers until this year.

The euro zone emerged from recession and took significant steps towards integration, particularly in banking union. Spain also achieved positive growth in the fourth quarter of 2013, which helped it recover market confidence, as shown by the fall in the risk premium, the rise of the stock market and the inflows of foreign investment.

The positive surprise was in the UK, which ended the year with more dynamic growth rates. The US, which is further advanced in the cycle, had another year of good GDP growth, in spite of its fiscal problems. The pace of growth meant that, at the end of the year, the Federal Reserve was able to announce it would taper its quantitative easing programme.

Emerging economies began 2013 with more modest growth rates than in previous years but this picked up in the second half of the year, albeit unevenly. Mexico clearly improved in the second half and the new government launched a series of far-reaching and ambitious reforms, ranging from taxation to the energy sector.

In Brazil, the need to curb inflation led to interest rate hikes that weighed on economic growth. Overall, Latin America was affected by less favourable financial conditions and lower raw material prices than in previous years, which reduced the region's growth.

## Highlights 2013

BRANCHES
**13,927**

CUSTOMERS (MILLION)
**106.6**

LOANS*
**668,856**

DEPOSITS*
**607,836**

ATTRIBUTABLE PROFIT*
**4,370 (+90.5%)**

*million euros

Headquarters of Santander UK, London.

### Commercial activity and revenues

The Group's customer lending declined 2% as growth in emerging countries (+14%) was insufficient to offset lower demand for loans in mature countries (-6%), in spite of the effort made to support SMEs in Spain and the UK. The Group's deposits grew 0.1%, with significant market share gains in Spain in the last two years.

Despite the still difficult environment, the Group was able to generate around EUR 10,000 million of revenues every quarter (excluding the impact of exchange rates) and EUR 39,753 million for the whole of 2013.

Costs were practically flat at around EUR 5,000 million a quarter, with a downward trend in mature countries and increases in emerging ones because of the continued expansion of the retail network. The Group's cost-to-income ratio (49.9%) continued to place Santander among the most efficient international banks. Synergies from the mergers underway in Spain and Poland are beginning to yield results and should have a greater impact in 2014 and 2015.

The pre-provision profit (net operating income) figure of EUR 19,909 million was among the highest of the world's major banks.

### Credit quality

The Group's non-performing loan (NPL) ratio rose to 5.64%, with an uneven performance by country: in Brazil the ratio dropped sharply to 5.64%; in the UK it fell to below 2% and in Spain it increased to 7.49%, affected by the decline in lending and the re-classification of substandard loans. The Group's NPL coverage ratio was 62%.

Net loan-loss provisions declined to EUR 10,863 million (-14.1%), helped by the positive trend in Brazil. As a result, the cost of credit (provisions/total lending) fell to 1.53% from 2.38% at the end of 2012.

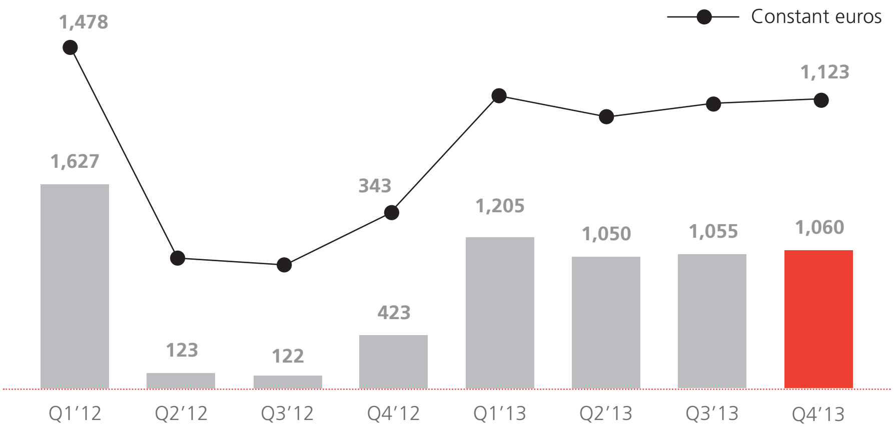
### Attributable profit

These trends in revenues, costs and provisions, along with lower real estate write downs, resulted in a 90.5% jump in profits to EUR 4,370 million.

Net profit remained highly diversified in geographic terms: Brazil accounted for 23%, the UK 17%, Mexico and the US 10% each, Spain 7%, Chile, Germany and Poland 6% each, Argentina 5%, Portugal 2%, the rest of Latin America 3% and the rest of Europe 5%.


Santander Select branch in São Paulo, Brazil.

GROUP ATTRIBUTABLE PROFIT
Million euros




## Balance sheet strength

In 2013, Grupo Santander continued to reinforce its main capital and liquidity ratios, in response to the difficult economic and financial environment and the new regulatory requirements.

The core capital ratio increased by 138 b.p. to 11.71% (BIS II criteria), highlighting the Group's significant capacity to generate capital organically. The composition of its capital puts Banco Santander in a very comfortable position to comply with the Basel III ratios, whose regulations came into force on January 1, 2014.

Weak demand for loans, together with the Group's capacity to capture deposits through its retail network, enabled Santander to continue to improve its liquidity position in 2013. The commercial gap (the difference between loans and deposits) shrank by EUR 23,000 million and the loan-to-deposit ratio was 109% (113% at the end of 2012).

# RESULTS BY COUNTRIES AND BUSINESSES

## SPAIN

**Santander made a profit of EUR 478 million in Spain in 2013. It has a market share of 13.0% in loans and 15.6% in deposits. It has retail and wholesale banking businesses and online banking (OpenBank).**

Santander branch, Madrid, Spain.

### 2013 highlights

→ In a complicated economic and financial environment, Santander's strategy focused on:
- Reducing the cost of deposits. The cost of new time deposits dropped by 170 basis points.
- Attracting and retaining customer funds. In the last two years the Bank has gained two percentage points of market share.
- Selective growth in lending in sectors such as SMEs and exporters, with a special credit line of EUR 10,000 million that has been taken up by 99,828 customers.
- The improvement in liquidity. The loan-to-deposit ratio improved to 87%.

→ Gross income declined 8.6%, mainly due to lower loan volumes and the re-pricing of mortgages, and operating costs fell 1.4%. The non-performing loan ratio increased to 7.49%, although it was still below the sector average.

→ Santander granted 295,466 loans totalling EUR 25,430 million and gained 40 b.p. of market share.

→ In 2013, it captured 606,663 new customers. The *We want to be your Bank plan,* which exempts linked customers from service charges, was extended to include 804,025 customers from Banesto.

### Integration of Santander, Banesto and Banif

The merger is proceeding ahead of schedule. All the retail branches have already been incorporated technologically, bringing forward cost synergies that are expected to reach EUR 436 million in the third year (2015).

The integration makes the branch network better balanced, strengthens company and private banking and expands the range of products and services available.

### Contribution to Group profit

**7%**

**BRANCHES**
**4,067**

**CUSTOMERS (MILLION)**
**14.1**

**LOANS***
**159,752**

**DEPOSITS***
**181,117**

**ATTRIBUTABLE PROFIT***
**478 (-44.6%)**

*million euros

**Read the QR code**
Access the Santander Spain commercial website.

# POLAND

**Bank Zachodni WBK made an attributable profit of EUR 334 million and progressed in its merger with Kredyt Bank.**

**Read the QR code**
Access the Bank Zachodni WBK commercial website.


Bank Zachodni WBK branch in Poland.

## 2013 highlights

→ The merger of Bank Zachodni WBK and Kredyt Bank in January 2013 positions Santander as the third biggest bank in Poland by market share, with 7.4% of loans and 8.4% of deposits.

→ Bank Zachodni WBK's business model centres on retail banking and strong support for SMEs, which is complemented by a significant presence in asset management, stockbroking, leasing and wholesale banking specialising in large Polish companies and international customers.

→ Loans and deposits rose 1% (constant perimeter) in 2013, which provides the Bank with a solid financial base (it has a loan-to-deposit ratio of 88%). Revenues were stable and costs fell 6%, helped by the first synergies resulting from the merger. Loan quality remains high.

→ The Bank continues to offer customers innovative products, such as *An Account Worth Recommending, the Contactless Card,* funds managed by BZ WBK TFI, factoring products and online and mobile banking services.

→ The Bank signed an agreement with Aviva in 2013 renewing its strategic cooperation in bankassurance.

**Contribution to Group profit**
**6%**

**BRANCHES**
**830**

**CUSTOMERS (MILLION)**
**4.2**

**LOANS***
**16,214**

**DEPOSITS***
**18,503**

**ATTRIBUTABLE PROFIT****
**334 (+3.9%)**

* million euros
**million euros, variation in local currency and on a like-for-like basis

# PORTUGAL

**Santander is the third largest private sector bank by assets in Portugal and the leader in terms of attributable profit generated, which in 2013 amounted to EUR 114 million.**

**Read the QR code**
Access the Santander Totta commercial website.


Santander Totta branch in Lisbon.

## 2013 highlights

→ Santander Totta focuses on commercial banking (individuals and SMEs). It has a market share of 10% in loans and in deposits.

→ Its strategy is based on increasing linkage and improving the transaction levels of customers, managing spreads on loans and deposits and lifting market share in company lending (*PME Investe* and *PME Crecimiento* lines, factoring and confirming).

→ The Bank supports Portuguese companies through initiatives such as the *Plano Activação* and *Top Exporta.* It signed an agreement with the European Investment Bank to provide EUR 200 million of loans to SMEs.

→ In a very difficult economic environment, Santander Totta generated positive results, maintained solid capital ratios, kept its non-performing loan ratio under control, reduced the balance of real estate loans and kept them well covered.

→ Lending declined 5% and deposits 4%, as a result of which gross income dropped 12%. Costs continued to decline (-2.2%).

→ In 2013, Santander Totta was named Best Bank in Portugal by *Euromoney* and *Global Finance* and Bank of the Year by *The Banker.*

**Contribution to Group profit**
**2%**

**BRANCHES**
**640**

**CUSTOMERS (MILLION)**
**2.0**

**LOANS***
**24,482**

**DEPOSITS***
**24,191**

**ATTRIBUTABLE PROFIT***
**114 (-6.3%)**

*million euros

# SANTANDER CONSUMER FINANCE

**Santander Consumer Finance (SCF) made an attributable profit of EUR 794 million (+9.6%) in Continental Europe, a notable performance in an environment of weak consumption and lower car sales.**

Headquarters of Santander Consumer Bank in Mönchengladbach, Germany.

**Read the QR code** Access the SCF website.

SCF is one of the European leaders in consumer finance. It specializes in auto finance and also offers products such as personal loans, durable goods financing and credit cards. Its business model is based on providing financial solutions through more than 122,500 associated points-of-sale (vehicle dealers and shops). **In the past five years it has signed 60 auto finance agreements with car and motorbike manufacturers in Europe.**

SCF has adapted well to the weak environment, achieving solid results and increasing its market share of profitable business, thanks to its geographic diversification and its critical mass in key products, strict spread management, a risk control and loan loss recovery system common to all the countries in which it operates and higher efficiency than that of its competitors.

## 2013 highlights (Continental Europe)

- SCF's solid results are based on practically stable revenues, a slight rise in costs and, above all, lower loan-loss provisions (-25%). Of note are the results of the Nordic countries, Spain and Germany. The non-performing loan ratio remained low at around 4% and coverage was 105%.
- Gross lending was steady at EUR 58,500 million, with growth in central and northern Europe and declines in southern Europe.
- SCF has attained a level of net self-financing. The volume of customer deposits reached EUR 30,878 million and SCF is Europe's largest issuer of auto finance securities, at more than EUR 4,200, and it issued almost EUR 2,000 million of senior debt during 2013.
- SCF signed a strategic agreement in Spain with El Corte Inglés to acquire 51% of its consumer finance business, the country's leader in financing consumer goods.

## Germany

Santander has 253 branches and 6.4 million customers in Germany, where it is number one in consumer finance and also has a retail banking businesses. Germany accounted for 53% of SCF's profits and 6% of the Group total.

Continued high lending (almost EUR 11,000 million) and the high level of deposits (more than EUR 27,000 million) reflect the consolidation of Santander's business model in the German market.

**Contribution to Group profit**

**12%**

SCF 12%
Germany 6%

**BRANCHES**
**613**

**CUSTOMERS (MILLION)**
**12.1**

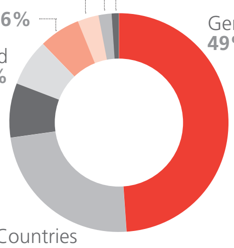
**LOANS***
**56,024**

**DEPOSITS***
**30,878**

**ATTRIBUTABLE PROFIT***
**794 (+9.6%)**

*million euros

**NEW LENDING BY COUNTRIES**



# UNITED KINGDOM

**Santander UK posted an attributable profit of EUR 1,149 million in 2013.**


Santander branch in London, UK.

The Bank's goal is to support individual customers and companies through simple, personal and fair banking. Its strategy focuses on three objectives: increase the number of loyal and satisfied retail customers, become the first choice bank of companies and seek a consistent profit and a strong balance sheet.

It has a growing weight in current accounts, thanks to the innovative *1|2|3* current account and is continuing to grow its presence in corporate banking and SMEs, which already account for 12% of customer loans.

## 2013 highlights

→ Santander UK's attributable profit was £976 million, 16.4% more than in 2012. Net interest income rose (+8.3%), while costs remained broadly flat, absorbing the investments in businesses. Provisions fell 24.6%, due to the improved quality in retail and corporate businesses. The non-performing loan (NPL) ratio was reduced to 1.98%.

→ In personal banking, *1|2|3 World* products attracted more than 1.1 million new customers in 2013 to a total of 2.4 million. Thanks to the *1|2|3* current account, which attracts high quality primary banking clients, current account balances grew by £12,000 million (+75%). In addition Santander UK was the first choice for customers switching their current account provider in 2013, with a net gain of 11% of accounts transferred. New mortgage loans amounted to £18,483 million, 27% more than in 2012.

→ Lending to SMEs and large companies increased 13% in 2013, the fourth straight year of double-digit growth. Commercial banking is carried out via a network of dedicated corporate business centres, of which there were 50 at the end of the year. Santander UK also introduced a new advanced online banking service for corporate customers.

→ Santander UK is one of the strongest and best capitalised banks in the UK. Its capital position improved in 2013, with a Common Equity Tier 1 Capital ratio of 11.6% under CDR IV. The loan-to-deposit ratio reached 123%.

**Contribution to Group profit**

**17%**

**BRANCHES**
**1,157**

**CUSTOMERS* (MILLION)**
**25.5**

**LOANS****
**231,046**

**DEPOSITS****
**187,467**

**ATTRIBUTABLE PROFIT*****
**1,149 (+16.4%)**

* Santander UK has 14 million active customers
** million euros
***million euros, variation in local currency

**Read the QR code**
Access the Santander UK commercial website.

# BRAZIL

**Santander Brazil is the country's third largest private sector bank by assets. It posted a profit of EUR 1,577 million.**


Santander branch in São Paulo, Brazil.

## 2013 highlights

→ Lending grew 7%, mainly due to mortgages (+32%) and large companies (+17%), and customer funds increased 9%. These increases, however, did not feed through to gross income (-6%) due to the narrowing of interest rate spreads throughout the banking sector.

→ Costs rose by a moderate 4%, below the inflation rate. Provisions declined 9% and the NPL ratio fell sharply to 5.64%, below the average of competitors.

→ Santander Brazil's objective is to grow in an efficient, profitable and customer-focused way. It continued to progress in 2013 in developing its four-pronged strategy:

1. Customer satisfaction: launch of the *Trabalhar Bem* plan, which seeks to identify and resolve the problems that generate complaints and dissatisfaction.

2. Efficiency: improve internal processes in order to become a simple bank for customers.

3. Commercial model: measures to increase customer linkage.
   - Launch of *Cuentas Combinadas*, services that offer a current account and credit card designed to meet the needs of four main individual customer profiles.
   - Launch of the Santander Select specialized attention model for high-income customers.
   - Signing of the agreement with the multinational iZettle, which means companies can accept customer transactions via smartphones or tablet.

4. Disciplined use of capital: on September 26 the Bank announced it was optimising its capital structure by replacing BRL 6,000 million of core Tier 1 capital with newly issued instruments of an equivalent value eligible as regulatory capital, which would be offered to the Bank's shareholders. The operation improves the Bank's profitability, rewards shareholders and does not involve reducing the Group investment in the country.

→ *Bloomberg Markets* magazine named Santander Brazil in 2013 as the most solid bank in South America.

**Contribution to Group profit**

**23%**

**BRANCHES**
**3,566**

**CUSTOMERS (MILLION)**
**29.5**

**LOANS***
**66,446**

**DEPOSITS***
**61,490**

**ATTRIBUTABLE PROFIT****
**1,577 (-17.8%)**

* million euros
** million euros, variation in local currency.

**Read the QR code**
Access the Santander Brazil commercial website.

# MEXICO

**Santander Mexico's attributable profit amounted to EUR 713 million in 2013.**

Santander branch in Mexico.

Santander is the country's fourth largest financial group by business volume, with a market share of 13.9% in loans and 15.1% in deposits.

## 2013 highlights

- In 2013, in a context of slower growth, lending increased 12% and deposits 4%, and Santander outperformed the rest of the market in its strategic businesses:
  - Mortgages: growth of 28% consolidated the Bank as the country's second largest mortgage provider, thanks to the acquisition of ING Hipotecaria.
  - SMEs: the Bank secured its leadership, increasing its lending by 26%, which earned it the recognition of the Mexican economy minister as the leader in financing SMEs.

- Gross income continued to rise notably (+8%), with a positive trend in its main components. Fee income (+8.1%) and net interest income (+5.9%) stood out.

- Costs increased 10%, mainly due to the growth in the retail network. As part of its strategic plan to accompany the expansion of the country's economy, Santander Mexico opened 88 new branches. Its efficiency ratio of 40.7% makes it one of Mexico's most efficient banking franchises.

- Loan-loss provisions rose 72%, largely because of those set aside for homebuilders *(viviendera*s) in the second quarter.

- In order to boost linkage, campaigns were conducted to improve the interest rates on loans granted to linked customers, and differentiated customer service models have been set up, supported by a solid multi-channel distribution platform. Santander Mexico also launched the *Firma Vocal*, enabling customers to identify themselves for telephone banking by their voice instead of with passwords.

- Santander Mexico optimized its capital in order to make it more efficient and improve profitability so as to carry out its business plan. It issued USD 1,300 million of subordinated debt, which counts as supplementary capital under Basel III rules. This was the first such issue by a Mexican bank.

- *Euromoney* and *LatinFinance* recognized Santander Mexico in 2013 as the Best Bank in Mexico.

**Contribution to Group profit**

**10%**

**BRANCHES**
**1,258**

**CUSTOMERS (MILLION)**
**10.5**

**LOANS***
**22,269**

**DEPOSITS***
**24,663**

**ATTRIBUTABLE PROFIT****
**713 (-12.2%)**

* million euros
** million euros, variation before minority interests in local currency

**Read the QR code**
Access the Santander Mexico commercial website.

# CHILE

**Santander Chile is the country's largest bank in terms of assets and customers. Attributable profit in 2013 amounted to EUR 435 million.**

**Read the QR code** Access the Santander Chile commercial website.

Santander branch in Chile.

## 2013 highlights

→ Santander Chile has a market share of 19.1% in loans and 16.8% in deposits.

→ Lending increased 11% in 2013 (+16% in high income and +14% in SMEs) and deposits grew 8%. Gross income increased 3.0% in local currency.

→ The Bank continued to develop its strategic plan for 2015, whose main pillars are: focus on retail business with individual customers and SMEs, improving service quality; conservative risk management; and strict cost control.

→ Customer segmentation and the range of products were simplified, improving service quality and post-sale support. The Select brand was launched for the high-income segment and progress was made in defining the new value proposition for medium income clients. The roll-out of the new customer relationship management (CRM) system was completed, the new commercial system was installed and alternative channels (Internet, call centre and cashpoints) were strengthened.

→ *Global Finance* magazine recognized Santander Chile as the Best Bank in Chile and the Best Internet Bank.

**Contribution to Group profit**

**6%**

**BRANCHES**
**493**

**CUSTOMERS (MILLION)**
**3.5**

**LOANS***
**28,783**

**DEPOSITS***
**20,988**

**ATTRIBUTABLE PROFIT****
**435 (-6.6%)**

* million euros
** million euros, variation in local currency

# ARGENTINA

**Santander Río is the country's leading private sector bank by assets and earnings. Its attributable profit was EUR 333 million in 2013.**

**Read the QR code** Access the Santander Río commercial website.


Santander Río branch in Argentina.

## 2013 highlights

→ Santander Río has a market share of 9.1% in loans and 9.6% in deposits. In an environment of lower growth, the Bank's business was dynamic, with loans growing 35% and savings 30%. Gross income increased 30.7% in local currency.

→ The commercial strategy centred on attracting and linking customers, particularly high income ones and SMEs, through a multi-channel network focused on quality of service and customer satisfaction. The number of traditional branches increased 2% and new Select spaces were created for affluent clients.

→ Santander Río was named as the Best Bank in Argentina in 2013 by *Euromoney* and *The Banker* magazines and the Best Company to Work For by the *Great Place to Work* consultancy.

→ In the medium and long term, Santander Río will focus on improving its efficiency and the quality of customer service by investing in technology and cost management. It aims, thus, to maintain its high level of profitability, based on its leadership position in transaction banking and growth in lending and savings.

**Contribution to Group profit**

**5%**

**BRANCHES**
**377**

**CUSTOMERS (MILLION)**
**2.5**

**LOANS***
**5,095**

**DEPOSITS***
**5,873**

**ATTRIBUTABLE PROFIT****
**333 (+26.3%)**

* million euros
** million euros, variation in local currency.

# UNITED STATES

**Santander US made an attributable profit of EUR 724 million. The Bank does retail banking under the Santander brand and consumer finance through Santander Consumer USA.**


The rebranding of Santander in the US in October.

The Bank's business model is centred on 1.7 million retail customers and companies in nine states in the US north-east, where it has significant market share. Santander Consumer USA (SCUSA) provides loans to buy new and used cars via 14,000 auto dealerships across the country.

## 2013 highlights

→ Sovereign Bank became Santander Bank in October 2013. The Bank is now preparing for a new stage of building a retail franchise centred on offering customers a new value proposition and satisfying their needs while exploiting the Group's international scope.

→ Santander US announced a three-year USD 200 million investment plan to improve customer service, which will involve remodelling branches, installing new cashpoints, products and channels and includes the new website www.santanderbank.com and more applications for mobile phone banking.

→ Coinciding with the change of brand, Santander US launched the *Extra20 checking* account, which rewards customers with USD 20 a month if they have USD 1,500 of income domiciled in their account and have two or more direct debits via online banking.

→ Santander US made an attributable profit of USD 961 million, 7% lower than in 2012. This was the result of sales of the loan portfolio, revenues continuing to be affected by market conditions and the cost of investments to develop the franchise.

→ SCUSA contributed USD 413 million of profit. The agreement in February with Chrysler and the positive trends in the auto finance market continued to boost its business.

→ At the beginning of January 2014, SCUSA was successfully listed, with a market value of USD 8,300 million and capital gains for Grupo Santander of EUR 740 million.

**Contribution to Group profit**

**10%**

**BRANCHES**
**706**

**CUSTOMERS (MILLION)**
**1.7**

**LOANS***
**37,682**

**DEPOSITS***
**35,537**

**ATTRIBUTABLE PROFIT****
**724 (-7.1%)**

* million euros
** million euros, variation in local currency

Note: The figures for customers and business do not include SCUSA as it consolidates by the equity accounted method.

**Read the QR code**
Access the Santander Bank commercial website.

# GLOBAL BANKING & MARKETS

**Santander Global Banking & Markets' attributable profit was EUR 1,503 million, 22% of the total for the Group's operating areas.**

Treasury room, Santander Group City, Boadilla del Monte, Madrid, Spain.

Santander Global Banking & Markets (SGBM) is the global business unit for corporate clients and institutions that, because of their size, complexity or sophistication, require specially-tailored services or value-added wholesale products.

## 2013 highlights

- SGBM continued to reinforce its business model, which rests on three pillars: a focus on the customer, strong global product capacities and interconnection with its local units. Active management of risk, capital and liquidity are part of its strategy, which has required it to adapt its range of products to the new market conditions.

- Revenues generated by customer business accounted for 87% of total gross income. The generation of recurrent revenues and strict management of costs enabled SGBM to maintain its efficiency ratio at 33.7%, which is still a reference for the sector.

- In 2013, SGBM followed the Group's footsteps in its international development in Poland and continued to increase its coverage of corporate clients in the US north-east and in the UK.

## Major transactions in 2013

- SGBM led the advisory, execution and syndication phases of a EUR 42,000 million swap contract for Sareb[3], the largest interest rate hedging contract in the euro's history.

- In the project bonds market, it led operations such as the USD 1,700 million issue by Brazil's Odebrecht in the US market and a MXN 7,500 million bond for Red de Carreteras de Occidente in Mexico.

- It participated in Verizon's USD 49,000 million bond issue to finance the acquisition of Vodafone's 49% stake in Verizon Wireless, the largest corporate issue ever.

- It is major advisor for foreign investors in Spain. In 2013, it advised Beijing Enterprises' on its acquisition of Veolia Environment; British Columbia Investment Management Corporation on its purchase of 5% of CLH from Galp; and Branch Management (Mexico) on its acquisition of 253 branches from Banco Sabadell.

- SGBM was Telefónica's sole advisor in the sale of 40% of its assets in Guatemala, El Salvador, Nicaragua and Panama.

3. Sareb: Company for the Management of Assets proceeding from the Restructuring of the Banking System.

LOANS*
**77,511**

CUSTOMER DEPOSITS*
**58,366**

ATTRIBUTABLE PROFIT*
**1,503 (-21.4%)**

EFFICIENCY RATIO %
**33.7**

* million euros

**Read the QR code**
Access the SGBM website.

# ASSET MANAGEMENT

**Santander has a wide range of savings and investment products covering different customer needs, which are distributed globally by its retail networks.**

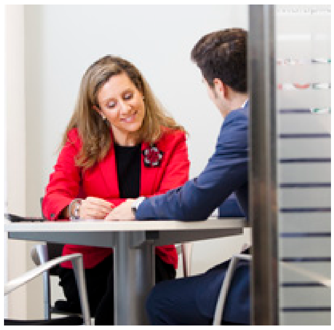
This activity revolves around three business areas: Santander Asset Management (SAM), for mutual and pension funds, companies and discretional portfolios; Santander Real Estate, specialized in managing property investments; and Santander Private Equity for venture capital. Santander Asset Management continued in 2013 to develop a global business model supported by local fund managers' market strength and knowledge.

## 2013 highlights

→ Santander reached a strategic agreement with Warburg Pincus and General Atlantic to strengthen its global asset management business. Warburg Pincus and General Atlantic will jointly hold a 50% stake in a holding company that will group SAM's 11 asset management companies, mainly in Europe and Latin America. This agreement will improve SAM's ability to compete with the leading international asset managers, while leveraging on its knowledge and experience in the markets where it operates.

→ New profiled funds were launched in Mexico and Chile for Select clients. Brazil, Portugal and Poland will also offer these products in 2014.

→ New local institutional mandates were awarded to manage various types of assets, such as fixed income, multi-strategy, structured products and equities in Brazil, Spain and Mexico.



ASSETS UNDER MANAGEMENT*
**156,352**

GROSS INCOME*
**340**

ATTRIBUTABLE PROFIT*
**80**

EFFICIENCY RATIO
**57.7%**

* million euros

# PRIVATE BANKING

**Private banking includes the units that specialise in providing advice and overall asset management for the Group's high net worth customers.**

Santander Private Banking units operate in Spain, Italy, Portugal, Brazil, Mexico and Chile, where they provide domestic private banking services, and in the US and Switzerland, where they provide services for international clients.

## 2013 highlights

→ Assets under management rose 11%, thanks to generating new business and winning new customers. Attributable profit was EUR 154 million.

→ The integration of Santander, Banesto and Banif in Spain under the Santander Private Banking brand gave a boost to business and strengthened Santander's leadership in the Spanish private banking market.

→ With the establishment of the specialized advice model in Portugal, Brazil, Chile and Mexico, the process was completed in all the markets where the Santander Private Banking brand operates. This model combines knowledge of markets at local level with the global view that professional investment management requires. The objective is to watch over and protect customers' investments, while constantly respecting their individual preferences in terms of portfolio risk, concentration of products, liquidity and financial culture.

→ *The Banker* and *Private Banker International* magazines named Santander Private Banking as the Best Private Bank in Latin America. *Euromoney* magazine recognized the units in Spain, Chile and Portugal as the Best Private Banks.


ASSETS UNDER MANAGEMENT*
**110,911**

GROSS INCOME*
**688**

ATTRIBUTABLE PROFIT*
**154**

EFFICIENCY RATIO
**51.5%**

* million euros

# INSURANCE

**Santander Insurance develops products for household protection and savings, with a segmented offer and multi-channel distribution to more than 17 million customers in 20 countries.**

## 2013 highlights

→ In 2013 Santander Insurance concentrated on developing a sustainable business model centred on:
- Completing and segmenting the range of products, with the focus on Select and SMEs.
- Reinforcing the multi-channel strategy.
- Strengthening bancassurance thanks to strategic alliances with Aegon in Spain (transaction closed in 2013 with a capital gain for the Group of EUR 385 million) and with Zurich in Brazil, Mexico, Chile, Argentina and Uruguay. An agreement was also signed in 2013 between Bank Zachodni WBK and Aviva to bolster insurance distribution through the branch network in Poland.

→ In Europe, the division continued to develop the insurance business independently of lending, with significant growth in all networks (Spain, Portugal, the UK and Poland), while the savings business also stood out.

→ The premium income of the insurers created in Ireland, to sell personal protection products distributed via Santander Consumer Finance, amounted to EUR 580 million.

→ In Latin America, progress was made in creating recurrent insurance business, which is less dependent on the credit cycle, with continuous investment to ensure the quality of customer service. Autocompara consolidated itself as an insurance comparison service for the whole region.

→ Santander adhered to the United Nations Principles for Sustainable Insurance in January 2014, underscoring its commitment to the societies in which it does its business.


**TOTAL REVENUES***
**2,641**

**GROSS INCOME***
**423**

**ATTRIBUTABLE PROFIT***
**233**

* million euros

# MEANS OF PAYMENT

**Santander Cards provides credit and debit cards for individuals and companies and services to help retailers capture customers and process payments. It manages 110 million cards in 16 countries and contributed 11% of Group gross income in 2013.**

This unit uses a global methodology, a common technology platform, a standardised risks model and global management tools.

## 2013 highlights

→ Launch of the *Débito Global Select,* which will be the symbol of this segment at global level, with a common image in all countries. It represents the first tangible offer of global value for customers in that they can withdraw cash from any Santander cashpoint with no charge. Two cards were also launched for this segment in Chile: *World Elite* and *Titanio*.

→ Santander continued its commitment to innovation:
- It took a stake in iZettle, the pioneering company for card payment acceptance through smartphone or tablet in Europe. Clients of Santander in Brazil, Spain, Mexico and the UK now have this tool.
- The *Contactless* card, which can be used without contact with a point-of-sale terminal, was introduced in the UK and Poland. There were pilot e-commerce wallet initiatives in Spain and the UK. In Chile cards migrated to chip technology, enhancing security.

→ Santander Cards launched the *123* card in Spain, where there are more than 100,000 units in the market, and in Poland. Since 2010, more than 560,000 Ferrari cards were issued in seven countries. The alliance with the airline Iberia was also strengthened with the launch of the *Iberia* card in Mexico.


**TOTAL NUMBER OF CREDIT CARDS (MILLION)**
**30**

**TOTAL NUMBER OF DEBIT CARDS (MILLION)**
**80**

**LENDING*/****
**14,691**

**GROSS INCOME***
**4,541**

* million euros
** not including Santander Consumer Finance

# 3

# CORPORATE GOVERNANCE REPORT

Santander´s head quarters in São Paulo, Brasil.

*The composition of the board is balanced between external and executive directors, all with a thorough knowledge of banking and finance and extensive international experience*

**EMILIO BOTÍN, CHAIRMAN**
**Banco Santander general shareholders' meeting, 22 March 2013.**

**Balanced and committed board.**

→ Of 16 directors, 11 are non-executive and 5 are executive.

**Equality of rights of shareholders.**

→ Principle of one share, one vote, one dividend.
→ No defensive mechanisms in Bylaws.
→ Encouragement of informed participation at meetings.

**Maximum transparency, particularly as regards remuneration.**

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

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

# MAIN ACTIVITIES OF THE BOARD ON MATTERS RESERVED THERETO

## Activities of the board

- The board held 15 meetings during 2013, of which two were solely dedicated to the global strategy of the Group. At nine meetings, the chief executive officer submitted to the board management reports, and the second vice-chairman and head of the risk division reported on Group risks.
- The external auditors and the heads of internal audit participated in 11 and 10 of the 12 meetings held by the audit and compliance committee and reported to the board on two occasions, respectively, during 2013.
- The shareholders at the general shareholders' meeting approved the corporate management of the Bank in 2012 with a 98% favourable vote.

## Changes in the composition of the board

At the board meeting of 29 April 2013, the following changes were made:

- Mr Alfredo Sáenz Abad voluntarily resigned his positions as second vice-chairman and chief executive officer, as well as leaving the board.
- It was agreed to appoint as new chief executive officer Mr Javier Marín Romano, until then executive vice president in charge of private banking, asset management and insurance.
- Mr Manuel Soto Serrano resigned as director and fourth vice-chairman of the board.
- Mr Juan Miguel Villar Mir was appointed as independent director.
- Mr Matías Rodríguez Inciarte (head of risk for the Group and chairman of the Bank's risk committee) was appointed second vice-chairman, and Mr Guillermo de la Dehesa Romero (independent director) was appointed third vice-chairman, replacing Mr Manuel Soto Serrano as chairman of the audit and compliance committee.

In December 2013, Lord Burns resigned from the position of director and has been appointed member of the international advisory board.

In January 2014, following the proposal by the appointments and remuneration committee, the board resolved to designate Ms. Sheila Bair as a new independent director.

## Shareholder compensation

- As regards dividends, in 2013 the board maintained the same compensation per share as in the previous four financial years, i.e., 0.60 euro.

## Director remuneration policy

- The board submitted the report regarding the director remuneration policy to the shareholders at the general shareholders' meeting held on 22 March 2013, as a separate item on the agenda and as a consultative matter; 92% of the votes were in favour of the report.

  This percentage is 8 points higher than the average for the five most highly capitalised Spanish entities.

## Remuneration of directors

- The total remuneration of directors for 2013 is 11% less than 2012.

## Bylaw-mandated payments

- The shareholders at the general shareholders' meeting held on 22 March 2013 approved the amendment of the Bylaws such that the remuneration to which the directors are entitled constitutes a fixed annual amount determined at the general shareholders meeting. Such amount shall remain in effect until the shareholders approve an adjustment thereof, although the board may approve a reduction in years for which it considers such reduction to be justified. The remuneration established by the shareholders for the financial year 2013 is 6 million euros and has two components: (a) annual allocation and (b) attendance fees.

  The total amount paid to directors as fees amounted to 4.3 million euros in 2013, which is 27.9% lower than the amount approved by the shareholders, and 0.5% less than the amount received in 2012.

## Remuneration of executive directors

- The board decided to make an average 13% reduction in the variable remuneration.

## Financial information periodically published by the Bank

- The board approved the quarterly financial information, the annual accounts, and the management report for 2013, in addition to other documents such as the annual report, the sustainability report, prudential 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

In 2013, the Bank carried out four capital increases within the framework of the Santander Scrip Dividend programme, for a total of 1,012,240,738 shares, representing an 8.93% increase in share capital at year-end 2013.

| | Number of shares | % of share capital* |
|---|---|---|
| 30 January | 217,503,395 | 1.919 |
| 30 April | 270,917,436 | 2.390 |
| 31 July | 282,509,392 | 2.493 |
| 31 October | 241,310,515 | 2.129 |
| **Total** | **1,012,240,738** | **8.931** |

* Share capital at year-end 2013.

The Bank's share capital at 31 December 2013 was represented by 11,333,420,488 shares, whose value per the listing price on Spain's Electronic Trading System (continuous market) of the Spanish stock exchanges at such date was 73,735 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[1] or interests that would permit a significant influence on the Bank) at 31 December 2013.

The interests held by State Street Bank & Trust (9.33%), Chase Nominees (7.05%), The Bank of New York Mellon (5.35%), EC Nominees Ltd. (4.57%), Clearstream Banking (3.49%) and Guaranty Nominees (3.29%), 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 (16), 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) on proportional representation, is 6.25%.

1. Limit set by Royal Decree 1362/2007, of 19 October, for defining the concept of significant interest.

## 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 material fact and is described in the public records thereof.

On 3 August and 19 November 2012, Banco Santander reported to the CNMV as material facts that it had been formally notified of amendments to this shareholders' agreement with regard to the signatories thereto.

On 17 October 2013, the Bank also reported to the CNMV as a material fact an update of the holders and of the distribution of shares included in the syndication, as a consequence of a business reorganisation carried out by one of the parties to the agreement.

The details of the shares currently included in the syndication are as described below:

### Shares included in the syndication

At year-end 2013, the syndication included a total of 79,297,349 shares of the Bank (0.7% of its share capital) broken down as follows:

| Signatories to the shareholders' agreement | Number of shares |
|---|---|
| Mr Emilio Botín-Sanz de Sautuola y García de los Ríos | 6,464,149 |
| Ms Ana Patricia Botín-Sanz de Sautuola O'Shea [1] | 17,082,380 |
| Mr Emilio Botín-Sanz de Sautuola O'Shea [2] | 16,873,709 |
| Mr Francisco Javier Botín-Sanz de Sautuola O'Shea [3] | 16,203,429 |
| Ms Paloma Botín-Sanz de Sautuola O'Shea [4] | 7,830,897 |
| Ms Carmen Botín-Sanz de Sautuola O'Shea | 8,633,998 |
| PUENTEPUMAR, S.L. | 0 |
| LATIMER INVERSIONES, S.L. [5] | 553,508 |
| CRONJE, S.L., Unipersonal | 4,024,136 |
| NUEVA AZIL, S.L. | 5,575,279 |
| **TOTAL** | **79,297,349** |

1. 7,971,625 shares indirectly through Bafimar, S.L. and 4,024,136 shares corresponding to the participation of Cronje as set out above.
2. 7,800,332 shares indirectly through Puente San Miguel, S.L.U.
3. 4,652,747 shares indirectly through Inversiones Zulú, S.L. and 6,794,391 shares through Apecaño, S.L.
4. 6,628,291 shares indirectly through Bright Sky 2012, S.L.
5. Bare ownership of 553,508 shares corresponds to the Marcelino Botín Foundation (Fundación Marcelino Botín), but voting rights are assigned to Latimer Inversiones, S.L. as beneficial owner thereof.

In all other respects the aforementioned shareholders' agreement remains unchanged.

The aforementioned material facts may be viewed on the Group's corporate website (www.santander.com).

## Treasury shares

### Treasury share policy

By resolution of the board of directors on 21 October 2013, the Bank adjusted its treasury share policy[2] taking into account the standards recommended by the CNMV. The sale and purchase of treasury shares, by the Company or by companies wholly owned thereby, shall conform to the provisions of applicable law and the resolutions of the shareholders in this regard.

Treasury share transactions are aimed at:

a) Encouraging liquidity or supply of securities, as applicable, on the market for the Bank's shares, giving depth to said market and minimising potential temporary imbalances between supply and demand.

b) Taking advantage of situations involving weak share prices in relation to medium-term development prospects for the benefit of the shareholders as a whole.

2. The treasury share policy is published on the Group's website (www.santander.com).

Treasury share transactions shall be subject to the following general guidelines:

- They shall not be the result of an attempt to interfere in free price-formation.
- They may not be carried out if the unit in charge of executing them has insider or material information.
- The execution of any buy-back programmes or share acquisitions to cover Bank or Group obligations shall be permitted.

Treasury share transactions shall be carried out by the investments and holdings department, ring-fenced as an area separate from the rest of the Bank's activities and protected by the corresponding barriers, such that no insider or material information shall be available. The director of such department shall be responsible for the management of treasury shares.

### Key data

At 31 December 2013, the Bank held 1,425,239 treasury shares, representing 0.013% of its share capital at year-end 2013 (at 31 December 2012, there were 48,893,603 treasury shares, representing 0.474% of the Bank's share capital at such date).

The following table sets out the monthly average percentages of treasury shares in 2013 and 2012.

MONTHLY AVERAGE PERCENTAGES OF TREASURY SHARES[1]
% of the Bank's share capital[2]

| | 2013 | 2012 |
|---|---|---|
| January | 0.441 | 0.365 |
| February | 1.264 | 0.184 |
| March | 0.792 | 0.362 |
| April | 0.794 | 0.588 |
| May | 1.061 | 1.372 |
| June | 0.752 | 1.211 |
| July | 0.209 | 1.228 |
| August | 0.497 | 1.822 |
| September | 0.482 | 1.470 |
| October | 0.171 | 0.912 |
| November | 0.431 | 1.999 |
| December | 0.393 | 1.180 |

1. Further information in this regard is included in section A.8 of the annual corporate governance report, which forms part of the management report, and in the capital and treasury share section of this latter report.
2. Monthly average of daily positions of treasury stock.

The transactions in treasury shares carried out by companies belonging to the consolidated Group in the interest thereof during financial year 2013 entailed the acquisition of 974,313,530 shares, equal to a nominal amount of 487.2 million euros (actual amount of 5,592.1 million euros), and the sale of 1,021,781,894 shares in the nominal amount of 510.9 million euros (actual amount of 5,876.5 million euros).

The average purchase price of shares of the Bank in financial year 2013 was 5.74 euros per share, and the average sale price of shares of the Bank in such financial year was 5.75 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 a loss of 28 million euros, 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% 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% 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".*

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

The additional authorised capital amounts to 2,634,670,786 euros, pursuant to the authorisation of the shareholders acting at the annual general meeting held on 22 March 2013. The period available to the directors of the Bank to carry out and make capital increases up to such limit expires on 22 March 2016. The resolution gives the board the power to exclude pre-emptive rights in whole or in part, pursuant to the provisions of article 506 of the Companies Act (Ley de Sociedades de Capital), though this power is limited to capital increases carried out pursuant to this delegation up to 1,053,868,314.50 euros.

In addition, the shareholders acting at the annual general meeting held on 22 March 2013 approved the following resolutions in connection with the content of this section:

1. Four share capital increases with a charge to reserves in the maximum amounts of 1,675 million, 1,775 million, 1,825 million and 1,900 million euros, respectively, within the shareholder compensation scheme (Santander Scrip Dividend) whereby the Bank offers the shareholders the possibility of receiving shares under a scrip issue for an amount equal to the dividends on the quarterly dates on which they are customarily paid.

   For such purposes, at 31 December 2013, three of the authorisations described in the previous section had been implemented, taking place on 30 April, 31 July and 31 October. The number of shares having a nominal value of 0.5 euro each which were issued in each case under the three capital increases by means of a scrip issue was 270,917,436, 282,509,392 and 241,310,515, accounting for a total of 7.012% of the Bank's share capital at year-end 2013. Already in 2014, the fourth capital increase took place on 30 January, with the issuing 227,646,659 new shares, representing 2.01% of the Bank´s share capital.

2. Delegation to the board of directors, in accordance with the general rules on issuance of obligations and pursuant to the provisions of article 319 of the Regulations of the Commercial Register (*Reglamento del Registro Mercantil*), of the power to issue, on one or more occasions, debentures, bonds, preferred shares 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 set-off.

   The issuance or issuances of securities carried out pursuant to this delegation come to the aggregate maximum amount of 10,000 million 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 22 March 2018.

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 1934** in Santander.
**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 Javier Marín Romano

**CHIEF EXECUTIVE OFFICER**
*Executive director*

**Born in 1966** in Madrid.
**Appointed director** at board meeting of 29 April 2013.
**Graduate** in Law with diploma in Business Sciences.

Joined the Bank in 1991. After performing various duties within the Group, he was appointed executive vice president of the global private banking division in 2007. He was appointed head of the global private banking and asset management division in 2009 and of the global private banking, asset management and insurance division in 2010.

**Committees of the board of which he is a member**
Executive, international and technology, productivity and quality.

## Mr Fernando de Asúa Álvarez

**FIRST VICE-CHAIRMAN**
*Non-executive (independent) director and lead non-executive director*

**Born in 1932** in Madrid.
**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*) and technology, productivity and quality.

## Mr Matías Rodríguez Inciarte

**SECOND VICE-CHAIRMAN**
*Executive director*

**Born in 1948** in Oviedo.
**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, and a non-executive director of Sanitas, S.A. de Seguros and of Financiera Ponferrada, S.A., SICAV.

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

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

## Mr Guillermo de la Dehesa Romero

**THIRD VICE-CHAIRMAN**
*Non-executive (independent) director*

**Born in 1941** in Madrid.
**Joined the board** in 2002.
**Government Economist and head of office** of the Bank of Spain (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. and of Grupo Empresarial San José, 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, audit and compliance (*chairman*), appointments and remuneration and international.

## Mr Rodrigo Echenique Gordillo

*Non-executive (independent) director*

**Born in 1946** in Madrid.
**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). He is also currently non-executive chairman of NH Hoteles, S.A. and non-executive director of Vocento, S.A.

**Committees of the board of which he is a member**
Executive, risk, audit and compliance, appointments and remuneration and international.

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

*Executive director*

**Born in 1960** in Santander.
**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 The Coca-Cola Company.

**Committees of the board of which she is a member**
Executive, international and technology, productivity and quality.

## Ms Isabel Tocino Biscarolasaga

*Non-executive (independent) director*

**Born in 1949** in Santander.
**Joined the board** in 2007.
**Doctorate** in Law. She has undertaken graduate studies in business administration at IESE and the Harvard Business School.
**Main activity:** full professor at the Complutense University of Madrid.

**Other significant positions:** she has formerly been Spanish Minister for the Environment, chairwoman of the European Affairs Committee and of the Foreign Affairs Committee of the Spanish Congress and chairwoman for Spain and Portugal and vice-chairwoman for Europe of Siebel Systems. She is currently an elected member of the Spanish State Council, a member of the Royal Academy of Doctors and a non-executive director of ENCE Energía y Celulosa, S.A.

**Committees of the board of which she is a member**
Executive, risk and appointments and remuneration.

## Ms Sheila Bair

*Non-executive director (independent)*

**Born in 1954** in Wichita, Kansas.
**Appointed director** at board meeting of 27 January 2014.
**JD** from University of Kansas School of Law and **BA** from University of Kansas.
**Main activity:** senior advisor and chairman of the Systemic Risk Council at The Pew Charitable Trusts and columnist in Fortune Magazine.

**Other significant positions:** Chairman of the Federal Deposit Insurance Corporation (2006 - 2011), Dean´s Professor of Financial Regulatory Policy for the Isenberg School of Management at the University of Massachusetts-Amherst (2002-2006) and Assistant Secretary for Financial Institutions at the U.S. Department of the Treasury (2001-2002).

## Mr Vittorio Corbo Lioi

*Non-executive director*

**Born in 1943** in Iquique (Chile).
**Joined the board** in 2011.
**Degree in Commercial Engineering** from the University of Chile and **Ph.D.** in Economics from MIT.

**Other significant positions:** he is the non-executive chairman of the board of Compañía de Seguros SURA Chile, non-executive director of Banco Santander - Chile, of Banco Santander (México), S.A., of CCU, S.A. and of Endesa Chile, and a financial advisor to various international institutions and Chilean businesses. He was previously chairman of the Central Bank of Chile (2003-2007), a professor of Economics at the Pontificia Catholic University of Chile (1981-1984 and 1991-2003) and at Concordia University in Montreal, Canada (1972-1981) and professorial lecturer at Georgetown University, Washington, DC (1985-1991), and held management positions at the World Bank in Washington, D.C. (1984-1991).

## Mr Ángel Jado Becerro de Bengoa

*Non-executive (independent) director*

**Born in 1945** in Santander.
**Joined the board** in 2010.
**Graduate** in Law.

**Other significant positions:** he was a director of Banco Santander from 1972 to 1999, and a director of Banco Banif, S.A. from 2001 to 2013.

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

*Non-executive (proprietary) director*

**Born in 1973** in Santander.
**Joined the board** in 2004.
**Graduate** in Law.

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

## Ms Esther Giménez-Salinas i Colomer

*Non-executive (independent) director*

**Born in 1949** in Barcelona.
**Joined the board** in 2012.
**Doctorate** in Law.
**Main activity:** full professor of Criminal Law at ESADE-URL Faculty of Law.

**Other significant positions:** has been a Rector of the Ramon Llull University, a member of the Spanish Supreme Judicial Council, a member of the Standing Committee of the Conference of Rectors of Spanish Universities and an executive vice-president of the Centre for Legal Studies of the Department of Justice of the Generalitat de Catalunya.

**Committees of the board of which she is a member**
International.

## Mr Abel Matutes Juan

*Non-executive (independent) director*

**Born in 1941** in Ibiza.
**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 and international.

## Mr Juan Rodríguez Inciarte

*Executive director and executive vice president*

**Born in 1952** in Oviedo.
**Joined the board** in 2008.
**Graduate** in Economics.

**Other significant positions:** he is vice-chairman of Santander UK plc and director of Santander Consumer Finance, S.A. and of SAM Investment Holdings Limited.

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

## Mr Juan Miguel Villar Mir

*Non-executive (independent) director*

**Born in 1931** in Madrid.
**Appointed director** at board meeting of 29 April 2013.
**Doctorate** in Civil Engineering, **graduate** in Law and **diploma** in Industrial Organisation.
**Principal activity:** Chairman of the OHL Group and representative of the latter as vice chairman of Abertis Infraestructuras, S.A.

**Other significant positions:** was Minister for Finance and vice president of the government for economic affairs (1975-1976). He has also served as chairman of Electra de Viesgo, Altos Hornos de Vizcaya, Hidro Nitro Española, Empresa Nacional de Celulosa, Empresa Nacional Carbonifera del Sur, Cementos del Cinca, Cementos Portland Aragón and Puerto Sotogrande. Furthermore, he is presently a member of the Royal Academy of Engineering.

## Mr Ignacio Benjumea Cabeza de Vaca

*General secretary and secretary of the board*

**Born in 1952** in Madrid.
**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. and a non-executive director of Sociedad Rectora de la Bolsa de Valores de Madrid, S.A., of Bolsas y Mercados Españoles, Sociedad Holding de Mercados y Sistemas Financieros, S.A. and of La Unión Resinera Española, S.A.

**Secretary of committees of the board**
Executive, risk, audit and compliance, appointments and remuneration, international and technology, productivity and quality.

## Re-election of directors at the 2014 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, such that one-third of the board is renewed each year.

The following directors will be proposed for re-election at the 2014 annual general shareholders' meeting, scheduled for 27 or 28 March 2013 on first and second call, respectively, and following the order determined by seniority for annual renewal and for renewal of one-third of the board as established by article 55 of the Bylaws: Ms Ana Patricia Botín-Sanz de Sautuola y O'Shea, Mr Vittorio Corbo Lioi, Mr Rodrigo Echenique Gordillo and Ms Esther Giménez-Salinas i Colomer, the first as executive director, the following two as non-executive directors and the last as an independent director. The general shareholders' meeting will also be asked to ratify the appointments of Mr Javier Marín Romano – also re-electing him for a three-year term – and of Mr Juan Miguel Villar Mir and Ms. Sheila Bair – also re-electing her for a three-year term –, the first as executive and the other two as independent directors. Their professional profiles, together with a description of their activities, appear on the preceding pages.

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

The re-elections 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.

## 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.

### COMPOSITION AND STRUCTURE OF THE BOARD OF DIRECTORS AT 31 DECEMBER 2013

| Board of Directors | | | | Committees | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Executive | Non-executive | 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 |
| Chief executive | Mr Javier Marin Romano[6] | ■ | | ■ | | | | ■ | ■ |
| First vice-chairman | Mr Fernando de Asúa Álvarez | | I | ■ | V | ■ | C | | ■ |
| Second vice-chairman | Mr Matías Rodríguez Inciarte[2] | ■ | | ■ | C | | | | |
| Third vice-chairman | Mr Guillermo de la Dehesa Romero | | I | ■ | | C | ■ | ■ | |
| Members | Ms Ana Patricia Botín-Sanz de Sautuola y O'Shea[1] | ■ | | ■ | | | | ■ | ■ |
| | Mr Javier Botín-Sanz de Sautuola y O'Shea[1 3] | | D | | | | | | |
| | Lord Burns (Terence) | | N | | | | | | |
| | Mr Vittorio Corbo Lioi | | N | | | | | | |
| | Mr Rodrigo Echenique Gordillo | | I | ■ | ■ | ■ | ■ | ■ | |
| | Mr Esther Giménez-Salinas i Colomer | | I | | | | | ■ | |
| | Mr Ángel Jado Becerro de Bengoa | | I | | | | | | |
| | Mr Abel Matutes Juan | | I | | | ■ | | ■ | |
| | Mr Juan Rodríguez Inciarte | ■ | | | ■ | | | | |
| | Ms Isabel Tocino Biscarolasaga | | I | ■ | ■ | | ■ | | |
| | Mr Juan Miguel Villar Mir[6] | | I | | | | | | |
| 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, 93,026,412 shares owned by the Botín Foundation (0.821% of the share capital), 2,469,558 shares owned by Mr Jaime Botín-Sanz de Sautuola y García de los Ríos (0.022% of the share capital), 6,128,787 shares owned by Nueva Azil, S.L. and Latimer Inversiones, S.L. (0.054% of the share capital); 8,633,998 shares owned by Ms Carmen Botín-Sanz de Sautuola y O'Shea (0.076% of the share capital); 7,830,897 shares owned by Ms Paloma Botín-Sanz de Sautuola y O'Shea (0.069% of the share capital); and 16,873,709 shares owned by Mr Emilio Botín-Sanz de Sautuola y O'Shea (0.149% of the share capital). Additionally, Mr Emilio Botín-Sanz de Sautuola y García de los Ríos has the right to vote 17,082,380 shares owned by Ms Ana Patricia Botín-Sanz de Sautuola y O'Shea (0.151% of the share capital) and 16,283,429 shares owned by Mr Javier Botín-Sanz de Sautuola y O'Shea (0.144% of the share capital). This table refers to the direct and indirect shareholding of each of the latter two, who are directors of the Bank, but in the column relating to total percentage of share capital, such shareholdings are calculated together with those owned or represented by Mr Emilio Botín-Sanz de Sautuola y García de los Ríos.
2. Mr Matías Rodríguez Inciarte has the right to vote 83,452 shares owned by two of his children.
3. Mr Javier Botín-Sanz de Sautuola y O'Shea is a proprietary non-executive director because on the board of directors he represents the aggregate interests owned by the Botín Foundation, Bafimar, S.L., Cronje, S.L., Puente de San Miguel, S.L.U., Inversiones Zulú, S.L., Latimer Inversiones, S.L., Jardín Histórico Puente San Miguel, S.A., Nueva Azil, S.L., Leugim Bridge, S.L., Apecaño, S.L., Bright Sky 2012, S.L., Mr Emilio Botín-Sanz de Sautuola y García de los Ríos, Ms Ana Patricia Botín-Sanz de

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 share 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 selection, the interim appointment and the ongoing evaluation of the directors, the selection, appointment and, if appropriate, removal of the other members of senior management (executive vice presidents and equivalents) and the monitoring of management activity and ongoing evaluation thereof, as well as 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 very active role in the Group's risk management. 10 of its 16 members are members of at least one of the three board committees with powers in the area of risks: the executive committee, the risk committee and the audit and compliance committee.

**Shareholding at 31 December 2013**

| Direct | Indirect | Shares represented | **Total** | % of share capital | Date of first appointment | Date of last appointment | Expiration date[5] | Date of last proposal of the appointments and remuneration committee |
|---|---|---|---|---|---|---|---|---|
| 6,464,149 | - | 134,963,361 | **141,427,510** | 1.542% | 04/07/1960[4] | 30/03/2012 | First six months of 2015 | 17/02/2012 |
| 291,199 | 2,963 | - | **294,162** | 0.003% | 29/04/2013[4] | 29/04/2013 | First six months of 2014 | 29/04/2013 |
| 83,746 | 65,777 | - | **149,523** | 0.001% | 17/04/1999 | 22/03/2013 | First six months of 2016 | 13/02/2013 |
| 1,279,132 | 108,560 | 83,452 | **1,471,144** | 0.013% | 07/10/1988[4] | 30/03/2012 | First six months of 2015 | 17/02/2012 |
| 128 | - | - | **128** | 0.000% | 24/06/2002 | 22/03/2013 | First six months of 2015 | 13/02/2013 |
| 5,086,619 | 11,995,761 | - | **17,082,380** | 0.000% | 04/02/1989[4] | 17/06/2011 | First six months of 2014 | 11/04/2011 |
| 4,793,481 | 11,489,948 | - | **16,283,429** | 0.000% | 25/07/2004 | 22/03/2013 | First six months of 2016 | 13/02/2013 |
| 30,128 | 27,001 | - | **57,129** | 0.001% | 20/12/2004 | 17/06/2011 | First six months of 2014 | 11/04/2011 |
| 1 | - | - | **1** | 0.000% | 22/07/2011 | 30/03/2012 | First six months of 2014 | 17/02/2012 |
| 658,758 | 12,202 | - | **670,960** | 0.006% | 07/10/1988 | 17/06/2011 | First six months of 2014 | 11/04/2011 |
| 4,651 | - | - | **4,651** | 0.000% | 30/03/2012 | 30/03/2012 | First six months of 2014 | 17/02/2012 |
| 2,000,000 | 4,950,000 | - | **6,950,000** | 0.061% | 11/06/2010 | 22/03/2013 | First six months of 2016 | 13/02/2013 |
| 197,882 | 2,643,807 | - | **2,841,689** | 0.025% | 24/06/2002 | 22/03/2013 | First six months of 2015 | 13/02/2013 |
| 1,528,082 | - | - | **1,528,082** | 0.013% | 28/01/2008[4] | 30/03/2012 | First six months of 2015 | 17/02/2012 |
| 106,780 | - | - | **106,780** | 0.001% | 26/03/2007 | 22/03/2013 | First six months of 2016 | 13/02/2013 |
| 1,056 | - | - | **1,056** | 0.000% | 07/05/2013 | 07/05/2013 | First six months of 2014 | 29/04/2013 |
| **22,525,792** | **31,296,019** | **135,046,813** | **188,868,624** | **1.666%** | | | | **Total** |

Sautuola y O'Shea, Mr Emilio Botín-Sanz de Sautuola y O'Shea, Ms Carmen Botín-Sanz de Sautuola y O'Shea, Ms Paloma Botín-Sanz de Sautuola y O'Shea, Mr Jaime Botín-Sanz de Sautuola y García de los Ríos, Mr Jorge Botín-Sanz de Sautuola Ríos, Mr Francisco Javier Botín-Sanz de Sautuola Ríos, Ms Marta Botín-Sanz de Sautuola Ríos and his own interest.

4. The date on which they were appointed for the first time as executive directors coincides with their first appointment as a director.
5. However, and pursuant to the provisions of article 55 of the Bylaws, 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.
6. His appointment is pending ratification at the next general shareholders' meeting, scheduled for the first six months of 2014.
7. Lord Burns resigned from the position of director effective 31 December 2013.
8. The re-election of Mr Rodrigo Echenique Gordillo as director is expected at the annual general shareholders' meeting in 2014, from which moment he shall be considered a non-executive but not independent director, having held the position of director for more than 12 years.

C Chairman of the committee
V Vice-chairman of the committee
P Proprietary
I Independent
N Non-executive, neither proprietary nor independent

# Commitment of the board and experience of its members

## BOARD'S INTEREST IN THE BANK'S CAPITAL

Data at year-end 2013

**Number of shares of the board**

**188,868,624**

1.666% of share capital

**Stock exchange value**

**1,229**

million euros

**Share listing price**

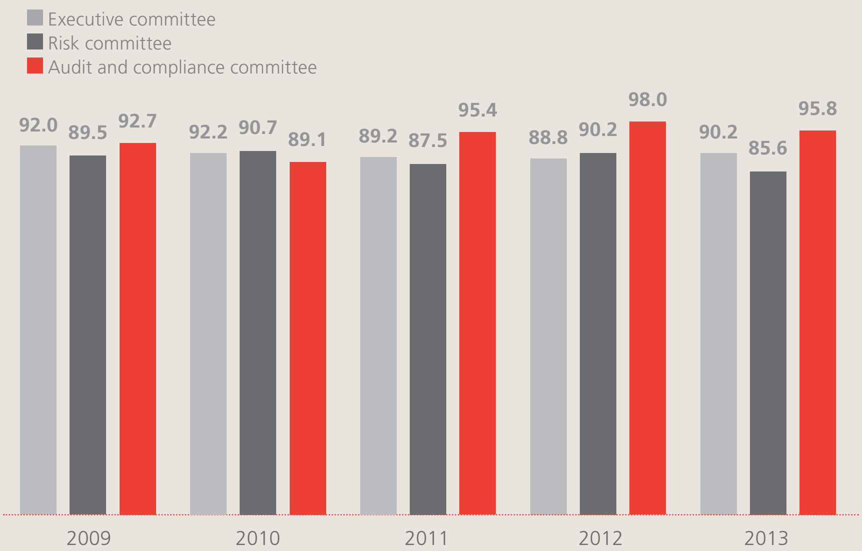
**6.506**

euros

# Corporate governance in risk management

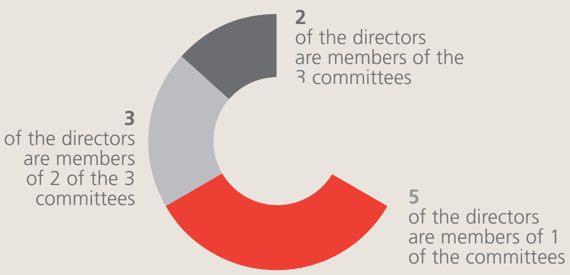
## AVERAGE RATE OF ATTENDANCE AT MEETINGS OF THE COMMITTEES OF THE BOARD

%




- Mr Matías Rodríguez Inciarte, second 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 97 meetings in 2013, each of which lasted approximately 3 hours.
- The executive committee held 58 meetings in 2013 and devoted a significant amount of time to discussions on risks.

## CROSS-PARTICIPATION ON EXECUTIVE, RISK AND AUDIT AND COMPLIANCE COMMITTEES




## NUMBER OF MEETINGS OF THE EXECUTIVE COMMITTEE, THE RISK COMMITTEE AND THE AUDIT AND COMPLIANCE COMMITTEE

| Committees | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|
| Executive | 56 | 55 | 59 | 59 | 58 |
| Risk | 99 | 99 | 99 | 98 | 97 |
| Audit and compliance | 11 | 11 | 12 | 11 | 12 |
| **Total meetings** | **166** | **165** | **170** | **168** | **167** |

## Size and composition of the board

Since the end of 2010, the size of the board has been reduced by 20%, from 20 to 16 members.

The composition of the board of directors is balanced between executive and non-executive directors. All members are distinguished by their professional ability, integrity and independence of opinion.

Pursuant to article 6.3 of the Rules and Regulations of the Board, the appointments and remuneration committee verified the status of each director at its meeting of 23 January 2014. Its proposal was submitted to the board, which approved it at its meeting of 27 January 2014.

Of the 16 members currently sitting on the board, 5 are executive and 11 are non-executive. Of the 11 non-executive directors, nine are independent, one is proprietary and another is, in the opinion of the board, neither proprietary nor independent.

The following changes to the composition of the board occurred during financial year 2013. At its meeting of 29 April 2013, Mr Alfredo Sáenz Abad notified the board of his voluntary resignation from the positions of second vice-chairman and chief executive, thereby also leaving the board, and it was resolved to appoint Mr Javier Marín Romano, until then executive vice president in charge of private banking, asset management and insurance, as the new chief executive.

At the aforementioned meeting, Mr Manuel Soto Serrano resigned his positions as director and fourth vice-chairman of the board and Mr Juan Miguel Villar Mir was appointed as independent director. Mr Matías Rodríguez Inciarte, executive vice president of risk and chairman of the Bank's risk committee, was appointed second vice-chairman, and Mr Guillermo de la Dehesa Romero, independent director, was appointed third vice-chairman and replaced Mr Manuel Soto Serrano as chairman of the audit and compliance committee.

At the board meeting of 16 December 2013, Lord Burns presented his resignation of his position of director with effect from 31 December 2013, and was appointed member of the international advisory board.

Finally, in 2014, at the board meeting on 27 January and following the proposal by the appointments and remuneration committee, it was resolved to designate Ms. Sheila Bair as an independent director to cover the vacancy following the resignation of Lord Burns. It is envisaged that this appointment will be submitted to shareholders for ratification at the next general meeting of the Bank.

### 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 Javier Marín Romano, Mr Matías Rodríguez Inciarte, Ms Ana Patricia Botín-Sanz de Sautuola y O'Shea and Mr Juan Rodríguez Inciarte.

### Proprietary non-executive directors

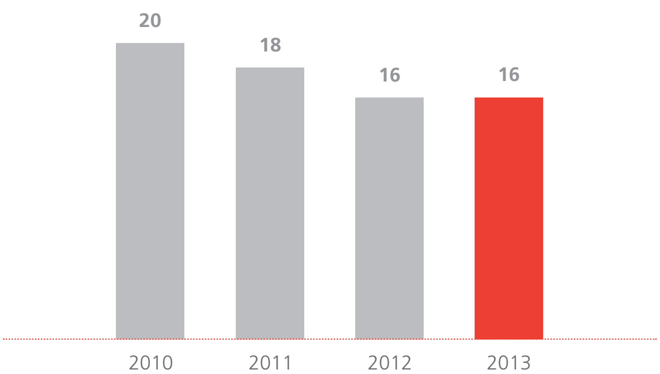
Order ECC/461/2013 (article 8.3) provides that proprietary non-executive directors shall be *"those possessing a shareholding equal to or greater than that which is legally deemed significant or who have been appointed due to their condition as shareholders, though their shareholding does not reach such amount"*, as well as anyone representing such shareholders.

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 proprietary non-executive director is that he/she hold or represent at least 1% of the share capital of the Bank. This percentage was set by the Bank exercising its powers of self-regulation.

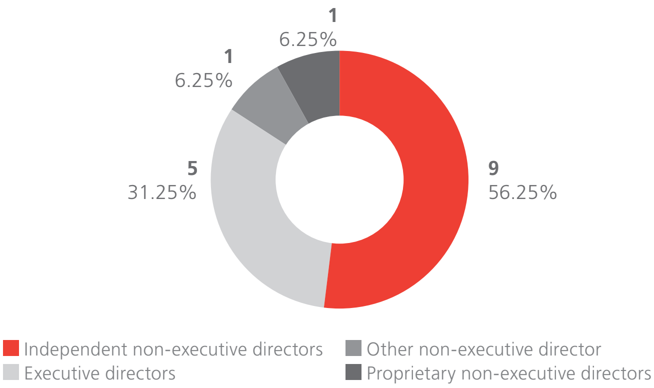
Taking into account the circumstances of the case, and upon the prior report of the appointments and remuneration committee, the board believes that Mr Javier Botín-Sanz de Sautuola y O'Shea is a proprietary non-executive director.

CHANGE IN SIZE OF THE BOARD

Data at year-end




COMPOSITION OF THE BOARD



### Independent non-executive directors

The unity of the board is essential in determining its composition. All directors must act in the interests of the Bank and of its shareholders and bear the same responsibility for board decisions.

The board believes that independence should be the standard required of all directors, and should be based on the good character, integrity and professionalism of each director.

The Rules and Regulations of the Board (article 6.2.c)) include the definition of independent director established in the Unified Good Governance Code, according to which those non-executive directors that have been appointed based on their personal or professional status and who perform not conditioned by relationships with the Bank, its shareholders or its officers will be considered independent directors. This definition is complemented by the provisions of article 8.4 of Order ECC/461/2013, which provides a legal definition of independent director, also taking into account the second transitory provision of such order.

Taking into account the circumstances of each case and upon a prior report of the appointments and remuneration committee, the board considers the following nine directors to be independent non-executive directors: Mr Fernando de Asúa Álvarez, Mr Guillermo de la Dehesa Romero, Mr Rodrigo Echenique Gordillo, Ms Esther Giménez-Salinas i Colomer, Mr Ángel Jado Becerro de Bengoa, Mr Abel Matutes Juan, Ms Isabel Tocino Biscarolasaga, Mr Juan Miguel Villar Mir and Ms. Sheila Bair.

Mr Rodrigo Echenique Gordillo, who is currently considered an independent non-executive director, shall continue to be considered as such until the completion of his term at the next general shareholders' meeting. The re-election of Mr Echenique as non-executive director, following the rotation determined by seniority for annual renewal of one-third of the board as provided in article 55 of the Bylaws, is to be proposed at said general shareholders' meeting, because he cannot be reappointed as an independent director due to having been in the position for more than 12 years.

Likewise, at the board meeting on 27 January 2014 and following the proposal by the appointments and remuneration committee, it was resolved to designate Ms. Sheila Bair as an independent director to cover the vacancy following the resignation of Lord Burns. It is envisaged that this appointment will be submitted to shareholders for ratification at the next general meeting of the Bank.

Given the current number of directors (16), independent non-executive directors account for 56% of the board.

Such percentage exceeds the minimum of one-third established by article 6.1 of the Rules and Regulations of the Board and reflects the board's goal for the board to be made up predominantly of non-executive directors, which in turn are predominantly independent.

At 31 December 2013, the average length of service of independent non-executive directors in the position of board member was 9.47 years.

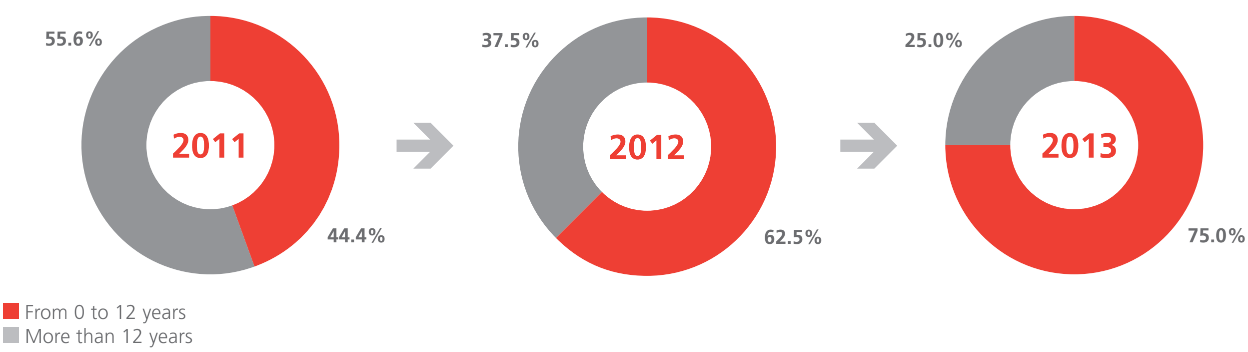
### Other non-executive directors

Mr Vittorio Corbo Lioi is a non-proprietary, non-executive director. As he provides remunerated professional services to the Group other than the collective management and supervision services inherent in his position as director (receiving remuneration as a director of Grupo Financiero Santander México and of Banco Santander Chile, and as an advisor of the latter), 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.

## Diversity on the board

As established in article 17.4.a) of the Rules and Regulations of the Board, the appointments and remuneration committee is responsible for preparing and reviewing the standards that must be followed for the

YEARS OF SERVICE OF INDEPENDENT DIRECTORS
Data at year-end



composition of the board and for determining who is to be proposed for the position of director.

As regards gender diversity, both the appointments and remuneration committee and the board of directors are aware of the importance of fostering equal opportunities between men and women and of the appropriateness of appointing to the board women who fulfil the requirements of ability, suitability and effective dedication to the position of director.

At present, there are four women on the board of directors: Ms Ana Patricia Botín-Sanz de Sautuola y O'Shea, Ms Esther Giménez-Salinas, Ms Isabel Tocino Biscarolasaga and Ms. Sheila Bair, the first being an executive director and the other three independent directors.

The percentage of women on the Banco Santander board (25%) is higher than the average for large European listed companies. According to a study carried out by the European Commission with data from April 2013, this percentage was 16.6% for the group of 27 countries forming the European Union and 14.5% for Spain.

One may observe the number and percentage of women on the board and on each of the committees thereof in the table below.

| | Number of members | Number of female directors | % of female directors |
|---|---|---|---|
| Board | 16 | 4 | 25 |
| Executive committee | 8 | 2 | 25 |
| Risk committee | 5 | 1 | 20 |
| Audit and compliance committee | 4 | - | - |
| Appointments and remuneration committee | 4 | 1 | 25 |
| Technology, productivity and quality committee | 4 | 1 | 25 |
| International committee | 7 | 2 | 28 |

## Executive chairman and chief executive officer

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.

However, it is the chief executive officer, in accordance with article 10.3 of the Rules and Regulations of the Board, in his capacity as such, who is entrusted with the day-to-day management of the different business areas and the highest executive functions.

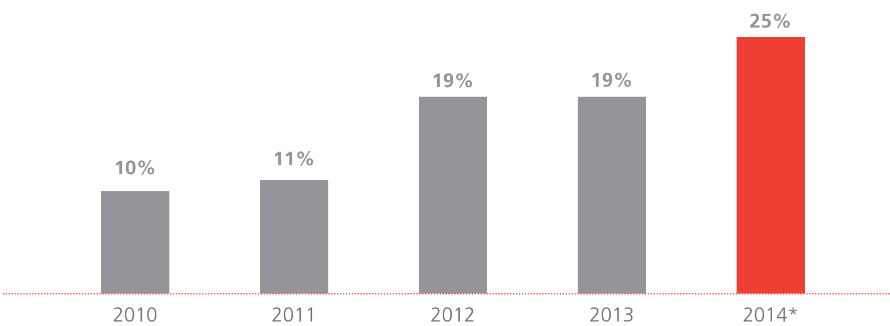
There is a clear separation of duties between the executive chairman, the chief executive officer, the board and the committees thereof, as well as various checks and balances that assure proper equilibrium in the corporate governance structure of the Bank, including the following:

- 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 lead non-executive director.
- The second vice-chairman, who is chairman of the risk committee, reports directly to the executive committee and to the board.
- 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 to itself.

At the 2014 ordinary general meeting, the board of directors will propose a technical improvement to the bylaws consisting of explaining the general rule contemplated in the Capital Requirements Directive IV, under which the chairman may not simultaneously serve as chief executive officer.

### % OF FEMALE DIRECTORS ON THE BOARD

Data at year-end except for 2014




* as of date of this report

## 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. It is regulated by article 24 of the Rules and Regulations of the Board.

## Appointment of new chief executive

On the occasion of the decision by Mr Alfredo Sáenz to resign from his positions as second vice-chairman and chief executive, and to withdraw as director, the appointments and remuneration committee met on 29 April 2013, with the attendance of all its members, to deliberate upon his replacement. The committee chose to appoint Mr Javier Marín, then executive vice president and head of the global private banking, asset management and insurance division, as chief executive.

On analysing the suitability of Mr Marín, the committee concluded that he met the necessary requirements and was the most appropriate person for the position, highly valuing his professional career within the Group, during which he has held various positions of responsibility since joining in 1991.

The committee put the corresponding resolution to the board, which approved it.

In the opinion of the appointments and remuneration committee and of the board, the speed and efficiency with which the process of replacement of the previous chief executive was organised and carried out demonstrate the existence within the Bank of clear and established procedures for the replacement of the principal executives of the Group, and the in-depth knowledge of the committee and the board of their leading executives in order to select candidates to occupy key positions within the organisation.

## Rules for interim replacement of the chairman

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 each year based on the directors' seniority. In this regard, at its meeting of 29 April 2013, the board resolved to assign the current directors 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 Abel Matutes Juan
4. Mr Francisco Javier Botín-Sanz de Sautuola y O'Shea
5. Ms Isabel Tocino Biscarolasaga
6. Mr Juan Rodríguez Inciarte
7. Mr Ángel Jado Becerro de Bengoa
8. Mr Vittorio Corbo Lioi
9. Ms Esther Giménez-Salinas i Colomer
10. Mr Javier Marín Romano
11. Mr Juan Miguel Villar Mir

## 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.

The Rules and Regulations of the Board (article 17.4d)) provide 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 15 meetings during financial year 2013.

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).

Additionally, at the annual general shareholders' meeting of 2014, the board of directors will propose an amendment to the Bylaws to incorporate within the Bylaws the figure of lead

**Decision-making process**

- A board of directors that is balanced, experienced and well-versed in the business.
- Collective decision-making and a long-term vision.

director currently established in the Rules and Regulations of the Board, and to empower such director to, among other things, call a meeting of the board of directors.

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. A proxy shall be given with instructions.

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.

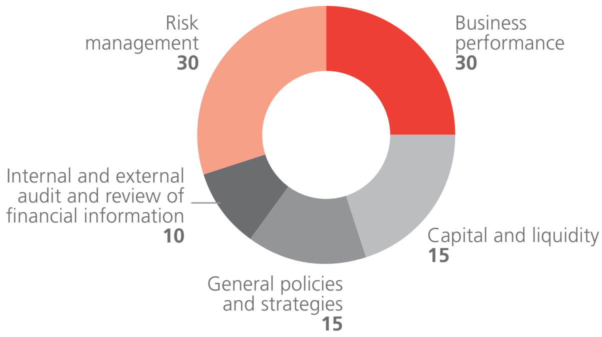
## Conduct of meetings

In 2013, the board was kept continuously and fully informed of the running of the various business areas of the Group through the ten management reports and the risk reports presented by the chief executive officer and the second vice-chairman in charge of the risk division, respectively, at the meetings held during the financial year.

During the year, the board of directors also addressed other matters that come within its area of supervision, in addition to being informed of the conclusions of the external and internal audits.

The following chart shows a breakdown of the approximate time dedicated to each duty at the meetings held by the board in financial year 2013.

**APPROXIMATE TIME DEDICATED TO EACH DUTY**
%




## Dedication to board duties

One of the directors' duties expressly established in the Rules and Regulations of the Board is that of diligent management, which, among other duties, requires that directors dedicate the necessary time and effort to their position, the maximum number of boards of directors to which they may belong as provided in Law 31/1968 of 27 July, which is applicable thereto*.

The directors must ensure that they are absent from meetings of the board and of the committees to which they belong only when absolutely necessary.

The appointments and remuneration committee analyses directors' dedication to their position on an annual basis, using information received from directors regarding their other professional obligations and other available information, such as attendance at meetings, to evaluate whether the directors dedicate the necessary time to their duties. Dedication is also taken into account for re-election, since proposals by the appointments and remuneration committee must contain an evaluation of work and of effective dedication to the position during the latest period of time in which the proposed director has performed his or her duties.

In 2013, on occasion of the appointment of Ms Ana Patricia Botín-Sanz de Sautuola y O'Shea as director of the parent company of The Coca-Cola Company group, domiciled in Atlanta (USA), the appointments and remuneration committee at its meeting of 3 June, on the basis of the estimated meetings held each year by the board of The Coca-Cola Company and the time required to attend them, concluded that such appointment is not incompatible, nor will it interfere, with the dedication required of Ms Ana Patricia Botín-Sanz de Sautuola y O'Shea for the effective performance of her duties as executive director of the Bank.

* Capital Requirements Directive IV (Directive 2013/36/EU) provides for the amendment of the incompatibility rules applicable to directors and executive vice presidents of credit entities. In summary, the draft law that will transpose this directive in Spain, repealing Law 31/1968, provides that directors and executive vice presidents of the Bank will be unable to hold at the same time more than: (a) one executive position and two non-executive positions, or (b) four non-executive positions. For such purposes, positions held within the same group (including companies in which the Bank has a significant shareholding) will be counted as a single position, and positions held at non-profit organizations or organizations not pursuing commercial ends will not be counted. The Bank of Spain may authorise a director to hold an additional non-executive position if it considers that it does not impede the proper performance of the director's duties at the Bank.
As a consequence, the repeal of Law 31/1968 will take effect when the aforementioned law transposing Capital Requirements Directive IV comes into effect.

## Training of directors and induction 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.

Seven meetings were held in 2013 with the attendance of an average of ten directors, who devoted approximately one hour and a half to each session. Various issues were reviewed in depth at such meetings in connection with Capital Requirements Directive IV and risk decision systems and future trends, as well as Private Banking, Poland, Santander Consumer Finance and the technological evolution of cards.

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

## Self-evaluation by the board

The continuous self-evaluation exercise undertaken by the board with the support of the firm Spencer Stuart is based on a questionnaire and personal interviews with directors and includes (as stated in the Rules and Regulations of the Board) a special section for the individual evaluation of the chairman, the chief executive officer and the rest of the directors.

Furthermore, in the exercise presently underway, an independent evaluation of the board by the aforementioned firm has been included, based on a market comparison *(benchmarking)* of certain practices versus other comparable international banks.

The board of Banco Santander carried out its first self-evaluation exercise in 2005, in response to a commitment made by the chairman at the general shareholders' meeting of 19 June 2004.

Since then, successive self-evaluation exercises have given rise to significant changes in the internal organisation and procedures applicable to the activities of the board and in its composition, including the following:

- The appointment in 2011 of a director from Latin America, Mr Vittorio Corbo Lioi, is a consequence of the renewal and internationalisation process promoted by the board itself.

- An amendment to the Bylaws, approved at the general shareholders' meeting, to reduce the maximum size of the board from 30 directors to 22.

- A more detailed replacement procedure for positions on the board, in particular those of chairman and chief executive, established in the Rules and Regulations of the Board.

- Holding of annual board meetings dedicated specifically to the strategy of the Group.

- An on-going director training programme that has been carried out continuously since proposed during the self-evaluation process of 2005.

The process of on-going self-evaluation by the board during this year focused on the organisation, proceedings and content of board and committee meetings, a comparison with other international banks, and open questions on issues related to the future (strategy, internal and external factors that may affect the Group) and other matters of interest.

The directors highlighted the following as strengths of the Group's corporate governance: the directors' knowledge of the banking business and experience, balance between executive and non-executive directors, dedication of board members and involvement in risk control. Also highlighted was the role of the board in management of the crisis, taking advantage of business opportunities and risk control, as well as strategic support for management.

The committee structure, which the directors considered functioned very well, also brought the board closer to the day-to-day functioning and operations of the Group, emphasising the directors' dedication and involvement.

In the opinion of the directors, these strengths have enabled the Group to become a benchmark for management amid the current crisis due to the involvement of the board in the control of credit risk and other risks, including reputational and operational risks.

Furthermore, in connection with the organisation, proceedings and content of board meetings, the following aspects were highlighted: high level of strategic debate and high level of commitment on the part of the directors, and the possibility of attendance at executive committee meetings and at the other committees by directors who are not members thereof.

In summary, the self-evaluation has again revealed a very positive appraisal of the organisation and functioning of the board and of its committees.

## 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

The shareholders acting at the general shareholders' meeting of 22 March 2013 approved an amendment to the Bylaws, such that the remuneration of the directors now consists of a fixed annual amount determined at the general shareholders' meeting. Such amount shall remain in force until the shareholders resolve to change it, though the board may reduce the amount in the years it considers such action necessary. The shareholders established the remuneration for financial year 2013 at 6 million euros, with two components: (a) an annual allocation, and (b) attendance fees.

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 may be beneficiaries of remuneration systems consisting of the delivery of shares or rights thereon.

### Remuneration of the board in 2013

In 2013, the board resolved to reduce the total remuneration of the directors, for all items, by 11%.

The total amount accrued by the board as attendance fees amounted to 4.3 million euros in 2013, which is 27.9% lower than the maximum amount of 6 million euros approved by the shareholders for the financial year, and 0.5% less than that paid in 2012.

As regards executive directors, the board decided to make an average 13% reduction in the variable remuneration.

All details regarding the director remuneration policy in 2013 may be consulted in the report of the appointments and remuneration committee forming part of the corporate documentation of Banco Santander.

### Anticipation and adjustment to the regulatory framework

The board of directors, at the proposal of the appointments and remuneration committee, promotes and encourages a remuneration system that fosters a rigorous management of risks, and implements 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 article 10 of Order ECC/461/2013 and 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 and submitting it to a consultative vote.

In 2013, the report corresponding to financial year 2012 was submitted to the shareholders at the general shareholders' meeting held on 22 March, as a separate item on the agenda and as a consultative matter; 92% of the votes were in favour of the report.

### 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.

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 progress of the Bank and to dedicate to the position the time and effort needed to effectively carry it out.

## Related-party transactions

Except as described below, 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 entered into any significant transaction or any transaction on non-customary market conditions with the Bank during financial year 2013 and through the date of publication of this report.

The board, without the participation of the director and following a report by the appointments and remuneration committee, authorised the purchase, under market conditions, of shares representing up to 0.25% of the Bank's capital by Espacio Activos Financieros, S.L.U., a company indirectly controlled by Mr. Juan Miguel Villar Mir.

## Control mechanisms

As provided in the Rules and Regulations of the Board (article 30), directors must inform the board of any direct or indirect conflict of interest with the interests of the Bank in which they may be involved. If the conflict relates to a transaction, the director may not carry it out without the approval of the board, following a report from 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 addition to the previously described situation, there were another 103 cases during financial year 2013 in which other directors abstained from participating and voting in the discussion of matters at the meetings of the board of directors or of the committees thereof.

The breakdown of the 103 cases is as follows: on 29 occasions, the abstention was due to proposals to appoint or re-elect directors; on 26 occasions, the matter under consideration was the approval of terms of remuneration and other terms of the contracts with the directors, including the authorisation of the financing policy for executive directors; on 18 occasions, the matter concerned the evaluation of suitability procedure that the Bank, as a credit institution, must undertake regarding members of the management body and holders of key positions, all in accordance with the provisions of Royal Decree 1245/1995, as amended by Royal Decree 256/2013; on 18 occasions, proposals were discussed regarding the provision of financing or security for companies related to various directors; on 5 occasions, the abstention concerned the annual verification of the status of the directors made by the appointments and remuneration committee at its meeting of 13 February 2013; on 2 occasions, the matter concerned proposals to appoint two independent directors to positions at the Banco Santander Foundation and in one it concerned the appointment of a relative of an executive director as member of the board of a Group subsidiary; on one occasion, the matter at hand was the approval of a contribution in favour of a foundation chaired by a director; and on another three occasions the matter was placing on record gratitude for the work carried out by a director.

Finally, Lord Burns abstained from participating in the resolutions of the board relating to his resignation from the position of director effective from 31 December 2013 and his appointment as member of the international advisory board as from 1 January 2014.

### 2011: renewal of position of director for three-year term

Since the general shareholders' meeting of 2011, directors are renewed for three-year terms.

### 2012: maximum limit for share capital increases without pre-emptive rights

At the proposal of the board, the shareholders for the first time established a maximum limit on the power to exclude pre-emptive rights for share capital increases; pre-emptive rights may only be excluded for up to the equivalent of 20% of the share capital of the Bank as of the date of the general shareholders' meeting.

### 2013: cap on annual remuneration of the directors

The shareholders established a maximum amount of 6 million euros, which may only be amended by a decision of the shareholders acting at a general shareholders' meeting.

## Committees of the board and its committees

### General information

The board has the following decision-making committees: an executive committee, to which general decision-making powers are delegated, and a risk committee, with delegated powers specifically relating to risk.

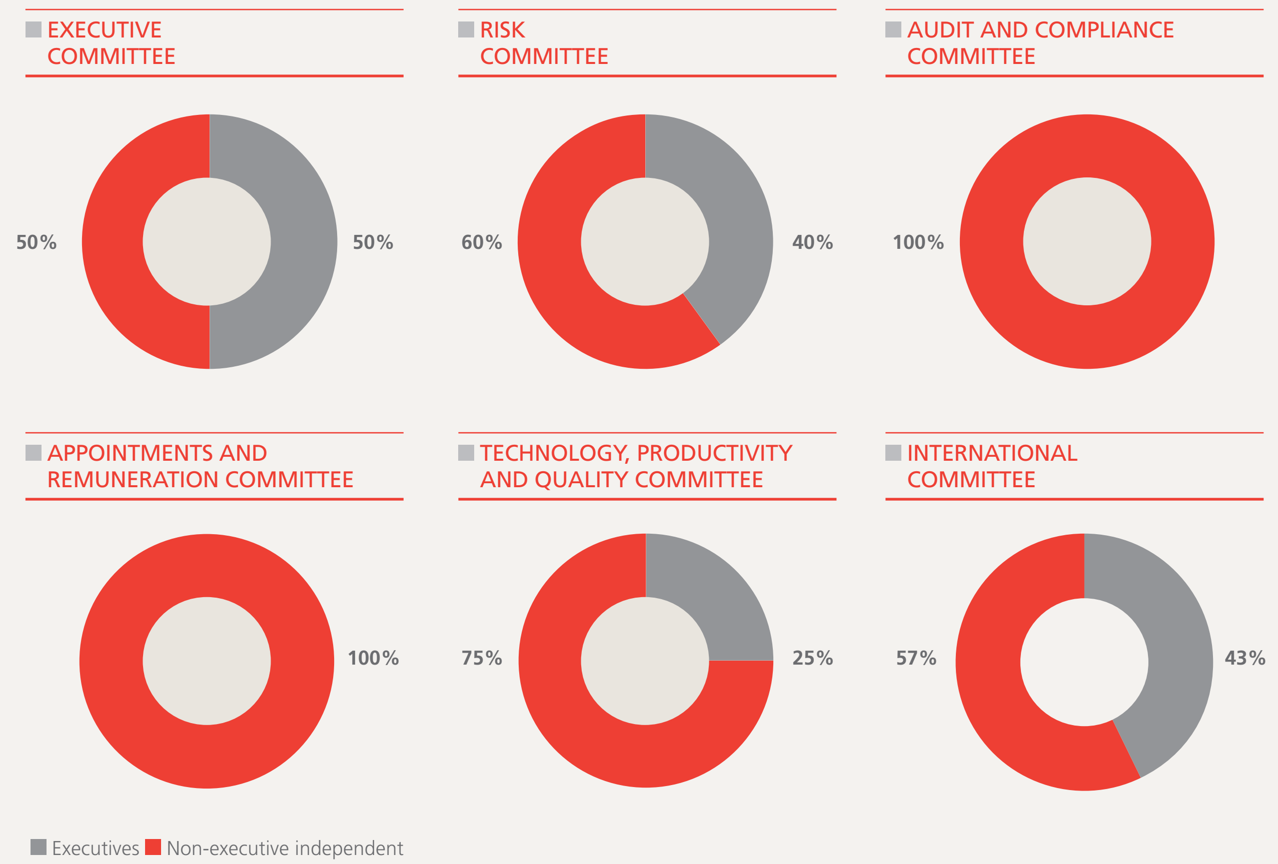
The board also has other committees with powers of supervision, information, advice and proposal (the audit and compliance, appointments and remuneration, technology, productivity, and quality and international committees).

### Executive committee

The executive committee is a basic instrument for the corporate governance of the Bank and its Group. It exercises by delegation all the powers of the board (except those which cannot be legally delegated or which cannot be delegated pursuant to the provisions of the Bylaws or the Rules and Regulations of the Board), assuming the day-to-day management of the business. It reports to the board on the matters dealt with and the resolutions adopted by making the minutes of its meetings available to the directors. It meets once per week.

At the board meeting of 29 April 2013 it was resolved to appoint the executive director Mr Javier Marín Romano and

## Composition of committees of the board




## Number of meetings and duration of committees

| Committees | No. of meetings | Hours* |
|---|---:|---:|
| Executive committee | 58 | 290 |
| Risk committee | 97 | 291 |
| Audit and compliance committee | 12 | 60 |
| Appointments and remuneration committee | 17 | 51 |
| Technology, productivity and quality committee | 2 | 4 |
| International committee | 2 | 4 |

* Estimated hours of average dedication per director.

the independent director Ms Isabel Tocino Biscarolasaga as members of the executive committee.

There are currently eight directors sitting on the committee, of whom four are executive and the other four are independent non-executive directors.

Its duties, composition and functioning are established in the Bylaws (article 51) and in the Rules and Regulations of the Board (article 14).

## Risk committee

This is also an executive committee, with powers delegated thereto by the board in matters regarding risks. It normally meets twice per week.

It is governed by the Bylaws (article 52) and the Rules and Regulations of the Board (article 15), which define the composition, functioning and duties of this committee.

At the board meeting of 29 April 2013 it was resolved to appoint the independent director Mr Rodrigo Echenique Gordillo as member of the risk committee.

The committee is currently made up of five directors, of whom two are executive and three are independent non-executive. Its chairman is a vice-chairman with executive duties pursuant to the Rules and Regulations of the Board (article 15.1).

Pages 162 et seq. 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.

At the 2014 annual general meeting and in compliance with the recent CRD IV, the board of directors will propose an amendment to the bylaws which envisages the establishment of a new committee to assist the board on matters of risk, regulation and compliance. Once this committee has been set up, the risk committee will retain its powers with respect to risk management and the new committee will assume advisory and support functions on questions of supervision and risk control, the definition of Group risk policies, relations with supervisors and compliance issues, the latter being handed over from the present audit and compliance committee, which will henceforth be known as the audit committee.

## Audit and compliance committee

The audit and compliance committee, among other duties, reviews the Group's financial information and its internal control and risk management systems, serves as a communication channel between the board and the auditor, ensuring the independent exercise of the latter's duty, supervises work regarding the internal audit function, and is informed of the reports published both by Spanish supervisory authorities and by those of other countries in which the Group has business. It normally meets on a monthly basis (it met 12 times in 2013).

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 four independent non-executive directors.

At the board meeting on 29 April 2013, the resignation of Mr Manuel Soto Serrano as director and chairman of the audit and compliance committee was recorded and the independent director Mr Guillermo de la Dehesa Romero was appointed as new member and chairman of the audit and compliance committee.

The audit and compliance committee prepared a report regarding its activities in 2013, which is available to the shareholders as part of the annual documentation.

### Appointments and remuneration committee

Banco Santander established the appointments and remuneration committee, then named the compensation committee, in 1995.

This committee, among other duties, proposes the director remuneration policy to the board, producing the corresponding report, and proposes the appointments and remuneration of its members including the executives and other members of senior management and key Group personnel, also proposing the remuneration policy for the latter.

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.

Its four current members are non-executive directors.

During financial year 2013, 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.

Since 2004, the appointments and remuneration committee has published an activities report which, since 2006, has also included 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 four directors, of whom three are executive and one is independent non-executive.

### 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 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 made up of seven directors, of whom three are executive and four are independent non-executive.

* * *

In accordance with the Rules and Regulations of the Board, any director may attend meetings of board committees of which the director is not a member, with the right to participate but not to vote, at the invitation of the chairman of the board and of the respective committee, and by prior request to the chairman of the board.

Additionally, all board members who are not also members of the executive committee may attend its meetings, whatever the reason for the president calling such meetings. During financial year 2013, nine directors not forming part of the executive committee each attended an average of 11 meetings thereof.

## International advisory board

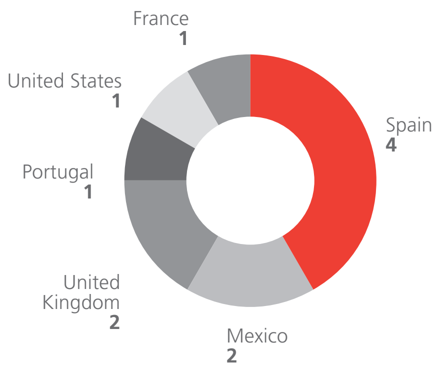
Since 1997, the board of directors has had an international advisory board made up of members of various nationalities and from various areas of activity, all of whom come from outside the Bank and none of whom serve as directors; such international advisory board cooperates with the board of directors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

During 2013, the international advisory board held two meetings, during which the following issues were discussed, among others: the evolution of the Group's results, the situation of and viewpoints on France and its position with respect to the European Union, the evolution of the Spanish economy and of the principal countries in which the Group does business and progress on the reform of the financial system in Europe.

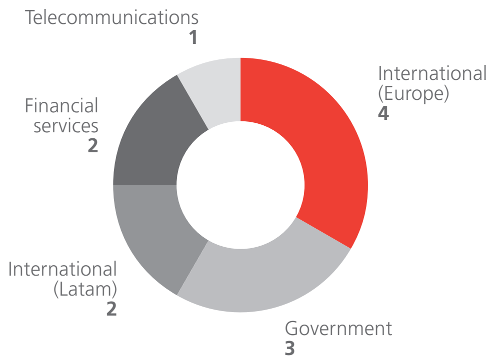
It is currently composed of the following 12 members, representing 6 nationalities:

| | |
|---|---|
| **Chairman** | Mr Antonino Fernández, *former chairman of Grupo Modelo in México* |
| **Members** | Lord Terence Burns, *chairman of Channel Four Television Corporation* |
| | Mr Bernard de Combret, *chairman of Total Trading Geneve* |
| | Mr Antonio Escámez Torres, *chairman of Fundación Banco Santander* |
| | Mr Carlos Fernández González, *chairman and executive vice president of Grupo Modelo in México* |
| | Mr Santiago Foncillas, *former chairman of Grupo Dragados* |
| | Mr Richard N. Gardner, *former US ambassador to Spain* |
| | Sir George Mathewson, *former chairman of the Royal Bank of Scotland* |
| | Mr Fernando Masaveu, *chairman of Grupo Masaveu* |
| | Mr Francisco Pinto Balsemâo, *former prime minister of Portugal* |
| | Mr Rodrigo Rato Figaredo, *former managing director of the International Monetary Fund* |
| | Mr Luis Alberto Salazar-Simpson Bos, *chairman of France Telecom España, S.A.* |
| **Secretary** | Mr Ignacio Benjumea Cabeza de Vaca |

### COMPOSITION OF THE INTERNATIONAL ADVISORY BOARD BY NATIONALITY




### PRINCIPAL AREAS OF PROFESSIONAL EXPERIENCE OF THE MEMBERS OF THE INTERNATIONAL ADVISORY COMMITTEE



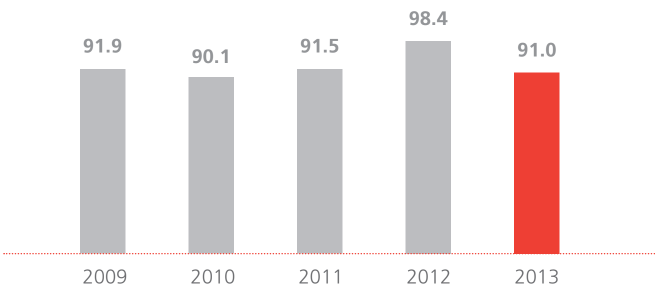
## Attendance at meetings of the board of directors and its committees in 2013

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 2013 was 91.03%.

The rate of attendance at meetings of the board has exceeded 90% in recent years.

### RATE OF ATTENDANCE AT MEETINGS OF THE BOARD

%




### ATTENDANCE AT MEETINGS OF THE BOARD OF DIRECTORS AND ITS COMMITTEES IN 2013

| | | COMMITTEES | | | | | |
|---|---|---|---|---|---|---|---|
| | | Decision-making | | Reporting | | | |
| **Directors** | **Board** | **Executive** | **Risk** | **Audit and compliance** | **Appointments and remuneration** | **Technology, productivity and quality** | **International** |
| **Average attendance:** | **91.03%** | **90.29%** | **85.57%** | **95.83%** | **94.59%** | **77.78%** | **92.86%** |
| **Individual attendance:** | | | | | | | |
| Mr Emilio Botín-Sanz de Sautuola y García de los Ríos | 15/15 | 51/58 | | | | 2/2 | 2/2 |
| Mr Javier Marín Romano[1] | 6/6 | 35/37 | | | | 1/1 | 1/1 |
| Mr Fernando de Asúa Álvarez | 15/15 | 57/58 | 94/97 | 12/12 | 17/17 | 2/2 | |
| Mr Matías Rodríguez Inciarte | 14/15 | 54/58 | 97/97 | | | | |
| Mr Guillermo de la Dehesa Romero[5] | 15/15 | 54/58 | | 8/8 | 16/17 | | 2/2 |
| Ms Ana Patricia Botín-Sanz de Sautuola y O'Shea | 12/15 | 42/58 | | | | 1/2 | 2/2 |
| Mr Javier Botín-Sanz de Sautuola y O'Shea | 13/15 | | | | | | |
| Lord Burns (Terence) | 11/15 | | | | | | |
| Mr Vittorio Corbo Lioi | 12/15 | | | | | | |
| Mr Rodrigo Echenique Gordillo[6] | 14/15 | 50/58 | 44/63 | 11/12 | | | 2/2 |
| Ms Esther Giménez-Salinas i Colomer[7] | 13/15 | | | | | | 1/1 |
| Mr Ángel Jado Becerro de Bengoa | 14/15 | | | | | | |
| Mr Abel Matutes Juan | 12/15 | | | 11/12 | | | 1/1 |
| Mr Juan Rodríguez Inciarte | 15/15 | | 57/97 | | | | |
| Mr Alfredo Sáenz Abad[2] | 9/9 | 20/21 | | | | 1/1 | 1/1 |
| Mr Manuel Soto Serrano[2] | 8/9 | | 30/34 | 4/4 | 6/6 | 0/1 | |
| Ms Isabel Tocino Biscarolasaga[4] | 15/15 | 37/37 | 93/97 | | 17/17 | | |
| Mr Juan Miguel Villar Mir[3] | 6/6 | | | | | | |

Note: the denominator refers to the number of meetings held during the year in which a director served as such or as a member of the respective committee. The table details the attendance of directors whenever the latter have personally attended meetings of the board or its committees. For this purpose, absent directors who are represented are not counted as having attended.

1. Director and member of the executive, technology and international committees since 29 April 2013
2. Withdrawal as member of the board on 29 April 2013
3. Member of the board since 7 May 2013
4. Member of the executive committee since 29 April 2013
5. Member of the audit and compliance committee since 29 April 2013
6. Member of the risk committee since 29 April 2013
7. Member of the international committee since 26 November 2013
8. Lord Burns resigned from the position of director effective from 31 December 2013

# 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.

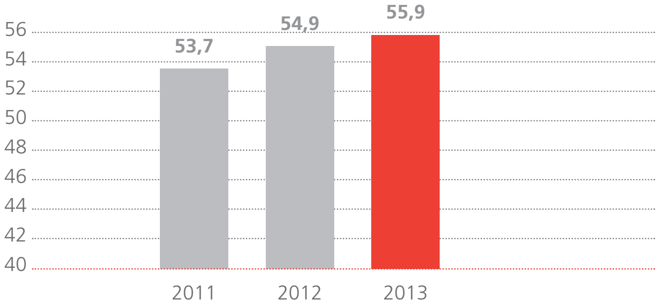
## Quorum at the annual general shareholders' meeting held in 2013

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 2013 annual general shareholders' meeting was 55.869%, continuing a trend of improvement in each of the last three years.

QUORUM AT ANNUAL GENERAL SHAREHOLDERS' MEETINGS

Percentage 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, since the annual general meeting held in 2011, the shareholders have had access to the electronic shareholders' forum, in compliance with the provisions of the Companies Act.

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.

## Information provided to the shareholders and communication with them

During 2013, the Bank held 600 meetings with investors and maintained an on-going relationship with analysts and rating agencies, which entailed personal contact with 1,086 investors/analysts. In addition, the investor and analyst relations department continued to hold numerous meetings throughout the financial year to spread information regarding the Group's policies relating to sustainability and governance.

In 2013, the aforementioned department attained third place in the European banking industry according to the Extel survey conducted by Thomson Reuters.

Banco Santander's 2012 annual report was awarded the prize as the best international annual report by the Investor Relations Society of London.

Santander has continued to strengthen the channels for shareholder information and service through the eight shareholders' offices it has in significant markets in which it is present. The Bank currently has offices in Spain, the United Kingdom, the United States, Mexico and Portugal to serve the shareholders in the share matrix, and three more in Mexico, Chile and Brazil to serve the shareholders of its subsidiaries.

### CHANNELS FOR SHAREHOLDER INFORMATION AND SERVICE

| | | |
|---|---|---|
| Telephone service lines | 251,812 | questions |
| Shareholder's mailbox | 30,977 | e-mails answered |
| | 226,419 | subscriptions |
| Events | 15,659 | participants |
| | 279 | held |
| SMS alerts | 784,483 | alerts sent |
| | 99,026 | subscriptions |
| Writing | 544,259 | letters answered |

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

## Annual general shareholders' meeting held on 22 March 2013

**Information on the call to meeting, the establishment of a quorum, attendance, proxy-granting and voting**
A total of 400,412 shareholders attended in person or by proxy, with 5,887,824,129 shares. The quorum was thus 55.869% of the share capital of the Bank at the date of the annual general shareholders' meeting.

The shareholders at the general shareholders' meeting approved the corporate management of the Bank in 2012 with a 98.406% favourable vote.

The average percentage of affirmative votes upon which the proposals submitted by the board were approved was 95.33%.

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

| | |
|---|---|
| Physically present | 0.252%[1] |
| By proxy | 41.733%[2] |
| Absentee votes | 13.883%[3] |
| Total | 55.869% |

1. Of such percentage (0.252%), 0.005% 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 0.106%.
3. Of such percentage (13.883%), 13.853% 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 2013

The full text of the resolutions adopted at the 2013 annual general shareholders' meeting is available on the websites of both the Group (www.santander.com) and the CNMV (www.cnmv.es).

# 4. SANTANDER GROUP MANAGEMENT TEAM

## COMPOSITION

| | |
|---|---|
| **Chairman** | Mr Emilio Botín-Sanz de Sautuola y García de los Ríos |
| **Chief executive officer** | Mr Javier Marín Romano |
| **Executive vice presidents and country heads** | |
| Argentina | Mr Enrique Cristofani |
| Germany | Mr Ulrich Leuschner |
| Internal Audit | Mr José Francisco Doncel Razola |
| Commercial Banking | Mr Francisco Javier San Félix García<br>Mr Ángel Rivera Congosto |
| Global Wholesale Banking | Mr José García Cantera<br>Mr Jorge Maortua Ruiz–López |
| Private Banking, Asset Management and Insurance | Mr Luis Moreno García |
| Brazil | Mr Jesús M.ª Zabalza Lotina |
| Communications, Corporate Marketing and Research | Mr Juan Manuel Cendoya Méndez de Vigo |
| Chile | Mr Claudio Melandri Hinojosa |
| United States | Mr Román Blanco Reinosa<br>Mr Juan Andrés Yanes Luciani |
| Spain | Mr Enrique García Candelas |
| Strategy and Asia | Mr Juan Rodríguez Inciarte |
| Consumer Finance | Ms Magda Salarich Fernández de Valderrama |
| Financial Management and Investor Relations | Mr José Antonio Álvarez Álvarez |
| Financial Accounting and Control | Mr José Manuel Tejón Borrajo |
| Mexico | Mr Marcos Martínez Gavica |
| Poland | Mr Gerry Byrne<br>Mr Mateusz Morawiecki |
| Portugal | Mr Antonio Vieira Monteiro |
| Human Resources, Organisation and Costs | Mr Jesús Cepeda Caro<br>Mr José Luis Gómez Alciturri |
| Risk | Mr Matías Rodríguez Inciarte<br>Mr Juan Guitard Marín<br>Mr José María Espí Martínez |
| Asset Recovery and Restructuring | Mr Remigio Iglesias Surribas |
| United Kingdom | 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 |
| Universities | Mr José Antonio Villasante Cerro |
| Uruguay | Mr Juan Carlos Chomali |

## 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 therewith during financial year 2013 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 division 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. Material 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 2013, the Bank published 77 material facts, which are available on the websites of the Group (www.santander.com) and the CNMV (www.cnmv.es).

## Relationship with the auditor

### Independence of the auditor

The shareholders acting at the general shareholders' meeting of 22 March 2013 approved the re-election of Deloitte, S.L. as auditor for one year, with the affirmative vote of 94.762% 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 2% 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 2013 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 2013 are submitted without qualifications.

At its meeting of 10 February 2014, 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 Royal Legislative Decree 1/2011, of 1 July, restated text of the Audit of Accounts Act.

Such committee, at the aforementioned meeting of 10 February 2014, 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

Except as described below, there were no intra-group transactions in financial year 2013 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.

In May 2013, Banco Santander completed the process of merger by absorption of Banesto and Banco Banif.

## Website

Since 2004, the Group's website (www.santander.com) has disclosed in the Shareholders and Investor Relations section of the main menu all information required under applicable law (currently the Companies Act (Ley de Sociedades de Capital) and Order ECO/3722/2003 of 20 March).

The contents of the Group's website, which are presented with specific sections for institutional investors and shareholders and are accessible in Spanish, English and Portuguese, received approximately 132,000 visits per week.

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.
- 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 announcement of the call to the 2014 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).

## Unified Good Governance Code

Banco Santander follows the recommendations concerning corporate governance in the special working group report, which was updated in June 2013, on the good governance of listed companies.

# 4

# ECONOMIC AND FINANCIAL REVIEW

Santander UK headquarters in London, United Kingdom.

# CONSOLIDATED FINANCIAL REPORT

## General background

Grupo Santander conducted its business in an economic environment of slower growth than in 2012, with business activity decelerating in some countries for the whole year, but improving as the year progressed, backed by a cyclical improvement in developed economies. The year ended with the euro zone out of recession as of the second quarter and with the UK and the US showing firm signs of recovery. Emerging countries, particularly China, maintained solid growth despite their slowdown. In this environment, the main central banks insisted on keeping interest rates low for a prolonged period of time, indicating that monetary stimulus would be maintained.

The euro zone took major steps toward banking union. Of note was approval of the Single Supervisory Mechanism that will come into force in November 2014, and the first agreement on the Banking Recovery and Resolution Directive and the Single Resolution Mechanism, which is expected to be approved and operating in January 2015. All of this helped to improve the conditions in the wholesale markets, particularly those related to sovereign debt, which led to sharp falls in risk premiums.

In the **US**, the upswing in private domestic demand, well established in an expanding housing sector, lower unemployment and the banking sector's financing capacity, was the main driver of growth (fourth quarter GDP: +0.8% quarter-on-quarter; +2.7% year-on-year) and the recovery in employment pointed to growth of around 1.9% for the whole of 2013. In this scenario, and after Congress's agreement to reduce fiscal uncertainties, the Federal Reserve confirmed its tapering plan as of the beginning of 2014, although it remained committed to keeping short-term interest rates at their current levels until 2015.

Latin American economies and financial markets reflected in their currencies and investment flows the change envisaged in the Fed's liquidity injection policy, although on a varied basis by country. Its impact, better noticed after the end of the year, (general depreciation of emerging country currencies in January 2014) was very limited on the region's growth which remained in line with that of 2012.

In **Brazil**, third quarter GDP growth eased to 2.2% year-on-year, in line with the forecast for the whole year (2.3%), driven by the strength of consumption and a labour market offsetting investor weakness. The still high inflation, although lower than at the start of the year, triggered several rises in the benchmark Selic rate to 10% at the end of 2013 (+ 275 b.p.), and further ones in January 2014 to 10.50%. These hikes did not stop the real from depreciating as of May after the Fed's first announcements.

**Mexico** recovered momentum in the third quarter (+0.8% quarter-on-quarter and +1.3% year-on-year), spurred by stronger exports and domestic demand which, offsetting the reduced impulse from the public sector, pointed to growth of 1.2% for the whole of 2013. With inflation on target, the central bank focused on growth and reduced the benchmark rate in the second half of the year to 3.50% (-50 b.p.), while the peso remained relatively stable.

**Chile's** growth accelerated in the third quarter (+1.3% quarter-on-quarter; +4.7% year-on-year) due to the external sector and mining which offset the drop in domestic demand. The slowdown in consumption continued in the fourth quarter, reducing GDP growth for the year to between 4.2% and 4.4%. With inflation under control, the central bank cut is benchmark rate by 50 b.p. to 4.50%, the first reduction since January 2012, and the peso remained stable.

The **euro zone**, out of recession since the second quarter, expanded moderately in the third quarter (+0.1% quarter-on-quarter; -0.4% year-on-year), backed by less restrictive fiscal and monetary conditions and upturns in the periphery countries (Portugal: +0.2%; Spain: +0.1% and Italy: -0.1%).

Of note was the growth in Germany (+0.3%) and the downturn in France (-0.1%).

With inflation at below 1%, the European Central Bank (ECB) cut its benchmark rate again to 0.25% (-50 b.p. in the year) and intends to keep it low "for an extensive period of time" and continue to inject all the necessary liquidity into the financial system. Meanwhile, the early return by banks to the ECB of three-year borrowed funds reduced the surplus of liquidity, exerting pressure on short-term money market rates and contributing to the euro's appreciation against the dollar.

In **Spain,** the economy registered in the third quarter positive growth over the second quarter (+0.1% quarter-on-quarter; -1.1% year-on-year), for the first time since the start of 2011. The recovery in private consumption and capital goods, added to the strength of exports, explains this upward trend. The 0.3% growth in the fourth quarter and the job creation figures on a seasonally adjusted basis confirmed the exit from recession. GDP growth for the whole of 2013 would be 1.2% negative.

Throughout 2013, progress in correcting imbalances, the strength of the external sector, further improvements in competitiveness from the decline in unit labour costs and the advances in structural reforms, both in Spain as well as European governance, enabled relaxation of the markets, and reduced the risk premium sharply. This trend continued in early 2014. At the end of 2013, the premium over the benchmark 10-year German bond was 220 b.p., down from 395 b.p. at the end of 2012 and a high of 637 b.p. in July 2012.

The **UK** economy remained strong in the fourth quarter (+0.7% quarter-on-quarter and 2.8% year-on-year), thanks to private consumption, improvements in employment and lending, which joined the impulse from the residential and external sectors. The growth forecast for the whole year was 1.9%.

With inflation close to target, the Bank of England held its base rate. However, in the face of the strong economic improvement, particularly consumption and housing, the Bank of England recommended ending the *Funding for Lending Scheme* for households, while keeping it for companies. This would represent the first reduction in monetary stimulus measures. All of these factors strengthened sterling's appreciation against the dollar and partially corrected its depreciation against the euro.

The **Polish** economy continued to accelerate in the third quarter (+0.6% quarter-on-quarter and +1.7% year-on-year), with more balanced growth, a greater weight of consumption and private investment, as well as an upturn in employment and a still strong external sector. An important factor was the large cut in the central bank's benchmark rate in the first half of the year (-225 b.p. in nine months to 2.50% in July 2013) in an environment of contained inflation, and a depreciated zloty against the euro in the first half of the year. In the second half, part of this was corrected. The fourth quarter activity indicators pointed to a further upswing, which brought GDP growth for the whole year to around 1.5%.

## EXCHANGE RATES: 1 EURO / CURRENCY PARITY

| | 2013 | | 2012 | |
|---|---|---|---|---|
| | Year end | Average | Year end | Average |
| US$ | 1.379 | 1.327 | 1.319 | 1.284 |
| Pound sterling | 0.834 | 0.849 | 0.816 | 0.811 |
| Brazilian real | 3.258 | 2.852 | 2.704 | 2.501 |
| Mexican peso | 18.073 | 16.931 | 17.185 | 16.894 |
| Chilean peso | 724.579 | 656.524 | 631.729 | 624.467 |
| Argentine peso | 8.990 | 7.220 | 6.487 | 5.830 |
| Polish zloty | 4.154 | 4.196 | 4.074 | 4.182 |

## 2013 Summary of Grupo Santander

In a year where the environment was again complex in several of the markets in which we operate, Santander's business model withstood all phases of the cycle and continued to generate high recurring results.

The main points of 2013 were:

- **Strong results.** During the last few years and despite the difficult scenario, Grupo Santander demonstrated its solid capacity to generate recurring results, backed by its geographic diversification and management centred on adapting to each market. This enabled it to post profits in every year of the crisis: it is one of the world's few large international banks that did not make a loss in any quarter.

  Grupo Santander's attributable profit jumped 90.5% over 2012 to EUR 4,370 million, largely due to the reduced need for provisions.

  This growth was achieved with an improvement in the basic trends as the year progressed, reflected in more stable commercial revenues, higher net interest income and net fee income in the fourth quarter and declining provisions and cost of credit quarter-on-quarter.

- **The balance sheet continued to be strengthened** thanks to the high level of revenues. After the large provisions made in 2012 (EUR 18,806 million), the Group assigned EUR 11,073 million to specific loan-loss provisions in 2013, enabling it to tackle a new scenario of greater economic growth from a solid position and with a healthy balance sheet.

  The effort in provisions was combined with a strategy of reducing the real estate exposure in Spain. The balance sheet of Spain run-off real estate activity declined by EUR 1,496 million (-12%). The reduction since December 2008 is EUR 30,000 million (-73%). Of note was the sale of a stake in Altamira, which manages loan recoveries and properties in Spain and sells or rents foreclosed real estate assets.

  The Group more than doubled the coverage of its loan portfolio during the crisis, and its level is higher than the average of large European banks.

- **Solid funding structure** and improved liquidity ratios. The Group's improved liquidity position has been a priority objective in the last few years and has been achieved thanks to the capacity to capture funds in the retail market of the extensive branch network, the wide and diversified access to wholesale markets via Santander's model of subsidiaries and the current context of a reduced funding need in some markets from deleveraging, reflected in mature markets in the credit risk reduction.

  Some ratios that reflect the improved liquidity position are:

  – At Group level, the net loan-to-deposit ratio ended 2013 at 109% (113% in December 2012 and 150% in December 2008), the structural liquidity surplus increased to over EUR 150,000 million and the liquidity reserve reached EUR 200,000 million.

  – Liquidity management by the subsidiaries enabled the Group to maintain a conservative strategy, materialized in EUR 22,540 million of medium and long-term issues and EUR 6,273 million of securitisations.

- **High solvency** underscored by a core capital ratio that continued to rise, for the seventh year running. The ratio, according to the BIS II international standard, ended 2013 at 11.71% compared to 10.33% in 2012.

- **Shareholder remuneration.** Santander held its dividend per share at EUR 0.60, under the Santander Dividendo Elección programme (scrip dividend) in four quarterly payments, which meant a dividend yield of 10% in 2013 (remuneration / average share price). This programme enables shareholders to receive the remuneration in cash or in shares. The average level of acceptance for the payments made in 2013 was 87%.

- In addition, and in order to achieve the best positioning in the current scenario, the Group took the following **initiatives**:

  1. Adjustments to the competitive environment in Spain. The integration of Banesto and Banif in Banco Santander, which is advancing ahead of schedule, will enable cost synergies to be anticipated. The objective is to gain market share in Spain, through the offer of a wider range of products and better quality service.

2. The integration of Kredyt Bank in Poland is proceeding very satisfactorily, with the rebranding of branches and technological integration.

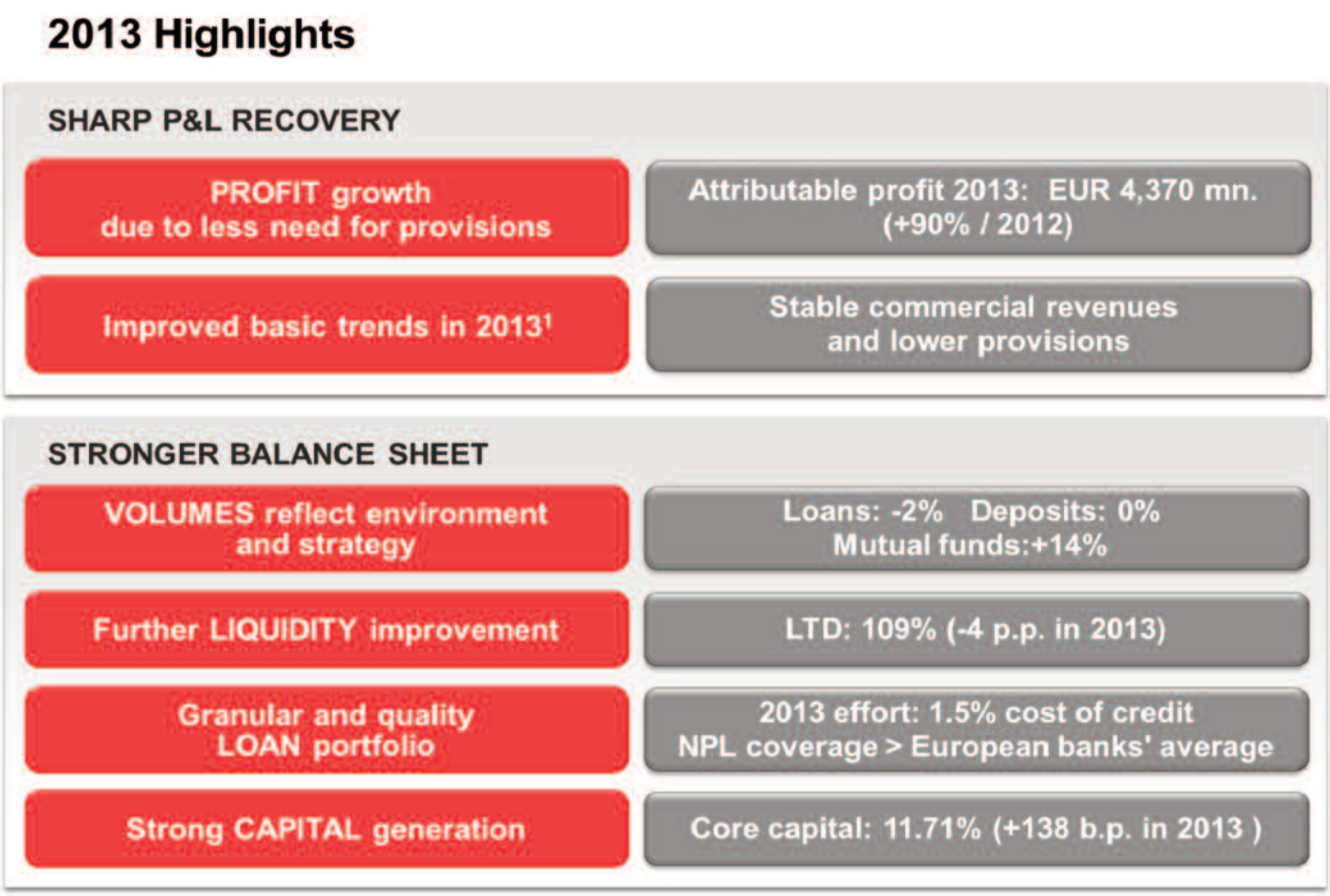
3. In the US, where installed capacity and the commercial capacity are being increased, the Santander brand has been adopted and branches rebranded.

4. In consumer business, the Group and El Corte Inglés reached a strategic agreement with Santander Consumer Finance to acquire 51% of Financiera El Corte Inglés. The agreement is expected to be completed during the first quarter of 2014.

5. The Group signed agreements with Warburg Pincus and General Atlantic to drive the global development of Santander Asset Management (SAM). Warburg Pincus and General Atlantic now jointly own 50% of the holding company that integrates SAM's fund management institutions. The other 50% belongs to Grupo Santander.

6. Sale of a stake of Altamira.

All these operations enabled Grupo Santander to end 2013 in a solid position to exploit the growth opportunities in the coming years.




Note: volumes – year-on-year change excluding exchange rate impact and repos
1. In constant euros

## GRUPO SANTANDER RESULTS

- **Attributable profit** surged 90.5% to EUR 4,370 million.
- High capacity to **generate recurring revenues:** gross income of EUR 39,753 million and pre-provision profit of EUR 19,909 million.
- **Strict costs control**. Operating expenses declined 0.7%, with a very differentiated management on the basis of markets and businesses.
- **Loan-loss provisions** (-14.1%) began to **return to normal.**

Grupo Santander generated an attributable profit of EUR 4,370 million, 90.5% more than in 2012.

The key points affecting year-on-year comparisons were:

- The context of lower growth and interest rates at record lows, after falling significantly in some countries where the Group operates. Also, the strategy of giving preference to capital and liquidity, with the consequent impact on results, chiefly via the cost of funding.
- Non-recurring provisions were made in 2012 for real estate risk in Spain, which hit the income statement.
- A negative perimeter effect on attributable profit of EUR 368 million (-16 p.p.) due to the difference between:

## INCOME STATEMENT

EUR Million

| | | | Variation | | | |
|---|---|---|---|---|---|---|
| | 2013 | 2012 | Amount | % | % w/o FX | 2011 |
| **Net interest income** | **25,935** | **29,923** | **(3,988)** | **(13.3)** | **(7.0)** | **28,883** |
| Net fees | 9,761 | 10,259 | (499) | (4.9) | 0.8 | 10,145 |
| Gains (losses) on financial transactions | 3,469 | 2,698 | 772 | 28.6 | 35.4 | 2,499 |
| Other operating income | 587 | 525 | 62 | 11.7 | 12.3 | 940 |
| Dividends | 378 | 423 | (44) | (10.5) | (9.1) | 394 |
| Income from equity-accounted method | 500 | 427 | 73 | 17.1 | 25.9 | 775 |
| Other operating income/expenses | (291) | (324) | 33 | (10.3) | 0.4 | (230) |
| **Gross income** | **39,753** | **43,406** | **(3,653)** | **(8.4)** | **(2.2)** | **42,466** |
| Operating expenses | (19,843) | (19,983) | 140 | (0.7) | 4.9 | (19,412) |
| General administrative expenses | (17,452) | (17,801) | 349 | (2.0) | 3.6 | (17,331) |
| *Personnel* | *(10,069)* | *(10,307)* | *237* | *(2.3)* | *3.2* | *(10,136)* |
| *Other general administrative expenses* | *(7,382)* | *(7,494)* | *112* | *(1.5)* | *4.3* | *(7,196)* |
| Depreciation and amortisation | (2,392) | (2,182) | (210) | 9.6 | 15.3 | (2,080) |
| **Net operating income** | **19,909** | **23,422** | **(3,513)** | **(15.0)** | **(8.4)** | **23,055** |
| Net loan-loss provisions | (10,863) | (12,640) | 1,777 | (14.1) | (7.8) | (9,826) |
| Impairment losses on other assets | (524) | (853) | 329 | (38.6) | (38.4) | (173) |
| Other income | (1,261) | (1,449) | 188 | (13.0) | (5.1) | (2,826) |
| **Ordinary profit before taxes** | **7,262** | **8,481** | **(1,219)** | **(14.4)** | **(6.7)** | **10,230** |
| Tax on profit | (1,853) | (2,314) | 461 | (19.9) | (13.3) | (2,479) |
| **Ordinary profit from continuing operations** | **5,409** | **6,167** | **(758)** | **(12.3)** | **(4.1)** | **7,751** |
| Net profit from discontinued operations | (15) | 70 | (85) | — | — | 14 |
| **Ordinary consolidated profit** | **5,393** | **6,236** | **(843)** | **(13.5)** | **(5.5)** | **7,766** |
| Minority interests | 1,023 | 895 | 128 | 14.3 | 26.2 | 766 |
| **Ordinary attributable profit to the Group** | **4,370** | **5,341** | **(971)** | **(18.2)** | **(10.7)** | **7,000** |
| Net capital gains and provisions | — | (3,047) | 3,047 | (100.0) | (100.0) | (1,670) |
| **Attributable profit to the Group** | **4,370** | **2,295** | **2,075** | **90.5** | **136.8** | **5,330** |
| | | | | | | |
| **EPS (euros)** | **0.40** | **0.23** | **0.17** | **71.7** | | **0.60** |
| **Diluted EPS (euros)** | **0.40** | **0.23** | **0.17** | **72.0** | | **0.60** |
| | | | | | | |
| Pro memoria: | | | | | | |
| Average total assets | 1,214,199 | 1,286,597 | (72,398) | (5.6) | | 1,228,342 |
| Average shareholders' equity | 80,598 | 78,806 | 1,793 | 2.3 | | 74,901 |

– A positive impact from the entry of Kredyt Bank.

– A negative effect from the sale of the unit in Colombia in the second quarter of 2012, the lower contribution to results by the equity accounted method (due to the reinsurance of the individual life risk portfolio of the insurance companies in Spain and Portugal), the rise in minority interests in Mexico and Poland, and the reduced results in insurance from the materialization of the operation with Aegon.

- The impact of exchange rates of various currencies against the euro was 6 percentage points negative for the whole Group in year-on-year comparisons for revenues and costs. The main negative effects were in Brazil (-12 percentage points), the UK and Chile (-5 p.p. in each one) and the US (-3 p.p.).

The performance of the main lines was:

**Gross income** fell 8.4% to EUR 39,753 million (-2.2% without the exchange rate effect).

- This was largely due to **net interest income**, which declined 13.3% to EUR 25,935 million, and explanined almost entirely by:

  – Depreciation of some currencies (6 p.p. of the fall), particularly Brazil, the UK, Argentina and Chile.

  – Impact of the cost associated with the policy of strengthening liquidity that the Group has been implementing since the middle of 2012.

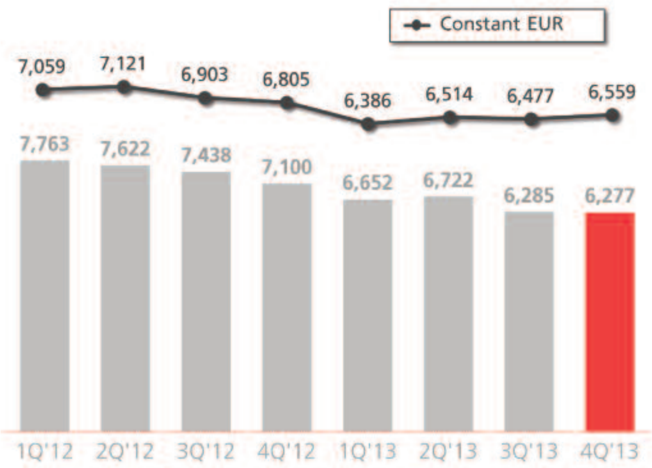
  – Lower lending due to deleveraging in some countries.

## QUARTERLY INCOME STATEMENT

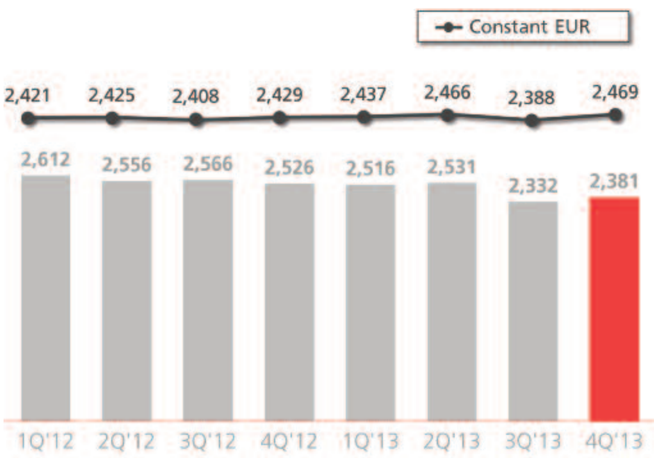
EUR Million

| | 2012 | | | | 2013 | | | |
|---|---|---|---|---|---|---|---|---|
| | 1Q | 2Q | 3Q | 4Q | 1Q | 2Q | 3Q | 4Q |
| **Net interest income** | **7,763** | **7,622** | **7,438** | **7,100** | **6,652** | **6,722** | **6,285** | **6,277** |
| Net fees | 2,612 | 2,556 | 2,566 | 2,526 | 2,516 | 2,531 | 2,332 | 2,381 |
| Gains (losses) on financial transactions | 797 | 675 | 643 | 583 | 969 | 879 | 992 | 630 |
| Other operating income | 114 | 270 | 67 | 75 | 154 | 187 | 129 | 117 |
| Dividends | 61 | 216 | 66 | 80 | 59 | 145 | 72 | 102 |
| Income from equity-accounted method | 136 | 120 | 84 | 87 | 154 | 114 | 122 | 110 |
| Other operating income/expenses | (83) | (66) | (83) | (93) | (59) | (72) | (65) | (95) |
| **Gross income** | **11,287** | **11,123** | **10,713** | **10,283** | **10,290** | **10,320** | **9,738** | **9,405** |
| Operating expenses | (5,043) | (4,934) | (5,067) | (4,939) | (4,996) | (5,000) | (4,862) | (4,985) |
| General administrative expenses | (4,519) | (4,422) | (4,464) | (4,396) | (4,428) | (4,400) | (4,303) | (4,322) |
| *Personnel* | *(2,634)* | *(2,587)* | *(2,608)* | *(2,478)* | *(2,582)* | *(2,548)* | *(2,431)* | *(2,509)* |
| *Other general administrative expenses* | *(1,885)* | *(1,835)* | *(1,856)* | *(1,918)* | *(1,846)* | *(1,852)* | *(1,871)* | *(1,813)* |
| Depreciation and amortisation | (524) | (512) | (603) | (543) | (569) | (600) | (559) | (664) |
| **Net operating income** | **6,244** | **6,188** | **5,646** | **5,344** | **5,294** | **5,320** | **4,876** | **4,420** |
| Net loan-loss provisions | (3,118) | (3,401) | (2,987) | (3,134) | (2,919) | (3,065) | (2,600) | (2,279) |
| Impairment losses on other assets | (83) | (97) | (81) | (592) | (110) | (126) | (141) | (146) |
| Other income | (487) | (381) | (475) | (105) | (261) | (415) | (369) | (215) |
| **Ordinary profit before taxes** | **2,556** | **2,309** | **2,103** | **1,512** | **2,003** | **1,713** | **1,766** | **1,779** |
| Tax on profit | (720) | (657) | (662) | (275) | (496) | (393) | (464) | (500) |
| **Ordinary profit from continuing operations** | **1,836** | **1,652** | **1,441** | **1,237** | **1,508** | **1,320** | **1,302** | **1,279** |
| Net profit from discontinued operations | 17 | 11 | 22 | 20 | — | (14) | (0) | (1) |
| **Ordinary consolidated profit** | **1,853** | **1,663** | **1,463** | **1,257** | **1,508** | **1,306** | **1,302** | **1,278** |
| Minority interests | 227 | 237 | 198 | 234 | 303 | 256 | 246 | 219 |
| **Ordinary attributable profit to the Group** | **1,627** | **1,427** | **1,264** | **1,024** | **1,205** | **1,050** | **1,055** | **1,060** |
| Net capital gains and provisions | — | (1,304) | (1,142) | (601) | — | — | — | — |
| **Attributable profit to the Group** | **1,627** | **123** | **122** | **423** | **1,205** | **1,050** | **1,055** | **1,060** |
| | | | | | | | | |
| **EPS (euros)** | **0.17** | **0.01** | **0.01** | **0.04** | **0.12** | **0.10** | **0.10** | **0.09** |
| **Diluted EPS (euros)** | **0.17** | **0.01** | **0.01** | **0.04** | **0.11** | **0.10** | **0.10** | **0.09** |

## NET INTEREST INCOME
EUR Million




## NET FEES
EUR Million




– Reduced spreads in an environment of interest rates at record lows in mature markets and the change of mix toward lower risk products in some markets. These impacts were not offset by reducing the cost of funds, which is still not fully reflected. The return on assets declined by 34 b.p. in 2013 to 4.58% and the cost of funds fell by 14 b.p. to 2.32%.

The performance of net interest income by countries was the following:

– Favourable evolution of Santander UK (+8.3% rise in pound sterling).

– Drop of 15.4% in Spain, largely due to deleveraging, mortgage repricing and the higher cost of funds. The strategy of improvement in the latter is already beginning to be reflected in the last few quarters and will continue.

– Latin America's net interest income declined 5.5% without the exchange rate effect, due to Brazil. Mexico and Chile, on the other hand, increased 5.9% and 3.4%, respectively, in local currency.

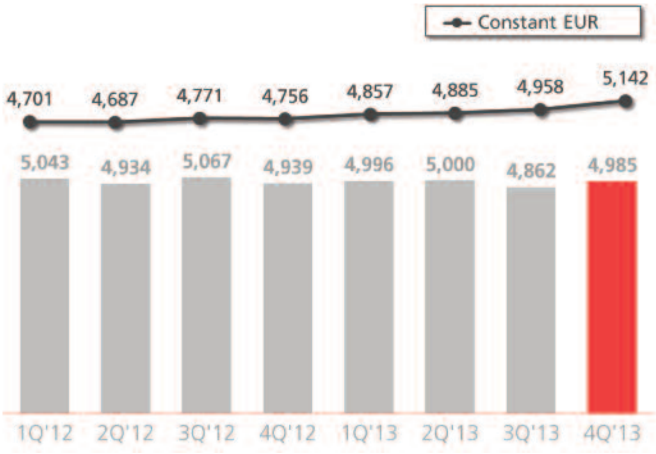
- **Net fee income** was down 4.9% at EUR 9,761 million. Excluding the exchange rate impact, it increased 0.8%. Income from advisory services and managing operations improved (+15.3%), cards (+12.7%), pension funds (+6.6%) and insurance (+4.7%).

- **Trading gains** increased 28.6%, due to GBM Europe and balance sheet active risk management of interest rates.

## NET FEES
EUR Million

| | 2013 | 2012 | Variation Amount | % | 2011 |
|---|---|---|---|---|---|
| Fees from services | 5,677 | 6,063 | (386) | (6.4) | 5,876 |
| Mutual & pension funds | 1,121 | 1,178 | (57) | (4.8) | 1,236 |
| Securities and custody | 678 | 702 | (24) | (3.4) | 668 |
| Insurance | 2,284 | 2,317 | (33) | (1.4) | 2,365 |
| **Net fee income** | **9,761** | **10,259** | **(499)** | **(4.9)** | **10,145** |

## OPERATING EXPENSES
EUR Million




## 2013 / 2012 CHANGE BY MAIN UNIT
%

| | Costs (1) | Inflation (2) | |
|---|---|---|---|
| Spain | -1.4 | 1.4 | Better than inflation |
| Portugal | -2.2 | 0.5 | |
| Poland (excl. perimeter) | -5.7 | 0.9 | |
| SCF | 1.1 | 1.4 | |
| UK | 1.5 | 2.7 | |
| Brazil | 3.9 | 6.2 | |
| Mexico | 9.9 | 3.8 | Franchise development |
| Chile | 5.5 | 1.8 | |
| USA | 10.1 | 1.7 | Rebranding, regulation... |

1. In constant euros (2) Average

- **Income by the equity accounted method,** which records the contributions to the Group of Santander Consumer USA and the corporate insurance operations in Europe and Latin America, rose 17.1%.
- **Other income,** including the contribution to the deposit guarantee funds, was EUR 291 million negative, 10.3% less than in 2012.

**Operating expenses** declined 0.7% (+4.9% excluding exchange rates), based on a varied performance.

In Spain, costs are beginning to reflect the synergies from integration, and so operating expenses declined 1.4%. Also in Poland, they are reflecting the integration. Costs were 5.7% lower excluding the perimeter, as synergies were obtained ahead of schedule. Portugal's expenses were 2.2% lower.

The UK's costs increased 1.5%, combining growth in target segments and investments in its commercial transformation plan. Costs rose at a slower pace than revenues and inflation.

In Brazil costs rose well below the inflation rate, underscoring the bank's focus on improving its efficiency plan. Costs in Mexico and Chile increased due to their expansion plans, particularly in Mexico, where 88 branches were opened in the year (8% of the network) and more than 300 ATMs.

## OPERATING EXPENSES
EUR Million

| | 2013 | 2012 | Variation Amount | % | 2011 |
|---|---|---|---|---|---|
| Personnel expenses | 10,069 | 10,307 | (237) | (2.3) | 10,136 |
| General expenses | 7,382 | 7,494 | (112) | (1.5) | 7,196 |
| Information technology | 992 | 889 | 103 | 11.5 | 822 |
| Communications | 519 | 638 | (119) | (18.7) | 628 |
| Advertising | 630 | 662 | (32) | (4.8) | 686 |
| Buildings and premises | 1,814 | 1,749 | 65 | 3.7 | 1,662 |
| Printed and office material | 166 | 166 | (0) | (0.1) | 175 |
| Taxes (other than profit tax) | 445 | 415 | 30 | 7.2 | 390 |
| Other expenses | 2,816 | 2,974 | (159) | (5.3) | 2,832 |
| **Personnel and general expenses** | **17,452** | **17,801** | **(349)** | **(2.0)** | **17,331** |
| Depreciation and amortisation | 2,392 | 2,182 | 210 | 9.6 | 2,080 |
| **Total operating expenses** | **19,843** | **19,983** | **(140)** | **(0.7)** | **19,412** |

## NET LOANS-LOSS PROVISIONS

EUR Million

| | 2013 | 2012 | Variation Amount | % | 2011 |
|---|---|---|---|---|---|
| Non performing loans | 11,928 | 13,950 | (2,022) | (14.5) | 11,234 |
| Country-risk | 2 | (2) | 4 | — | (7) |
| Recovery of written-off assets | (1,068) | (1,309) | 241 | (18.4) | (1,402) |
| **Total** | **10,863** | **12,640** | **(1,777)** | **(14.1)** | **9,826** |

Costs in the US also reflected the investments in building the franchise and commercial initiatives, as well as expenses associated with new regulatory requirements.

The **efficiency ratio** was 49.9%, comparing well with the sector. **Net operating income** (pre-provision profit) was EUR 19,909 million.

**Provisions for loan losses** amounted to EUR 10,863 million (-14.1% and -7.8% excluding the exchange rate effect).

By units, lower provisions in Brazil, the UK, Portugal, SCF, the US and, to a lesser extent, in Spain. Rises in the other Latin American countries, particularly in Mexico, with a large one-off impact for homebuilders.

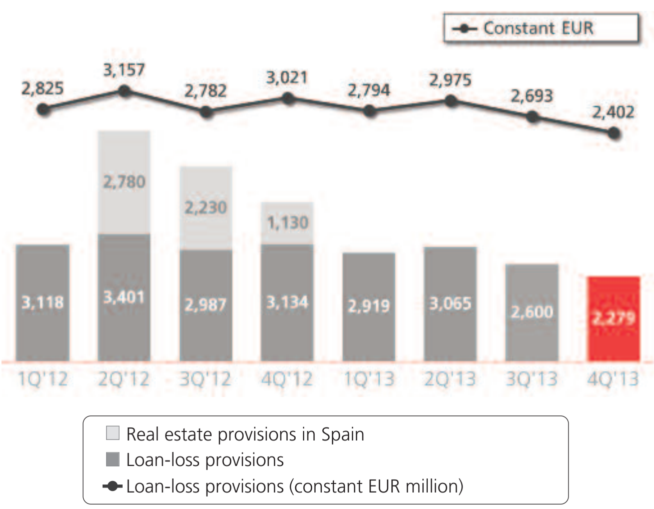
**Other asset impairment losses and other results** were EUR 1,785 million negative, compared to EUR 2,302 million also negative in 2012.

**Ordinary profit before tax** amounted to EUR 7,262 million (-14.4%).

After taxes, discontinued operations and higher minority interests from sale operations at the subsidiaries in Mexico and Poland, **ordinary attributable profit** was EUR 4,370 million.

## PROVISIONS

EUR Million




## COST OF CREDIT

%

This does not include capital gains of EUR 939 million net of taxes from the insurance operations in Spain and Santander Asset Management, as charges for an equivalent amount were made for restructuring costs, goodwill and other provisions.

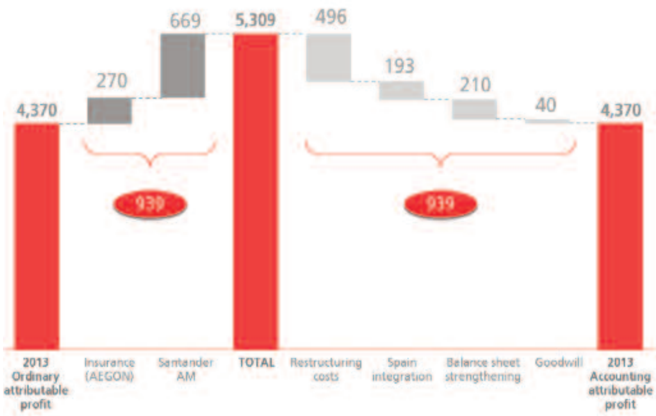
In 2012 the net between capital gains (EUR 1,064 million) and real estate provisions (EUR 4,111 million) was EUR 3,047 million negative. As a result, **Attributable profit** was 90.5% higher.

**Earnings per share** were EUR 0.40 (+71.7%).

The Group's **ROE** was 5.42%, **ROTE**, 7.73% and **RoRWA** 1.01%. All of them were better than in 2012 (+251 b.p., +345 b.p. and +45 b.p., respectively).

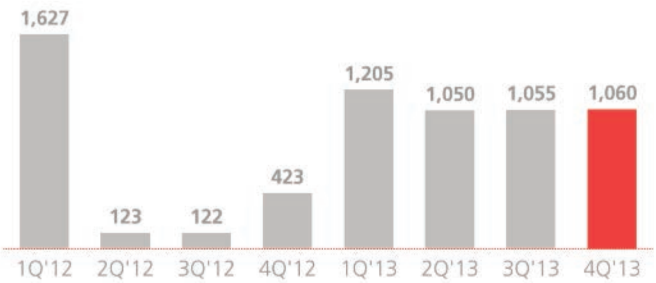
## CAPITAL GAINS AND PROVISIONS

EUR Million



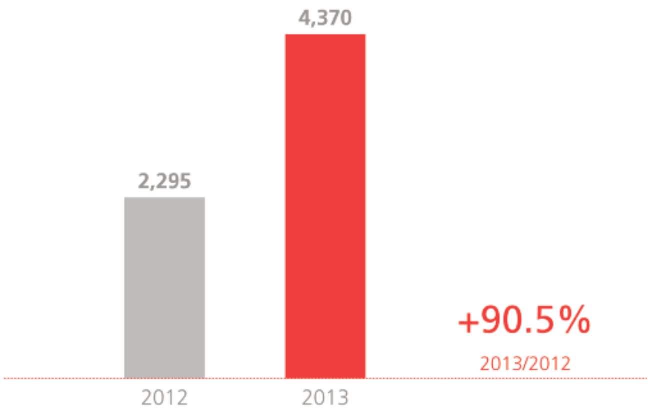

## ATTRIBUTABLE PROFIT QUARTERLY

EUR Million




## ATTRIBUTABLE PROFIT

EUR Million



## BALANCE SHEET

EUR Million

| ASSETS | 2013 | 2012 | Variation Amount | % | 2011 |
|---|---|---|---|---|---|
| Cash on hand and deposits at central banks | 77,103 | 118,488 | (41,385) | (34.9) | 96,524 |
| Trading portfolio | 115,287 | 177,917 | (62,630) | (35.2) | 172,637 |
| *Debt securities* | *40,841* | *43,101* | *(2,261)* | *(5.2)* | *52,704* |
| *Customer loans* | *5,079* | *9,162* | *(4,084)* | *(44.6)* | *8,056* |
| *Equities* | *4,967* | *5,492* | *(525)* | *(9.6)* | *4,744* |
| *Trading derivatives* | *58,899* | *110,319* | *(51,420)* | *(46.6)* | *102,498* |
| *Deposits from credit institutions* | *5,503* | *9,843* | *(4,341)* | *(44.1)* | *4,636* |
| Other financial assets at fair value | 31,381 | 28,356 | 3,025 | 10.7 | 19,563 |
| *Customer loans* | *13,196* | *13,936* | *(741)* | *(5.3)* | *11,748* |
| *Other (deposits at credit institutions, debt securities and equities)* | *18,185* | *14,420* | *3,766* | *26.1* | *7,815* |
| Available-for-sale financial assets | 83,799 | 92,267 | (8,468) | (9.2) | 86,612 |
| *Debt securities* | *79,844* | *87,724* | *(7,881)* | *(9.0)* | *81,589* |
| *Equities* | *3,955* | *4,542* | *(587)* | *(12.9)* | *5,024* |
| Loans | 714,484 | 756,858 | (42,373) | (5.6) | 777,967 |
| *Deposits at credit institutions* | *56,017* | *53,785* | *2,232* | *4.1* | *42,389* |
| *Customer loans* | *650,581* | *696,013* | *(45,432)* | *(6.5)* | *728,737* |
| *Debt securities* | *7,886* | *7,059* | *827* | *11.7* | *6,840* |
| Investments | 5,536 | 4,453 | 1,083 | 24.3 | 4,154 |
| Intangible assets and property and equipment | 16,613 | 17,296 | (682) | (3.9) | 16,840 |
| Goodwill | 23,281 | 24,626 | (1,344) | (5.5) | 25,089 |
| Other | 48,151 | 49,338 | (1,186) | (2.4) | 51,622 |
| **Total assets** | **1,115,637** | **1,269,598** | **(153,962)** | **(12.1)** | **1,251,008** |

| LIABILITIES AND SHAREHOLDERS' EQUITY | | | | | |
|---|---|---|---|---|---|
| Trading portfolio | 94,672 | 143,241 | (48,568) | (33.9) | 146,949 |
| *Customer deposits* | *8,500* | *8,897* | *(397)* | *(4.5)* | *16,574* |
| *Marketable debt securities* | *1* | *1* | *(0)* | *(7.9)* | *77* |
| *Trading derivatives* | *58,887* | *109,743* | *(50,856)* | *(46.3)* | *103,083* |
| *Other* | *27,285* | *24,600* | *2,685* | *10.9* | *27,214* |
| Other financial liabilities at fair value | 42,311 | 45,418 | (3,108) | (6.8) | 44,908 |
| *Customer deposits* | *26,484* | *28,638* | *(2,154)* | *(7.5)* | *26,982* |
| *Marketable debt securities* | *4,086* | *4,904* | *(818)* | *(16.7)* | *8,185* |
| *Due to central banks and credit institutions* | *11,741* | *11,876* | *(135)* | *(1.1)* | *9,741* |
| Financial liabilities at amortized cost | 863,115 | 959,321 | (96,206) | (10.0) | 935,669 |
| *Due to central banks and credit institutions* | *86,323* | *131,670* | *(45,347)* | *(34.4)* | *116,368* |
| *Customer deposits* | *572,853* | *589,104* | *(16,251)* | *(2.8)* | *588,977* |
| *Marketable debt securities* | *171,390* | *201,064* | *(29,674)* | *(14.8)* | *189,110* |
| *Subordinated debt* | *16,139* | *18,238* | *(2,100)* | *(11.5)* | *22,992* |
| *Other financial liabilities* | *16,410* | *19,245* | *(2,835)* | *(14.7)* | *18,221* |
| Insurance liabilities | 1,430 | 1,425 | 5 | 0.3 | 517 |
| Provisions | 14,474 | 16,148 | (1,673) | (10.4) | 17,308 |
| Other liability accounts | 19,735 | 22,771 | (3,036) | (13.3) | 24,844 |
| **Total liabilities** | **1,035,736** | **1,188,324** | **(152,587)** | **(12.8)** | **1,170,195** |
| Shareholders' equity | 84,740 | 81,333 | 3,406 | 4.2 | 80,874 |
| *Capital stock* | *5,667* | *5,161* | *506* | *9.8* | *4,455* |
| *Reserves* | *75,109* | *74,528* | *581* | *0.8* | *72,660* |
| *Attributable profit to the Group* | *4,370* | *2,295* | *2,075* | *90.5* | *5,330* |
| *Less: dividends* | *(406)* | *(650)* | *244* | *(37.5)* | *(1,570)* |
| Equity adjustments by valuation | (14,152) | (9,474) | (4,678) | 49.4 | (6,415) |
| Minority interests | 9,313 | 9,415 | (102) | (1.1) | 6,354 |
| **Total equity** | **79,900** | **81,275** | **(1,375)** | **(1.7)** | **80,813** |
| **Total liabilities and equity** | **1,115,637** | **1,269,598** | **(153,962)** | **(12.1)** | **1,251,008** |

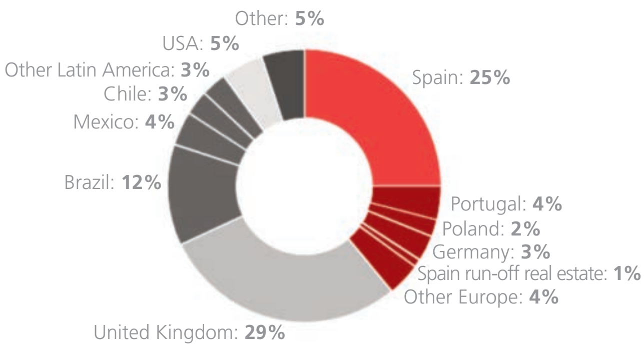
## ■ GRUPO SANTANDER. BALANCE SHEET

→ **Activity** continued to reflect the market context:

- Low demand for **loans** in Europe, particularly in Spain and Portugal. Growth of 9% in Latin America at constant exchange rates.
- In **funds**, greater focus on the cost of deposits and on marketing mutual funds.
- The Group generated EUR 23,000 million of liquidity in 2013, reducing the need for medium and long term issues.
- The Group's **net loan-to-deposit** ratio was 109%, (113% in December 2012).

→ Continued strong generation of capital. **Core capital ratio** (BIS II) of **11.71%, an annual record increase of 138 b.p.**

### DISTRIBUTION OF TOTAL ASSETS
December 2013




Total **managed funds** at the end of 2013 amounted to **EUR 1,240,806 million**, of which EUR 1,115,637 million (90%) were on-balance sheet and the rest mutual and pension funds and managed portfolios.

When making comparisons with 2012 it is important to take into account the significant impact of exchange rates as a result of the depreciations of the main currencies against the euro in which the Group operates.

The end-of-period depreciations were as follows: pound sterling and the Polish zloty (2%), the dollar (4%), the Mexican peso (5%), the Chilean peso (13%), the Brazilian real 17% and the Argentine peso 28%. The impact on year-on-year changes in lending and customer funds was 4 p.p. negative.

There was a positive perimeter effect of less than one percentage point, due to the merger in early 2013 of Bank Zachodni WBK and Kredyt Bank in Poland.

### Customer lending

The Group's gross customer lending amounted to EUR 693,759 million at the end of 2013, 7% lower year-on-year because of the impact of exchange rates. Excluding this impact and eliminating repos, balances were 2% lower.

The performance by geographic segment is as follows.

In **Continental Europe**, the low demand for loans emanating from the economic situation of some countries, affected balances in Spain and Portugal. Santander Consumer Finance's total lending remained stable, while Poland registered positive growth both organically as well as from the increased perimeter. The balance of Spain run-off

### CUSTOMER LOANS
EUR Million

| | 2013 | 2012 | Variation Amount | % | 2011 |
|---|---|---|---|---|---|
| Spanish Public sector | 13,374 | 16,884 | (3,510) | (20.8) | 12,147 |
| Other residents | 160,478 | 183,130 | (22,652) | (12.4) | 202,411 |
| Commercial bills | 7,301 | 8,699 | (1,399) | (16.1) | 9,679 |
| Secured loans | 96,420 | 103,890 | (7,470) | (7.2) | 117,946 |
| Other loans | 56,757 | 70,540 | (13,783) | (19.5) | 74,785 |
| Non-resident sector | 519,907 | 544,520 | (24,612) | (4.5) | 552,789 |
| Secured loans | 320,608 | 339,519 | (18,912) | (5.6) | 342,676 |
| Other loans | 199,300 | 205,000 | (5,701) | (2.8) | 210,114 |
| **Gross customer loans** | **693,759** | **744,534** | **(50,775)** | **(6.8)** | **767,347** |
| Loan-loss allowances | 24,904 | 25,422 | (518) | (2.0) | 18,806 |
| **Net customer loans** | **668,856** | **719,112** | **(50,257)** | **(7.0)** | **748,541** |
| Pro memoria: Doubtful loans | 40,320 | 35,301 | 5,019 | 14.2 | 31,257 |
| Public sector | 99 | 121 | (22) | (18.3) | 102 |
| Other residents | 21,763 | 16,025 | 5,739 | 35.8 | 14,745 |
| Non-resident sector | 18,458 | 19,156 | (697) | (3.6) | 16,409 |

real estate activity was much lower, as we maintained the strategy of reducing this type of risk.

- Gross lending in **Spain** (excluding the run-off real estate unit, commented on below) was 9% lower at EUR 165,809 million (-8% excluding repos). The distribution was as follows:

  – Lending to individuals amounted to EUR 62,665 million, most of them for home mortgages. This portfolio was concentrated in financing first homes, with a strong concentration in the lowest tranches of loan-to-value (88% with an LTV of less than 80%).

  – Loans directly to SMEs and companies without real estate purpose amounted to EUR 82,515 million and accounted for the largest share of lending (50% of the total).

  – Lending to the Spanish public sector stood at EUR 13,374 million compared to EUR 16,884 million in 2012. The drop was the result of the amortization of the financing to suppliers (about EUR 4,000 million).

  – Lastly, repos continued to decline (-26%).

- In **Portugal**, lending dropped 5%, due to all segments. Balances in construction and real estate, which represent only 2% of lending, declined 30%.

- In **Poland**, credit increased 73% in local currency, due to the consolidation of Kredyt Bank. Excluding this, growth was 1%.

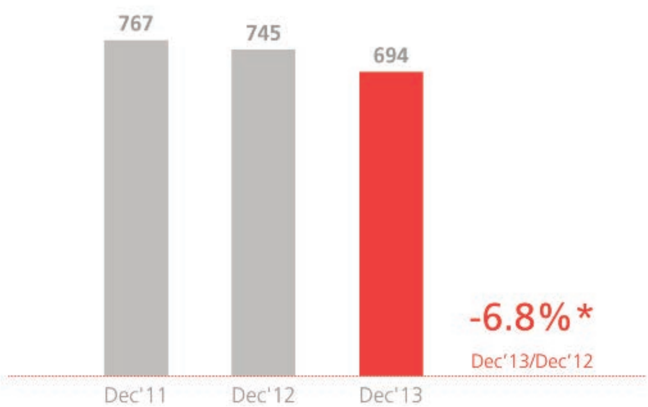
- **Santander Consumer Finance's** balances remained stable (-1%), with a varied performance by countries. Germany's lending, which accounted for 53% of the area's credit, rose 1%, the Nordic countries and Poland increased 18% and 6%, respectively, in local currency and that of periphery countries, more affected by the economic situation and deleveraging, declined.

  New loans in 2013 increased slightly (+1%) over 2012, as follows: +6% for durable goods, +4% for used vehicles and +2% for new ones, where the evolution was better than the sector's (-4% new car sales in the footprint).

- Net customer lending included in the unit of **Spain run-off real estate activity** amounted to EUR 5,735 million, a drop of EUR 1,563 million in the year and 21% less.

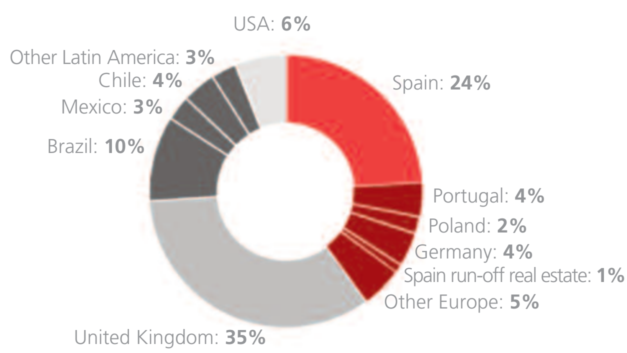
In the **United Kingdom**, the balance of customer loans was 4% lower in pound sterling. In local criteria, the balance of home mortgages dropped 5% because of the strategy of improving the risk profile, which meant discontinuing some products. Loans to companies, on the other hand, increased 13%.

**GROSS CUSTOMER LOANS**
EUR Billion




* Excluding exchange rate impact: -3.1%

**CUSTOMER LOANS**
% o/ operating areas. December 2013



## CREDIT RISK MANAGEMENT*

EUR Million

| | 2013 | 2012 | Variation Amount | % | 2011 |
|---|---|---|---|---|---|
| Non-performing loans | 41,652 | 36,061 | 5,591 | 15.5 | 32,006 |
| NPL ratio (%) | 5.64 | 4.54 | 1.10 p. | | 3.90 |
| Loan-loss allowances | 25,681 | 26,111 | (431) | (1.7) | 19,531 |
| Specific | 21,972 | 21,793 | 180 | 0.8 | 15,398 |
| Generic | 3,708 | 4,319 | (611) | (14.1) | 4,133 |
| NPL coverage (%) | 61.7 | 72.4 | (10.8 p.) | | 61.0 |
| Cost of credit (%) ** | 1.53 | 2.38 | (0.85 p.) | | 1.41 |

* Excluding country-risk
** 12 month net loan-loss provisions / average lending

Note: NPL ratio: Non-performing loans / computable assets

Lending in **Latin America** in constant currency increased 9%, with growth in all countries except Puerto Rico (-8%). Brazil's rose 7%, Mexico's 12%, Chile's 11%, Argentina's 35%, Uruguay's 24% and Peru's 29%.

Lastly, lending in the **US** declined 5% in dollars, as a result of the fall in the run-off portfolios and the strategy in the last year of mortgage origination for its subsequent sale.

At the end of 2013, Continental Europe accounted for 40% of the Group's total net lending (24% Spain), the UK 35%, Latin America 20% (10% Brazil) and the US 6%.

**Risks**

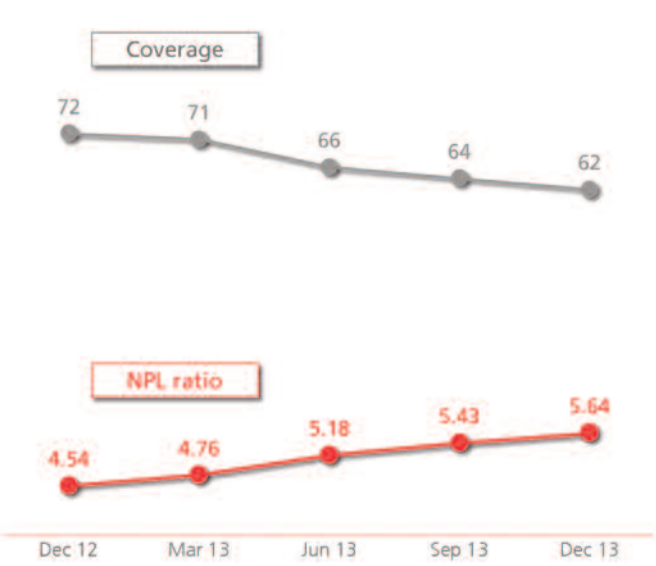
Net NPL entries in 2013 amounted to EUR 17,596 million after eliminating the perimeter and exchange-rate effects. Excluding the impact of the reclassification of substandard loans in Spain in the second quarter, entries were 6% lower than in 2012.

The Group's NPL ratio was 5.64% (+110 b.p.), affected by the reclassification in Spain in the second quarter and the decline in customer lending.

On-balance sheet loan-loss provisions amounted to EUR 25,681 million, of which EUR 3,708 million are generic

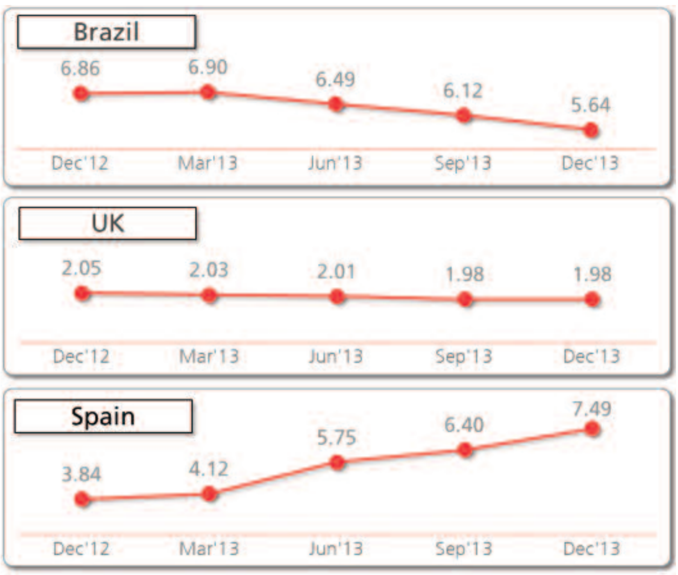
## GRUPO SANTANDER. NPL RATIO AND COVERAGE

%




## MAIN UNITS. NPL RATIO

%



provisions. NPL coverage at the end of 2013 was 62% (72% in December 2012).

More information on credit risk, the control and monitoring systems and the internal risk models for calculating provisions can be found in the risk management chapter in this annual report.

**Customer funds under management and marketed**

Total managed funds amounted to EUR 924,621 million, 5% lower than at the end of 2012. Excluding the exchange rate impact, the balance was below 1%.

Deposits (including retail commercial paper in Spain and Brazil's *letras financeiras* but excluding repos), mutual funds and pension funds rose 2%, after eliminating the exchange-rate effect. Deposits remained stable while mutual and pension funds increased 14% and 8%, respectively.

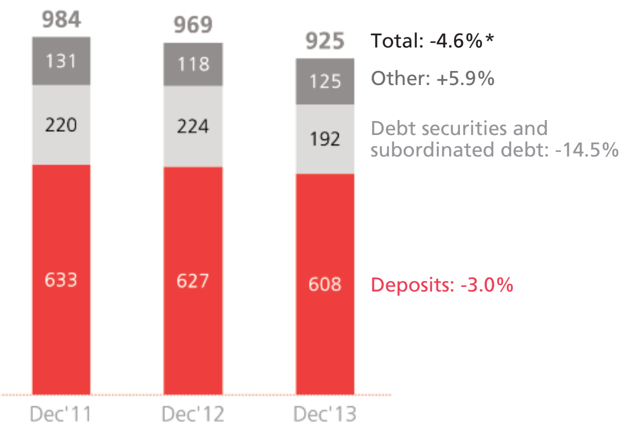
By geographic segment, **Continental Europe's** units performed as follows:

- **Spain's** funds grew 1%, very conditioned by the decline in expensive institutional balances. Excluding them, retail balances increased by around EUR 10,000 million. Mutual funds grew 29%, consolidating Grupo Santander's leadership. This big rise was due to the strategy of reducing expensive deposits and greater marketing of mutual funds, coupled with the favourable impact of the rise in stock markets in 2013. Pension funds increased 8%.
- **Portugal's** deposits dropped 4%, excluding repos, due to the greater focus on cost, which is reflected in the decline in time deposits. Mutual funds fell 32%, while pension funds increased 8%. The overall drop in funds was 5%.
- **Poland's** deposits increased 69% in local currency, due to the entry of Kredyt Bank. On a like-for-like basis, deposits rose 1% because of active management of funds. This is reflected in the reduction in the expensive deposits of Kredyt Bank and the rise in mutual funds (+12%).
- **Santander Consumer Finance's** deposits declined 3% due to Germany (89% of the area's total). The fall was due to the policy of reducing higher cost balances. Italy and the Nordic countries registered strong growth, although their balances were very modest.

In the **UK**, customer deposits excluding repos (in pound sterling) dropped 3%, due to the strategy of replacing expensive and less stable deposits with those that offer a better opportunity of linkage. Demand deposits grew 5% because of the rise in current accounts as a result of the success of the 1|2|3 range of products, which partly offset the reduction in the time deposits balances. Mutual funds dropped 29%.

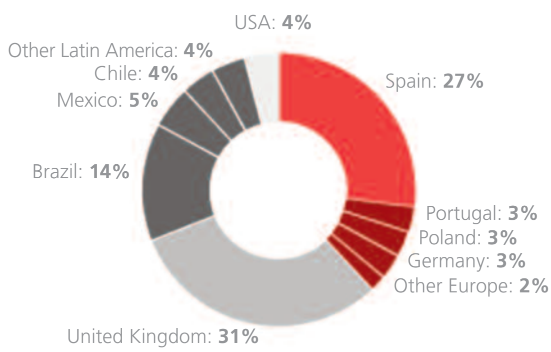
In **Latin America**, and, as in lending, in constant currency, all countries except for Puerto Rico increased their deposits and mutual funds (+12% overall, excluding repos and including Brazil's *letras financeiras*). Brazil's rose 15%, Mexico's 4% (12% on a like-for-like basis), Chile's 7%, Argentina's 30%, Uruguay's 17% and Peru's 15%.

**CUSTOMER FUNDS UNDER MANAGEMENT**
EUR Billion




* Excluding exchange rate impact: -0.5%

**CUSTOMER FUNDS UNDER MANAGEMENT**
% o/ operating areas. December 2013



## CUSTOMER FUNDS UNDER MANAGEMENT

EUR Million

| | 2013 | 2012 | Variation Amount | % | 2011 |
|---|---|---|---|---|---|
| Resident public sector | 7,745 | 8,487 | (741) | (8.7) | 6,528 |
| Other residents | 161,649 | 157,011 | 4,638 | 3.0 | 144,131 |
| Demand deposits | 74,969 | 71,526 | 3,443 | 4.8 | 68,389 |
| Time deposits | 80,146 | 75,414 | 4,731 | 6.3 | 61,185 |
| Other | 6,535 | 10,071 | (3,536) | (35.1) | 14,557 |
| Non-resident sector | 438,442 | 461,141 | (22,699) | (4.9) | 481,875 |
| Demand deposits | 245,582 | 228,698 | 16,884 | 7.4 | 220,299 |
| Time deposits | 146,433 | 179,503 | (33,070) | (18.4) | 197,249 |
| Other | 46,427 | 52,940 | (6,513) | (12.3) | 64,328 |
| **Customer deposits** | **607,836** | **626,639** | **(18,802)** | **(3.0)** | **632,533** |
| Debt securities* | 175,477 | 205,969 | (30,492) | (14.8) | 197,372 |
| Subordinated debt | 16,139 | 18,238 | (2,100) | (11.5) | 22,992 |
| **On-balance-sheet customer funds** | **799,452** | **850,846** | **(51,394)** | **(6.0)** | **852,898** |
| Mutual funds | 93,304 | 89,176 | 4,128 | 4.6 | 102,611 |
| Pension funds | 10,879 | 10,076 | 803 | 8.0 | 9,645 |
| Managed portfolios | 20,987 | 18,889 | 2,098 | 11.1 | 19,199 |
| **Other customer funds under management** | **125,169** | **118,141** | **7,028** | **5.9** | **131,456** |
| **Customer funds under management**** | **924,621** | **968,987** | **(44,366)** | **(4.6)** | **984,353** |

* Including retail commercial paper in Spain (EUR million): 3,553 in December 2013, 11,536 in December 2012 and 6,052 in December 2011

** Including marketed mutual and pension funds

Lastly, **US** customer deposits also continued to improve their mix and cost. Demand deposits increased 9%, a rise absorbed by the drop in time deposits. Total deposits without repos were 3% lower.

Continental Europe accounted for 38% of managed customer funds (27% Spain), the UK 31%, Latin America 27% (Brazil 14%) and the US 4%.

The successful capturing of deposits in the last two years enabled the Group to significantly reduce the need for wholesale funds through issuances. However, the Group, for strategic reasons, maintained a selective policy of issuing securities in the international fixed income markets and strived to adapt the frequency and volume of operations to the structural liquidity needs of each unit, as well as to the receptiveness of each market.

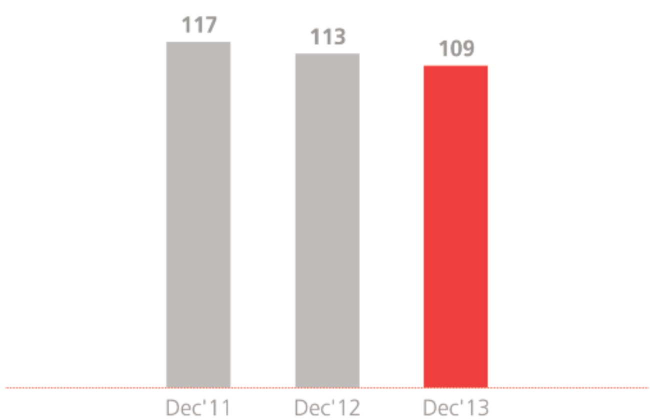
The Group captured EUR 22,540 million in medium- and long-term issues, of which EUR 18,003 million was senior debt, EUR 3,513 million covered bonds and EUR 1,024 million subordinated debt.

As regards securitizations, the Group's subsidiaries placed in 2013 a total of EUR 6,273 million, mainly in Santander UK and via the units of Santander Consumer Finance.

This issuing activity underscores the Group's capacity to access the different segments of institutional investors via more than 10 issuance units, including the parent bank, Banco Santander, and the main subsidiaries of the countries where it operates. All this reaffirms the Group's policy of self-sufficiency in liquidity for its subsidiaries so that each

## NET LOANS-TO-DEPOSITS RATIO. TOTAL GROUP*

%




* Including retail commercial paper in Spain

## MUTUAL FUNDS

EUR Million

| | 2013 | 2012 | Variation Amount | % | 2011 |
|---|---|---|---|---|---|
| Spain | 29,712 | 23,093 | 6,619 | 28.7 | 27,425 |
| Portugal | 1,050 | 1,544 | (494) | (32.0) | 1,866 |
| Poland | 2,683 | 2,443 | 239 | 9.8 | 1,747 |
| United Kingdom | 9,645 | 13,919 | (4,273) | (30.7) | 15,744 |
| Latin America | 50,214 | 48,178 | 2,036 | 4.2 | 55,829 |
| **Total** | **93,304** | **89,176** | **4,128** | **4.6** | **102,611** |

adapts its issuance programme to the evolution of its balance sheet.

Maturities of medium- and long-term debt amounted to EUR 37,318 million in 2013, of which EUR 26,121 million was senior debt, EUR 10,997 million covered bonds and EUR 199 million subordinated debt.

The performance of loans, deposits and retail commercial paper in Spain improved the net loan-to-deposit ratio to 109% (113% in 2012). Spain's ratio was 87% (90% in 2012).

The ratio of deposits plus medium- and long-term funding to the Group's loans was 119%, underscoring the comfortable funding structure of the Group's assets.

### Other items of the balance sheet

Total goodwill was EUR 23,281 million, EUR 1,344 million less than in 2012, due to the net impact of the evolution of exchange rates, particularly sterling and the Brazilian real, and the increase resulting from the incorporation of Kredyt Bank.

At the end of 2011 the European Central Bank put into effect extraordinary monetary policy measures, including increasing collateral and 3-year auctions in order to inject liquidity into the market.

The Group participated in these auctions and continued to deposit a large part of these funds in the ECB, as a liquidity insurance. This, together with the strategy of replacing repos

## PENSION FUNDS

EUR Million

| | 2013 | 2012 | Variation Amount | % | 2011 |
|---|---|---|---|---|---|
| Spain | 10,030 | 9,289 | 741 | 8.0 | 8,884 |
| Individuals | 8,657 | 8,002 | 655 | 8.2 | 7,670 |
| Collective plans | 293 | 258 | 35 | 13.6 | 249 |
| Group employee plans | 1,081 | 1,029 | 52 | 5.1 | 965 |
| Portugal | 848 | 787 | 61 | 7.8 | 760 |
| **Total** | **10,879** | **10,076** | **803** | **8.0** | **9,645** |

in the clearing houses with discounted assets in the ECB, is reflected in the evolution of balances with central banks.

In January 2013, and at the first opportunity possible, the Group returned the EUR 24,000 million corresponding to the total amount borrowed by Banco Santander and Banesto at the December 2011 auction. The Group continued to return funds, and at the end of 2013 had returned almost the total amount borrowed. The only relevant amount pending was that of Portugal. This strategy was reflected in the drop of more than EUR 40,000 million in the item of central banks, both in assets and liabilities.

The balance of financial assets available for sale was EUR 83,799 million, a decline of EUR 8,468 million (-9%), due to reduced positions in public debt, in particular Spain's, the UK's, Brazil's and the US's.

Trading derivatives of EUR 58,899 million in the assets side and EUR 58,887 million in liabilities (with significant drops of EUR 51,420 million and EUR 50,856 respectively), due to long-term interest rate hikes and the cancellation of positions.

### Shareholders' equity and solvency ratios

Total shareholders' funds, after retained profits, stood at EUR 84,269 million, an increase of EUR 3,348 million in the year (+4%).

There were several issues of ordinary shares during 2013 to tend to those shareholders who opted to receive the equivalent amount of the interim dividends in shares under the Santander Dividendo Elección programme (scrip dividend). A total of 1,012,240,738 shares were issued for the four scrip dividends – the third and fourth of 2012 and the first and second of 2013, with an overall acceptance of 87.3% of the capital.

Minority interests hardly changed. The rise from the operation in Poland was offset by declines in Spain (from the integration of Banesto) and Brazil (impact of exchange rates).

Valuation adjustments dropped by EUR 4,678 million, with a notable negative impact of exchange rates (partly hedged) on the value of stakes in foreign subsidiaries. The figure also includes the negative impact of exchange rates on goodwill,

#### TOTAL EQUITY AND CAPITAL WITH THE NATURE OF FINANCIAL LIABILITIES

EUR Million

| | 2013 | 2012 | Variation Amount | % | 2011 |
|---|---|---|---|---|---|
| Capital stock | 5,667 | 5,161 | 506 | 9.8 | 4,455 |
| Additional paid-in surplus | 36,804 | 37,302 | (498) | (1.3) | 31,223 |
| Reserves | 38,314 | 37,513 | 801 | 2.1 | 41,688 |
| Treasury stock | (9) | (287) | 278 | (96.9) | (251) |
| **Shareholders' equity (before profit and dividends)** | **80,776** | **79,689** | **1,087** | **1.4** | **77,115** |
| Attributable profit | 4,370 | 2,295 | 2,075 | 90.4 | 5,330 |
| Interim dividend distributed | (406) | (650) | 244 | (37.5) | (1,429) |
| Interim dividend not distributed[1] | (471) | (412) | (59) | 14.2 | (637) |
| **Shareholders' equity (after retained profit)** | **84,269** | **80,921** | **3,348** | **4.1** | **80,379** |
| Valuation adjustments | (14,152) | (9,474) | (4,678) | 49.4 | (6,415) |
| Minority interests | 9,313 | 9,415 | (102) | (1.1) | 6,354 |
| **Total equity (after retained profit)** | **79,430** | **80,862** | **(1,433)** | **(1.8)** | **80,318** |
| Preferred shares and securities in subordinated debt | 4,053 | 4,740 | (687) | (14.5) | 5,896 |
| **Total equity and capital with the nature of financial liabilities** | **83,483** | **85,602** | **(2,120)** | **(2.5)** | **86,214** |

1. In 2013, estimated data of May 2014 scrip dividend

## COMPUTABLE CAPITAL AND BIS II RATIO

EUR Million

| | 2013 | 2012 | Variation Amount | % | 2011 |
|---|---|---|---|---|---|
| Core capital | 57,346 | 57,558 | (212) | (0.4) | 56,694 |
| Basic capital | 61,723 | 62,234 | (511) | (0.8) | 62,294 |
| Supplementary capital | 11,040 | 11,981 | (941) | (7.9) | 15,568 |
| Deductions | (1,310) | (1,279) | (31) | 2.4 | (1,090) |
| **Computable capital** | **71,453** | **72,936** | **(1,483)** | **(2.0)** | **76,772** |
| Risk-weighted assets | 489,736 | 557,030 | (67,294) | (12.1) | 565,958 |
| | | | | | |
| **BIS II ratio** | **14.59** | **13.09** | **1.50 p.** | | **13.56 p.** |
| **Tier I (before deductions)** | **12.60** | **11.17** | **1.43 p.** | | **11.01 p.** |
| **Core capital** | **11.71** | **10.33** | **1.38 p.** | | **10.02 p.** |
| | | | | | |
| Shareholders' equity surplus (BIS II ratio) | 32,274 | 28,374 | 3,900 | 13.7 | 31,495 |

but with a neutral impact on capital ratios, as it is recorded in the same way in assets.

Total equity amounted to EUR 79,430 million at the end of 2013.

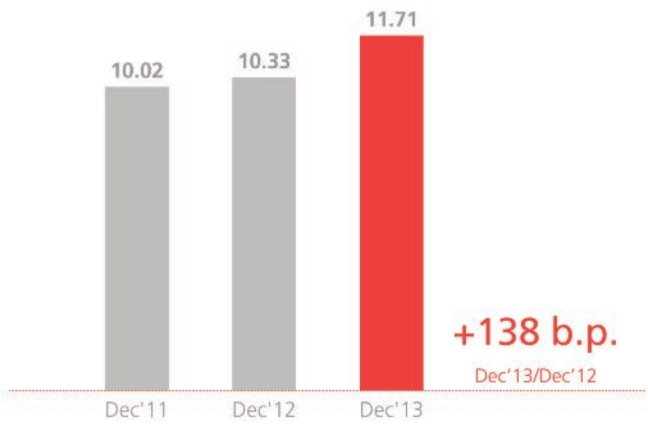
The Group's eligible equity at the end of December 2013, on the basis of BIS II criteria amounted to EUR 71,453 million (EUR 32,274 million above the minimum requirement; +82%).

The Group maintained in the year strong generation of capital. The BIS II core capital ratio was 11.71%, after rising by an annual record of 138 b.p. in 2013, favoured by reduced risk-weighted assets.

The core capital is of very high quality, solid and adjusted to Grupo Santander's business model, balance sheet structure and risk profile.

## CORE CAPITAL RATIO (BIS II)

%



## Rating agencies

The Group's access to wholesale funding markets, as well as the cost of issues, depends to some extent on the ratings accorded by rating agencies.

Rating agencies regularly review the Group's ratings. Classification of long-term debt depends on a series of internal factors (solvency, business model, capacity to generate profits, etc) and external ones related to the general economic environment, the sector's situation and the sovereign risk of the countries in which the Group operates.

The rating of the Kingdom of Spain by the main agencies is now at: BBB- from Standard & Poor's; BBB Fitch; Baa3 Moody's; and A (low) DBRS. Although there were no changes in the country's ratings throughout 2013, Fitch, Standard & Poor's and Moody's raised their outlook from negative to stable.

It is also worth mentioning that the methodology used by the agencies means that the rating of banks is linked to and limited by the sovereign debt rating of the country in which it is based. As a result, and despite Santander's good fundamentals, the Group's rating is limited by the sovereign debt rating.

In spite of this, Santander is the only bank worldwide with a rating higher than the sovereign of its country of origin by all four main agencies: BBB from Standard & Poor's; BBB+ Fitch; Baa2 Moody's; and A from DBRS. Morevoer, Fitch and S&P have raised their outlook to stable in November and December 2013 respectively, as a result of the improved outlook in the sovereign rating. Moody's also improved the outlook to stable in 2014. The granting of ratings above the sovereign ones, acknowledges Santander's financial strength and diversification.

The good valuation that the agencies have of Santander's credit profile is reflected in the rating of the Bank's individual fundamentals, which in the case of S&P is "a-", a rating similar to other competitor banks, even those domiciled in countries with a better macroeconomic environment.

### RATING AGENCIES

| | Long term | Short term | Outlook |
|---|---|---|---|
| Standard & Poor´s | BBB | A-2 | Stable |
| Fitch Ratings | BBB+ | F2 | Stable |
| Moody's | Baa2 | P-2 | Stable |
| DBRS | A | R1(low) | Negative |

## Description of the segments

Grupo Santander is maintaining in 2013 the general criteria used in 2012, with the following exceptions:

**1.** In the Group's financial statements:

- The change in International Accounting Standards 19 (IAS 19) requires that for periods beginning on or after January 1, 2013 actuarial gains and losses are immediately recognised against shareholders' equity, without the possibility for deferred recognition through the P&L, as it was done until now.
- As a result of the disposal of Santander UK card business formerly owned by GE, its 2012 results have been eliminated from the various lines of the income statement and recorded, net, in profit from discontinued operations.

**2.** In businesses by restructuring:

- Spain was incorporated as a principal or geographic segment, and includes the former branch networks of Santander, Banesto and Banif (merged in 2013), Global Wholesale Banking, Asset Management and Insurance and the ALCO portfolio in Spain.
- Discontinued real estate activity in Spain is segregated into a unit within Continental Europe (Spain run-off real estate). It includes: loans from customers whose activity is mainly real estate development, which have a specialised management model; equity stakes in real estate companies and foreclosed assets.

**3.** Other adjustments

- The annual adjustment was made to the Global Customer Relationship Model and resulted in a net increase of 60 new clients.
- The wholesale businesses in Poland and Banesto, previously in Retail Banking, were incorporated to Global Wholesale Banking.
- Corporate Activities was redefined due to funding allocation and transfer of real estate assets and their costs (already mentioned), as well as other reallocations of costs among units.

For comparison purposes, the figures for 2012 have been restated including the changes in the affected areas.

The financial statements of each business segment have been drawn up by aggregating the Group's basic operating units. The information relates to both the accounting data of the units in each segment 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.

The operating business areas are structured into two levels:

Principal level (or geographic). Geographical areas segment the activity of the Group's operating units. This coincides with the Group's first level of management and reflects Santander positioning in the world's three main currency areas (euro, sterling and dollar). The segments reported on are:

- **Continental Europe**. This covers all retail banking business, wholesale banking and asset management and insurance conducted in this region, as well as the unit of Spain run-off real estate. Detailed financial information is provided on Spain, Portugal, Poland and Santander Consumer Finance (which incorporates all the region's business, including the three countries mentioned herewith).
- **United Kingdom**. This includes retail and wholesale banking and 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 (including Puerto Rico). It also includes the specialised units of Santander Private Banking, as an independent and globally managed unit, and New York's business. The financial statements of Brazil, Mexico and Chile are also provided.
- **United States.** Includes the businesses of Santander Bank (former Sovereign Bank) and Santander Consumer USA (consolidated by the equity accounted method).

Secondary level (or business). This segments the activity of the operating units by type of business. The segments are: retail banking, wholesale banking, asset management and insurance and the unit of Spain run-off real estate.

- **Retail Banking**. This covers all customer banking businesses, including private banking (except those of Corporate Banking, managed through the Global Customer Relationship Model). Because of their relative importance, details are also provided by the main geographic areas (Continental Europe, United Kingdom, Latin America and the US), as well as the main countries and Santander Consumer Finance. 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 to the Group of the design and management of mutual and pension funds and insurance businesses carried out in some cases by the Group's fully-owned subsidiaries and in other by units where the Group participates via joint ventures with specialists. All units remunerate the distribution networks they use to market these products (mainly the Group's, although not exclusively) via revenue-sharing agreements. This means that the result recorded in this segment for each of the units included (in accordance with their participation and type of consolidation) is the net between the gross income and the distribution cost resulting from sharing agreements).

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 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 (charged to the areas), 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 this criteria, and therefore, may not match those publish by each institution individually.

| NET OPERATING INCOME (EUR Million) | 2013 | 2012 | Amount | % | % w/o FX |
|---|---|---|---|---|---|
| **Continental Europe** | **6,009** | **6,510** | **(501)** | **(7.7)** | **(7.5)** |
| o/w: Spain | 3,251 | 3,858 | (607) | (15.7) | (15.7) |
| Portugal | 421 | 531 | (110) | (20.7) | (20.7) |
| Poland | 731 | 542 | 189 | 34.8 | 35.3 |
| Santander Consumer Finance | 1,720 | 1,760 | (40) | (2.3) | (2.3) |
| **United Kingdom** | **2,276** | **2,217** | **59** | **2.7** | **7.5** |
| **Latin America** | **12,379** | **14,811** | **(2,432)** | **(16.4)** | **(6.8)** |
| o/w: Brazil | 8,219 | 10,651 | (2,432) | (22.8) | (12.0) |
| Mexico | 1,804 | 1,686 | 118 | 7.0 | 7.2 |
| Chile | 1,324 | 1,373 | (49) | (3.6) | 1.4 |
| **USA** | **896** | **1,422** | **(525)** | **(37.0)** | **(34.8)** |
| **Operating areas** | **21,560** | **24,960** | **(3,399)** | **(13.6)** | **(7.4)** |
| Corporate Activities | (1,651) | (1,537) | (114) | 7.4 | 7.4 |
| **Total Group** | **19,909** | **23,422** | **(3,513)** | **(15.0)** | **(8.4)** |

| ATTRIBUTABLE PROFIT (EUR Million) | 2013 | 2012 | Amount | % | % w/o FX |
|---|---|---|---|---|---|
| **Continental Europe*** | **1,127** | **1,365** | **(238)** | **(17.4)** | **(17.1)** |
| o/w: Spain | 478 | 862 | (384) | (44.6) | (44.6) |
| Portugal | 114 | 122 | (8) | (6.3) | (6.3) |
| Poland | 334 | 329 | 5 | 1.4 | 1.7 |
| Santander Consumer Finance | 794 | 724 | 69 | 9.6 | 9.6 |
| **United Kingdom*** | **1,149** | **1,034** | **115** | **11.1** | **16.4** |
| **Latin America** | **3,257** | **4,262** | **(1,004)** | **(23.6)** | **(16.3)** |
| o/w: Brazil | 1,577 | 2,188 | (611) | (27.9) | (17.8) |
| Mexico | 713 | 1,009 | (296) | (29.3) | (29.2) |
| Chile | 435 | 490 | (55) | (11.2) | (6.6) |
| **USA** | **724** | **805** | **(82)** | **(10.1)** | **(7.1)** |
| **Operating areas*** | **6,257** | **7,466** | **(1,209)** | **(16.2)** | **(10.9)** |
| Corporate Activities* | (1,887) | (2,125) | 238 | (11.2) | (11.2) |
| **Total Group*** | **4,370** | **5,341** | **(971)** | **(18.2)** | **(10.7)** |
| Net capital gains and provisions | — | (3,047) | 3,047 | (100.0) | (100.0) |
| **Total Group** | **4,370** | **2,295** | **2,075** | **90.5** | **136.8** |

*.- Excluding net capital gains and provisions

| CUSTOMER LOANS (EUR Million) | 2013 | 2012 | Amount | % | % w/o FX |
|---|---|---|---|---|---|
| **Continental Europe** | **266,355** | **283,427** | **(17,072)** | **(6.0)** | **(5.7)** |
| o/w: Spain | 159,752 | 178,426 | (18,674) | (10.5) | (10.5) |
| Portugal | 24,482 | 25,960 | (1,478) | (5.7) | (5.7) |
| Poland | 16,214 | 9,732 | 6,482 | 66.6 | 69.9 |
| Santander Consumer Finance | 56,024 | 56,683 | (659) | (1.2) | (1.2) |
| **United Kingdom** | **231,046** | **249,157** | **(18,111)** | **(7.3)** | **(5.3)** |
| **Latin America** | **132,542** | **140,090** | **(7,547)** | **(5.4)** | **10.0** |
| o/w: Brazil | 66,446 | 74,511 | (8,065) | (10.8) | 7.4 |
| Mexico | 22,269 | 20,384 | 1,886 | 9.3 | 14.9 |
| Chile | 28,783 | 29,677 | (894) | (3.0) | 11.2 |
| **USA** | **37,682** | **41,331** | **(3,649)** | **(8.8)** | **(4.7)** |
| **Operating areas** | **667,625** | **714,004** | **(46,379)** | **(6.5)** | **(2.7)** |
| **Total Group** | **668,856** | **719,112** | **(50,257)** | **(7.0)** | **(3.3)** |

| CUSTOMER DEPOSITS (EUR Million) | 2013 | 2012 | Amount | % | % w/o FX |
|---|---|---|---|---|---|
| **Continental Europe** | **256,138** | **256,154** | **(16)** | **(0.0)** | **0.1** |
| o/w: Spain | 181,117 | 187,261 | (6,144) | (3.3) | (3.3) |
| Portugal | 24,191 | 23,971 | 219 | 0.9 | 0.9 |
| Poland | 18,503 | 11,217 | 7,286 | 65.0 | 68.2 |
| Santander Consumer Finance | 30,878 | 31,892 | (1,014) | (3.2) | (3.2) |
| **United Kingdom** | **187,467** | **194,452** | **(6,985)** | **(3.6)** | **(1.5)** |
| **Latin America** | **125,844** | **134,765** | **(8,921)** | **(6.6)** | **8.3** |
| o/w: Brazil | 61,490 | 69,849 | (8,359) | (12.0) | 6.1 |
| Mexico | 24,663 | 24,743 | (80) | (0.3) | 4.8 |
| Chile | 20,988 | 22,411 | (1,423) | (6.3) | 7.4 |
| **USA** | **35,537** | **38,116** | **(2,579)** | **(6.8)** | **(2.5)** |
| **Operating areas** | **604,986** | **623,487** | **(18,501)** | **(3.0)** | **1.0** |
| **Total Group** | **607,836** | **626,639** | **(18,802)** | **(3.0)** | **1.0** |

## CONTINENTAL EUROPE

EUR Million

| INCOME STATEMENT | 2013 | 2012 | Variation Amount | % | % w/o FX |
|---|---|---|---|---|---|
| **Net interest income** | **8,123** | **8,854** | **(731)** | **(8.3)** | **(8.1)** |
| Net fees | 3,551 | 3,624 | (73) | (2.0) | (2.0) |
| Gains (losses) on financial transactions | 775 | 306 | 469 | 153.6 | 153.7 |
| Other operating income[1] | 135 | 183 | (48) | (26.0) | (26.0) |
| **Gross income** | **12,585** | **12,967** | **(382)** | **(2.9)** | **(2.8)** |
| Operating expenses | (6,576) | (6,457) | (119) | 1.8 | 1.9 |
| General administrative expenses | (5,807) | (5,790) | (17) | 0.3 | 0.4 |
| *Personnel* | *(3,527)* | *(3,498)* | *(29)* | *0.8* | *0.9* |
| *Other general administrative expenses* | *(2,280)* | *(2,292)* | *12* | *(0.5)* | *(0.4)* |
| Depreciation and amortisation | (769) | (667) | (102) | 15.2 | 15.3 |
| **Net operating income** | **6,009** | **6,510** | **(501)** | **(7.7)** | **(7.5)** |
| Net loan-loss provisions | (3,603) | (4,104) | 501 | (12.2) | (12.1) |
| Other income | (760) | (575) | (186) | 32.3 | 32.3 |
| **Ordinary profit before taxes** | **1,646** | **1,832** | **(186)** | **(10.2)** | **(9.8)** |
| Tax on profit | (376) | (412) | 36 | (8.7) | (8.2) |
| **Ordinary profit from continuing operations** | **1,270** | **1,420** | **(150)** | **(10.6)** | **(10.3)** |
| Net profit from discontinued operations | (6) | (7) | 1 | (15.0) | (12.9) |
| **Ordinary consolidated profit** | **1,264** | **1,413** | **(149)** | **(10.6)** | **(10.2)** |
| Minority interests | 137 | 48 | 89 | 182.8 | 183.7 |
| **Ordinary attributable profit to the Group** | **1,127** | **1,365** | **(238)** | **(17.4)** | **(17.1)** |
| Net capital gains and provisions | — | (4,110) | 4,110 | (100.0) | (100.0) |
| **Attributable profit to the Group** | **1,127** | **(2,745)** | **3,872** | **—** | **—** |

| BALANCE SHEET | | | | | |
|---|---|---|---|---|---|
| Customer loans[2] | 266,355 | 283,427 | (17,072) | (6.0) | (5.7) |
| Trading portfolio (w/o loans) | 50,317 | 87,992 | (37,675) | (42.8) | (42.8) |
| Available-for-sale financial assets | 37,319 | 38,309 | (990) | (2.6) | (2.4) |
| Due from credit institutions[2] | 38,506 | 49,020 | (10,514) | (21.4) | (21.3) |
| Intangible assets and property and equipment | 6,297 | 5,697 | 600 | 10.5 | 10.7 |
| Other assets | 37,847 | 30,827 | 7,020 | 22.8 | 23.0 |
| **Total assets/liabilities & shareholders' equity** | **436,641** | **495,272** | **(58,631)** | **(11.8)** | **(11.6)** |
| Customer deposits[2] | 256,138 | 256,154 | (16) | (0.0) | 0.1 |
| Marketable debt securities[2] | 16,781 | 21,119 | (4,338) | (20.5) | (19.9) |
| Subordinated debt[2] | 406 | 118 | 287 | 242.6 | 248.3 |
| Insurance liabilities | 1,430 | 1,425 | 5 | 0.3 | 0.3 |
| Due to credit institutions[2] | 59,041 | 78,177 | (19,136) | (24.5) | (23.8) |
| Other liabilities | 77,194 | 107,245 | (30,051) | (28.0) | (28.0) |
| Shareholders' equity[3] | 25,651 | 31,034 | (5,382) | (17.3) | (17.0) |
| **Other customer funds under management** | **50,962** | **43,391** | **7,570** | **17.4** | **17.6** |
| Mutual and pension funds | 44,323 | 37,156 | 7,168 | 19.3 | 19.4 |
| Managed portfolios | 6,638 | 6,236 | 403 | 6.5 | 6.5 |
| **Customer funds under management** | **324,286** | **320,783** | **3,504** | **1.1** | **1.2** |

| RATIOS (%) AND OPERATING MEANS | | | |
|---|---|---|---|
| ROE | 3.84 | 4.38 | (0.53 p.) |
| Efficiency ratio (with amortisations) | 52.3 | 49.8 | 2.5 p. |
| NPL ratio | 9.13 | 6.29 | 2.84 p. |
| NPL coverage | 57.3 | 73.0 | (15.7 p.) |
| Number of employees | 58,383 | 57,941 | 0.8 |
| Number of branches | 6,160 | 6,437 | (4.3) |

1. Including dividends, income from equity-accounted method and other operating income/expenses
2. Including all on-balance sheet balances for this item
3. Not including profit of the year

## ■ CONTINENTAL EUROPE

→ **Attributable profit of EUR 1,127** compared to a loss of EUR 2,745 million in 2012 because of real estate provisions.

- Comparisons affected by the impact on net interest income of low interest rates and sluggish macroeconomic growth.
- Flat expenses at constant perimeter (-0.8%) and lower ordinary provisions (-12.2%).

→ **Growth strategy:** maintain liquidity, with greater focus on costs in the second half of the year in a context of low demand for loans.

Continental Europe includes all activities carried out in this zone: retail banking, global wholesale banking, asset management and insurance, as well as Spain run-off real estate.

### Strategy

The main actions in 2013 focused on developing the mergers of retail networks in Spain and the banks in Poland. Also, in a still weak environment and with low interest rates, the general strategic lines of the last three years were maintained:

- Defending spreads on loans and on deposits.
- Greater focus on reducing the cost of funds, after reaching a comfortable liquidity position.
- Control of costs.
- Active risk management.

### Activity

Customer lending was 4% lower, reflecting deleveraging in the real estate sector and the low demand for loans in Spain and Portugal. On the other hand, lending grew in Poland (from the consolidation of Kredyt Bank) and more stable balances in Santander Consumer Finance.

The combined customer deposits (excluding repos and including retail commercial paper in Spain), mutual and pension funds increased 2%. By unit, Spain rose 1%, very affected by the strategy to reduce the more expensive institutional balances, as retail balances rose EUR 10,000 million. In the rest of units, lower balances in Portugal and Santander Consumer Finance, and 69% growth in Poland in local currency (1% excluding perimeter).

### Results

Comparisons with 2012 are affected by the perimeter. On the one hand, a positive impact from the consolidation of Kredyt Bank in Poland and, on the other, a negative effect from the reinsurance operation in Spain and Portugal. The overall impact was 2 p.p. positive in revenues and 6 p.p. negative in ordinary attributable profit.

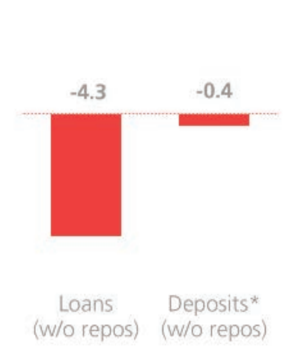
Gross income declined 2.9% due to the 8.3% fall in net interest income, which still reflects the economic weakness, low interest rates, a still high average cost of deposits and repricing of mortgages. Trading gains improved their contribution (wholesale businesses).

Operating expenses rose 1.8%, basically due to the perimeter in Poland, as on a like-for-like basis they were lower (-0.8%), with a downward or stable trend in all units.

Loan-loss provisions were 12.2% lower year-on-year. Higher minority interests in Poland due to the integration of Kredyt Bank.

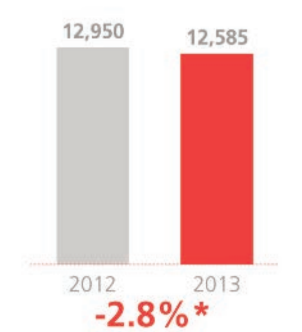
Attributable profit was EUR 1,127 million, 17.4% lower than 2012 before real estate provisions. Including these provisions, the area recorded a loss of EUR 2,745 million in 2012.

■ ACTIVITY
% var. 2013/12 (constant EUR)



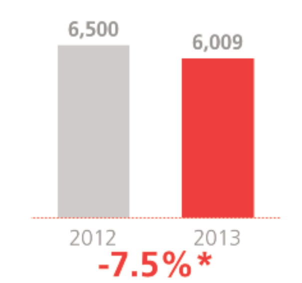

* Including retail commercial paper

■ GROSS INCOME
Constant EUR Million



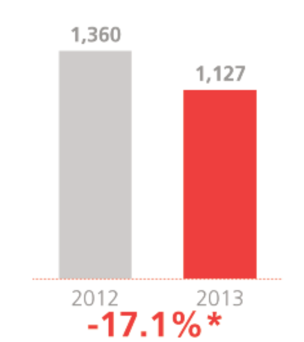

* In euros: -2.9%

■ NET OPERATING INCOME
Constant EUR Million




* In euros: -7.7%

■ ORDINARY ATTRIB. PROFIT
Constant EUR Million




* In euros: -17.4%

## SPAIN

EUR Million

| INCOME STATEMENT | 2013 | 2012 | Variation Amount | % |
|---|---|---|---|---|
| **Net interest income** | **4,371** | **5,168** | **(797)** | **(15.4)** |
| Net fees | 1,901 | 2,049 | (148) | (7.2) |
| Gains (losses) on financial transactions | 611 | 216 | 396 | 183.5 |
| Other operating income[1] | 136 | 248 | (111) | (44.9) |
| **Gross income** | **7,020** | **7,681** | **(661)** | **(8.6)** |
| Operating expenses | (3,769) | (3,823) | 54 | (1.4) |
| General administrative expenses | (3,377) | (3,457) | 80 | (2.3) |
| *Personnel* | *(2,134)* | *(2,208)* | *74* | *(3.3)* |
| *Other general administrative expenses* | *(1,243)* | *(1,249)* | *6* | *(0.5)* |
| Depreciation and amortisation | (392) | (366) | (26) | 7.2 |
| **Net operating income** | **3,251** | **3,858** | **(607)** | **(15.7)** |
| Net loan-loss provisions | (2,411) | (2,473) | 62 | (2.5) |
| Other income | (136) | (128) | (8) | 6.3 |
| **Profit before taxes** | **704** | **1,257** | **(553)** | **(44.0)** |
| Tax on profit | (225) | (393) | 168 | (42.8) |
| **Profit from continuing operations** | **479** | **864** | **(385)** | **(44.6)** |
| Net profit from discontinued operations | 0 | — | 0 | — |
| **Consolidated profit** | **479** | **864** | **(385)** | **(44.6)** |
| Minority interests | 1 | 2 | (1) | (32.7) |
| **Attributable profit to the Group** | **478** | **862** | **(384)** | **(44.6)** |

| BALANCE SHEET | | | | |
|---|---|---|---|---|
| Customer loans[2] | 159,752 | 178,426 | (18,674) | (10.5) |
| Trading portfolio (w/o loans) | 47,062 | 78,456 | (31,394) | (40.0) |
| Available-for-sale financial assets | 25,608 | 29,681 | (4,073) | (13.7) |
| Due from credit institutions[2] | 25,050 | 24,784 | 266 | 1.1 |
| Intangible assets and property and equipment | 4,261 | 4,160 | 100 | 2.4 |
| Other assets | 19,101 | 13,238 | 5,864 | 44.3 |
| **Total assets/liabilities & shareholders' equity** | **280,834** | **328,746** | **(47,911)** | **(14.6)** |
| Customer deposits[2] | 181,117 | 187,261 | (6,144) | (3.3) |
| Marketable debt securities[2] | 3,953 | 11,538 | (7,586) | (65.7) |
| Subordinated debt[2] | 8 | 8 | 0 | 5.3 |
| Insurance liabilities | 525 | 963 | (438) | (45.5) |
| Due to credit institutions[2] | 22,848 | 28,411 | (5,563) | (19.6) |
| Other liabilities | 60,815 | 87,066 | (26,251) | (30.2) |
| Shareholders' equity[3] | 11,569 | 13,499 | (1,930) | (14.3) |
| **Other customer funds under management** | **44,793** | **36,122** | **8,672** | **24.0** |
| Mutual and pension funds | 39,583 | 32,211 | 7,372 | 22.9 |
| Managed portfolios | 5,210 | 3,911 | 1,299 | 33.2 |
| **Customer funds under management** | **229,870** | **234,928** | **(5,058)** | **(2.2)** |

| RATIOS (%) AND OPERATING MEANS | | | | |
|---|---|---|---|---|
| ROE | 4.03 | 6.27 | (2.24 p.) | |
| Efficiency ratio (with amortisations) | 53.7 | 49.8 | 3.9 p. | |
| NPL ratio | 7.49 | 3.84 | 3.65 p. | |
| NPL coverage | 44.0 | 50.0 | (6.0 p.) | |
| Number of employees | 27,406 | 29,714 | (7.8) | |
| Number of branches | 4,067 | 4,611 | (11.8) | |

1. Including dividends, income from equity-accounted method and other operating income/expenses
2. Including all on-balance sheet balances for this item
3. Not including profit of the year

## SPAIN

- **Attributable profit of EUR 478,** 44.6% less than in 2012.
- **Loan-loss provisions** still high, but returning to normal.
- The comfortable **liquidity** position (LTD: 87%) enabled the development of a strategy to improve funding costs.
- **Lower costs** backed by efficiency plans and integration's first synergies.
- In **business activity,** deleveraging continued. Mutual funds rose 29%.

**Economic and financial environment**

The economy shrank in 2013, but showed signs of a gradual stabilization. Quarter-on-quarter growth was slightly positive in the third and fourth quarters (+0.1% and +0.3%, respectively), ending eight straight quarters of falls.

The recovery was due to domestic demand, thanks to some improvement in private consumption and investment in capital goods, which offset the fall in construction and public spending. Export growth also supported the change in trend. The jobless rate remained very high, but there has been a change of trend and jobs were created in net terms in the fourth quarter.

The progress in structural reforms, the restructuring of the banking sector and the exit from the European Stability Mechanism's bailout programme for ailing banks helped to restore international confidence in the Spanish economy, underscored by the sustained fall in the risk premium. Rating agencies improved their view of the economy.

Average inflation was 1.4%, but at the end of the year, excluding the impact of the VAT rise in September 2012, the annual rate was slightly above 0%.

The banking system continued to be affected by deleveraging of companies and households and, as a result, by reduced demand for loans, low interest rates (the ECB's benchmark rate was 0.5%), which still weighed on net interest income, and the high NPL ratio at a record 13.6% in December.

Lending to the resident private sector was down 9%, and it was particularly intense in that to companies (immersed in cleaning up their balance sheets). Deposits grew 4% both from companies and households.

**Strategy**

Santander Spain has a solid commercial presence (4,067 branches, 5,352 ATMs and more than 14 million customers) and is strengthened with global businesses in products and key segments (wholesale banking, asset management, insurance and cards).

In order to consolidate the Group's leadership in Spain and increase profitability and efficiency, Santander is merging its two large retail networks (Santander and Banesto) and its private bank (Banif).

The integration is on schedule, and even ahead of the initial forecasts in some areas. The process of branch concentration and optimization began in July, together with optimization of staff. This is running ahead of schedule in order to bring forward the obtaining of cost synergies.

**Activity**

Following the large volume of deposits captured in 2012 and the beginning of 2013, which is reflected in an organic gain in market share of around 200 b.p. in the last two years, the priority in the last few quarters has been to reduce the cost of deposits and develop a policy to retain customers via mutual funds and savings-insurance products.

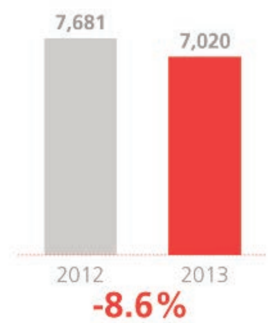
The effort made to manage funds more profitably was reflected in an improvement of 170 b.p. in the cost of new

ACTIVITY
% var. 2013/2012 (euros)


* Including retail commercial paper

NET INTEREST INCOME / ATAs
%


GROSS INCOME
EUR Million



time deposits during 2013, which is beginning to feed through to the reduction in the cost of the stock of customer deposits (-42 b.p. since the end of 2012 and which will gather pace in the coming quarters).

This strategy and the excellent liquidity position resulted in a fall of EUR 6,755 million (-3%) in total managed funds (deposits, repos, retail commercial paper, mutual and pension funds) to EUR 224,253 million at the end of the year.

This reduction was due to repos (-EUR 7,771 million) and the strategy of not renewing expensive institutional deposits, which hid the good performance of retail funds (deposits, mutual and pension funds) as they rose by more than EUR 10,000 million. Mutual funds increased 29% and the Group recovered its leadership position (+148 b.p. in market share).

In lending, the Group launched the *Plan 10.000* to gain share in a market that is still sluggish with significant falls. Activity was stepped up in loans to third parties via credit lines from the Official Credit Institute (ICO) and the European Investment Bank (EIB). In the case of ICO, activity was 52% higher, with 75% of total loans in the second half of 2013.

Gross lending, excluding repos, declined 8%, partly due to the cancellation of the public sector's financing to pay suppliers that represented almost all the fall in the fourth quarter.

The liquidity position improved: net loan-to-deposit ratio of 87% (90% in 2012).

The NPL ratio was 7.49% (+365 b.p.). This rise was due to several components: the impact of deleveraging on the denominator (which explains 74 b.p.), the aforementioned reclassification of balances in June (95 b.p.), and some deterioration in the lending portfolio, mainly in the companies segment. Coverage was 44%.

**Results**

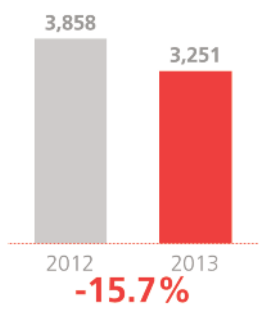
Attributable profit was EUR 478 million (-44.6%).

The results were conditioned by the large loan-loss provisions at this moment in the cycle, which amounted to EUR 2,411 million, similar to those in 2012.

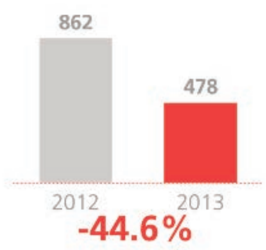
The fall in gross income reflects reduced business volumes, the repricing of mortgages and a lower cost of new deposits, which has not yet fed through to the total stock. The trend, however, is improving, and net interest income rose 3.2% in the fourth quarter over the third quarter.

Operating expenses were 1.4% lower. This fall was larger in the fourth quarter (-4.7% over the third quarter), reflecting the first savings from the merger and the fruits of efficiency plans.

NET OPERATING INCOME
EUR Million




ATTRIBUTABLE PROFIT
EUR Million




**Strategy and objectives in 2014**

- Gain market share in the most attractive segments.
- Increase customer linkage and satisfaction.
- Bring forward the merger synergies, and implement the efficiency plan and productivity.
- Grow revenues by reducing the cost of deposits.
- Improve the cost of credit.
- Increase lending in target segments.

## PORTUGAL

EUR Million

| INCOME STATEMENT | 2013 | 2012 | Variation Amount | % |
|---|---|---|---|---|
| **Net interest income** | **514** | **570** | **(56)** | **(9.8)** |
| Net fees | 318 | 328 | (11) | (3.3) |
| Gains (losses) on financial transactions | 51 | 109 | (58) | (53.3) |
| Other operating income[1] | 34 | 30 | 4 | 12.1 |
| **Gross income** | **916** | **1,037** | **(121)** | **(11.6)** |
| Operating expenses | (495) | (507) | 11 | (2.2) |
| General administrative expenses | (417) | (425) | 9 | (2.1) |
| *Personnel* | *(299)* | *(306)* | *7* | *(2.4)* |
| *Other general administrative expenses* | *(118)* | *(120)* | *1* | *(1.2)* |
| Depreciation and amortisation | (79) | (81) | 2 | (2.9) |
| **Net operating income** | **421** | **531** | **(110)** | **(20.7)** |
| Net loan-loss provisions | (192) | (393) | 200 | (51.0) |
| Other income | (78) | (11) | (67) | 624.3 |
| **Profit before taxes** | **150** | **127** | **23** | **18.5** |
| Tax on profit | (44) | (5) | (39) | 839.5 |
| **Profit from continuing operations** | **106** | **122** | **(16)** | **(13.0)** |
| Net profit from discontinued operations | — | — | — | — |
| **Consolidated profit** | **106** | **122** | **(16)** | **(13.0)** |
| Minority interests | (8) | 0 | (8) | — |
| **Attributable profit to the Group** | **114** | **122** | **(8)** | **(6.3)** |

| BALANCE SHEET | | | | |
|---|---|---|---|---|
| Customer loans[2] | 24,482 | 25,960 | (1,478) | (5.7) |
| Trading portfolio (w/o loans) | 1,831 | 1,947 | (117) | (6.0) |
| Available-for-sale financial assets | 4,724 | 4,023 | 701 | 17.4 |
| Due from credit institutions[2] | 2,895 | 3,527 | (632) | (17.9) |
| Intangible assets and property and equipment | 821 | 382 | 438 | 114.7 |
| Other assets | 7,096 | 6,047 | 1,049 | 17.3 |
| **Total assets/liabilities & shareholders' equity** | **41,848** | **41,887** | **(39)** | **(0.1)** |
| Customer deposits[2] | 24,191 | 23,971 | 219 | 0.9 |
| Marketable debt securities[2] | 2,329 | 3,492 | (1,163) | (33.3) |
| Subordinated debt[2] | 0 | 0 | 0 | 27.7 |
| Insurance liabilities | 75 | 87 | (12) | (13.6) |
| Due to credit institutions[2] | 12,319 | 11,721 | 598 | 5.1 |
| Other liabilities | 356 | 195 | 161 | 82.6 |
| Shareholders' equity[2] | 2,579 | 2,421 | 158 | 6.5 |
| **Other customer funds under management** | **2,041** | **2,421** | **(380)** | **(15.7)** |
| Mutual and pension funds | 1,898 | 2,331 | (433) | (18.6) |
| Managed portfolios | 142 | 90 | 52 | 57.8 |
| **Customer funds under management** | **28,560** | **29,884** | **(1,324)** | **(4.4)** |

| RATIOS (%) AND OPERATING MEANS | | | | |
|---|---|---|---|---|
| ROE | 4.49 | 4.84 | (0.35 p.) | |
| Efficiency ratio (with amortisations) | 54.1 | 48.8 | 5.2 p. | |
| NPL ratio | 8.12 | 6.56 | 1.56 p. | |
| NPL coverage | 50.0 | 53.1 | (3.1 p.) | |
| Number of employees | 5,635 | 5,719 | (1.5) | |
| Number of branches | 640 | 667 | (4.0) | |

1. Including dividends, income from equity-accounted method and other operating income/expenses
2. Including all on-balance sheet balances for this item
3. Not including profit of the year

## PORTUGAL

- **Attributable profit of EUR 114 million,** 6.3% less than in 2012 as a result of the higher tax charge.

- **Pre-tax profit up** 18.5% at **EUR 150 million,** due to:
  - Fall of 11.6% in gross income from the repurchase of securities in the first half of 2012. Lending was lower and the average cost of funding higher.
  - Operating expenses fell 2.2%.
  - Provisions dropped 51.0%, partly due to the large volume assigned in the first quarter of 2012.

- The **loan-to-deposit ratio** improved to 101%.

### Economic environment

The economy improved a little in 2013, although growth was moderate. After registering the strongest growth for the year in the second quarter (+1.1%), GDP grew by only 0.2% in the third quarter, based on a pick-up in domestic demand, particularly private consumption and investment, confirming a sustainable trend of a gradual exit from recession.

The improvement in private consumption is based on the recovery in the labour market: the jobless rate fell to 15.3% in the fourth quarter from 17.7% in the first. Furthermore, confidence surveys (households and companies) also show a gradual improvement in labour market conditions.

The 2014 budget was approved, although some measures need the approval of the Constitutional Court, in particular cuts in salaries and pensions for civil servants, which is the main risk for meeting the deficit target of 4.0% of GDP. The 10th assessment of the economic and financial adjustment plan is underway, which will serve as the basis of discussion for the post-programme period.

Long-term interest rates have fallen thanks to the improved risk perception and the 10-year government bond yield dropped below 6%. This improvement enabled the Treasury to swap EUR 6,000 million of debt maturing in 2014 and 2015 for debt with maturities in 2017 and 2018, facilitating access to international markets in 2014.

### Strategy

Santander Totta's strategy remained very focused on increasing linkage and improving the transaction levels of customers and defending spreads on deposits and loans.

In order to boost business volumes and market shares in the segment of SMEs, Santander Totta launched advertising campaigns throughout 2013. Of note was the *Plan Activaçao Santander Totta* and *Abrimos Portas ao Desemvolvimento da sua Empresa.*

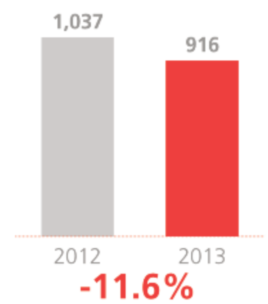
Management of bad loans also remained a strategic priority, with preventative actions above all.

The capital ratios remained very solid throughout the year. The core capital ratio was 15.2% at the end of 2013 (+2.9 p.p.). As regards liquidity management, the Bank's position remained very comfortable with a pool of sufficient assets available if needed to fund itself in the repo market or the ECB. Lastly the Bank maintained its capacity to generate positive results.

**ACTIVITY**
% var. 2013/2012 (euros)


**NET INTEREST INCOME / ATAs**
%


**GROSS INCOME**
EUR Million



**Activity**

At the end of 2013, deposits stood at EUR 24,191 million, 1% more than a year earlier (-4% excluding repos). Lending continued to decline, although at a more moderate rate (-1% in the fourth quarter and -5% for the whole year).

Santander Totta's NPL ratio was 8.12% at the end of the year, up from 6.56% in 2012 because of the difficult macroeconomic environment. Coverage was 50% (53% in December 2012). In local criteria, the NPL and coverage ratios were significantly better than Portugal's average.

**Results**

Gross income declined 11.6% to EUR 916 million, partially affected by the capital gain obtained in 2012 in the repurchase of securities which brought trading gains to EUR 109 million compared to EUR 51 million in 2013.

Net interest income fell 9.8% to EUR 514 million, which mainly reflected reduced lending and the higher average cost of funding. Of note was the improved trend in net interest income throughout the year, due to the decline in the cost of ECB funding and of deposits. This enabled recovery of spreads in the second half of 2013 and stabilised net interest income in the last few quarters, which were all higher than the fourth quarter of 2012 and the first of 2013.

Fee income was 3.3% lower year-on-year, impacted by lower business volumes and the new regulatory environment. Those from wholesale business performed well.

Other income was 12.1% higher despite reduced revenues from insurance, as a result of the agreement signed in July 2012 to reinsure the portfolio of individual risk.

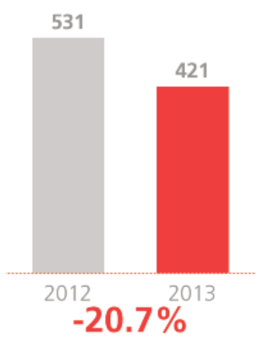
Trading gains declined 53.3%, largely due to the capital gain in 2012 from the repurchase of securities.

Operating expenses were still performing well, and the policy of optimising the commercial network to the sluggish business environment remained in force. Costs fell 2.2%, with personnel expenses down 2.4%, general ones 1.2% and amortisations 2.9%. The efficiency ratio was 54.1%.

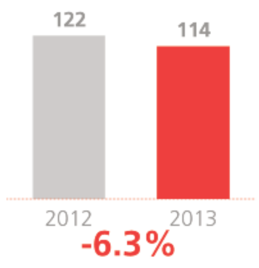
Loan-loss provisions dropped 51.0% to EUR 192 million, due to the reduced need for provisions in the last few quarters (lower cost of credit throughout the year) and the high ones in 2012.

Pre-tax profit was 18.5% higher at EUR 150 million. This was not reflected in attributable profit because of the higher tax charge.

**NET OPERATING INCOME**
EUR Million




**ATTRIBUTABLE PROFIT**
EUR Million




**Strategy and objectives in 2014**

- In companies: focus on profitability and gain in market share. Increase transactions. Priority in international business.
- In individual customers and SMEs: normalise the cost of funds. Growth in transactions.
- Measures to minimise regulatory impacts.
- Optimise costs: manage the commercial opportunity offered by the closure of competitors' branches.

## POLAND

EUR Million

| INCOME STATEMENT | 2013 | 2012 | Variation Amount | % | % w/o FX |
|---|---|---|---|---|---|
| **Net interest income** | **781** | **541** | **240** | **44.4** | **44.9** |
| Net fees | 424 | 331 | 93 | 28.2 | 28.6 |
| Gains (losses) on financial transactions | 119 | 79 | 39 | 49.4 | 49.9 |
| Other operating income[1] | 7 | 16 | (9) | (55.2) | (55.1) |
| **Gross income** | **1,331** | **967** | **364** | **37.6** | **38.1** |
| Operating expenses | (601) | (425) | (175) | 41.2 | 41.7 |
| General administrative expenses | (547) | (391) | (156) | 39.9 | 40.4 |
| *Personnel* | *(318)* | *(234)* | *(84)* | *36.1* | *36.6* |
| *Other general administrative expenses* | *(229)* | *(158)* | *(72)* | *45.4* | *45.9* |
| Depreciation and amortisation | (54) | (34) | (19) | 56.7 | 57.2 |
| **Net operating income** | **731** | **542** | **189** | **34.8** | **35.3** |
| Net loan-loss provisions | (167) | (112) | (55) | 49.0 | 49.5 |
| Other income | (6) | (1) | (5) | 599.2 | 601.6 |
| **Profit before taxes** | **557** | **429** | **129** | **30.0** | **30.5** |
| Tax on profit | (110) | (87) | (23) | 26.8 | 27.3 |
| **Profit from continuing operations** | **447** | **342** | **105** | **30.9** | **31.3** |
| Net profit from discontinued operations | — | — | — | — | — |
| **Consolidated profit** | **447** | **342** | **105** | **30.9** | **31.3** |
| Minority interests | 113 | 13 | 101 | 805.4 | 808.5 |
| **Attributable profit to the Group** | **334** | **329** | **5** | **1.4** | **1.7** |

| BALANCE SHEET | | | | | |
|---|---|---|---|---|---|
| Customer loans[2] | 16,214 | 9,732 | 6,482 | 66.6 | 69.9 |
| Trading portfolio (w/o loans) | 532 | 175 | 357 | 204.7 | 210.7 |
| Available-for-sale financial assets | 5,325 | 2,876 | 2,449 | 85.2 | 88.8 |
| Due from credit institutions[2] | 667 | 394 | 273 | 69.2 | 72.5 |
| Intangible assets and property and equipment | 273 | 146 | 127 | 86.6 | 90.3 |
| Other assets | 2,095 | 1,527 | 567 | 37.2 | 39.9 |
| **Total assets/liabilities & shareholders' equity** | **25,106** | **14,850** | **10,255** | **69.1** | **72.4** |
| Customer deposits[2] | 18,503 | 11,217 | 7,286 | 65.0 | 68.2 |
| Marketable debt securities[2] | 121 | — | 121 | — | — |
| Subordinated debt[2] | 333 | 100 | 233 | 231.9 | 238.5 |
| Insurance liabilities | 84 | — | 84 | — | — |
| Due to credit institutions[2] | 1,206 | 478 | 728 | 152.1 | 157.1 |
| Other liabilities | 2,984 | 1,258 | 1,726 | 137.2 | 141.9 |
| Shareholders' equity[3] | 1,875 | 1,796 | 79 | 4.4 | 6.4 |
| **Other customer funds under management** | **2,789** | **2,594** | **195** | **7.5** | **9.6** |
| Mutual and pension funds | 2,683 | 2,443 | 239 | 9.8 | 12.0 |
| Managed portfolios | 106 | 150 | (44) | (29.5) | (28.1) |
| **Customer funds under management** | **21,745** | **13,911** | **7,834** | **56.3** | **59.4** |

| RATIOS (%) AND OPERATING MEANS | | | |
|---|---|---|---|
| ROE | 17.68 | 18.93 | (1.24 p.) |
| Efficiency ratio (with amortisations) | 45.1 | 44.0 | 1.1 p. |
| NPL ratio | 7.84 | 4.72 | 3.12 p. |
| NPL coverage | 61.8 | 68.3 | (6.5 p.) |
| Number of employees | 12,363 | 8,852 | 39.7 |
| Number of branches | 830 | 519 | 59.9 |

1. Including dividends, income from equity-accounted method and other operating income/expenses
2. Including all on-balance sheet balances for this item
3. Not including profit of the year

**■ POLAND (changes in local currency)**

- **Attributable profit of EUR 334 million.** Before minority interests it was 31.3% higher, due to the consolidation of Kredyt Bank.
- **Solid funding structure:** loan-to-deposit ratio of 88%.
- **Integration ahead of schedule.** Focus on boosting productivity in Kredyt Bank's branches.
- **Enhanced commercial activity,** with new products and services offered.
- **Several corporate transactions announced,** to continue strengthening our position in Poland, which are expected to be completed in 2014.

In two years, Santander has become the third largest bank in Poland in terms of loans and deposits (market shares of 7.4% and 8.4%, respectively). It has 830 branches and 113 agencies.

The Group's business model in Poland continues to focus on retail banking, including retail customers and companies (SMEs and large companies), coupled with a leading presence in asset management, brokerage of securities and leasing. All of this provides a significant earnings potential in the coming years, both via business as well as synergies.

### Economic environment

The economy slowed down considerably at the beginning of 2013, to 0.5% year-on-year in the first quarter, and then picked up to 1.7% in the third quarter and an expected 2% for the whole year. Economic growth in the first half of the year was driven by exports, as domestic demand remained stagnant. In the second half, domestic demand quickened, with a gradual acceleration of private consumption and investment returning to positive growth after declining in the previous four quarters. The relative weakness of domestic demand halted growth in imports, resulting in a sharp improvement in the current account deficit and a turnaround in the trade account from deficit to surplus for the first time since the middle of the 1990s.

A better outlook for exports stimulated industrial output, which grew by almost 5.5% year-on-year in the third quarter compared to a slight fall in the first half of 2013.

Inflation fell sharply until the middle of the year. Although it rose in the second half, it remained at around 1% (well below the target of 2.5%).

In response to the slowdown in the economy, the central bank cut its benchmark rate to a record low of 2.50% in July.

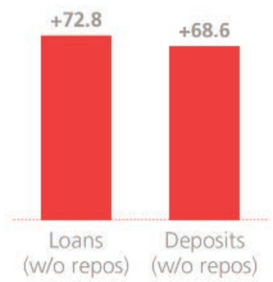
The zloty remained almost stable during 2013, fluctuating between PLN 4.10 and PLN 4.30/EUR 1.

### Strategy

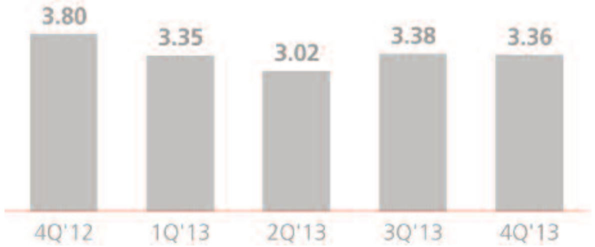
The merger of BZ WBK and Kredyt Bank is one of the main focuses of management. The process is proceeding faster than envisaged, with a very effective cost management made possible by the efficiency measures taken and the implementation of the integration plan. All branches already have the same IT systems and display the same brand. This rebranding was aided by a marketing campaign accross the country. The new merged bank is starting to reflect increased productivity and greater business activity (both in products and services).

BZ WBK continued to offer innovative products and solutions. These include the *Contactless card*, unique in the Polish market; *BZ WBK TFI*, the leader in acquiring retail funds and *BZ WBK Faktor* (factoring solutions), which doubled its market share in a year to 11%. BZ WBK was also the first bank to issue the *PayPass city* card (personalized and rechargeable card which is used for various urban activities) and the *PayPass school* card.

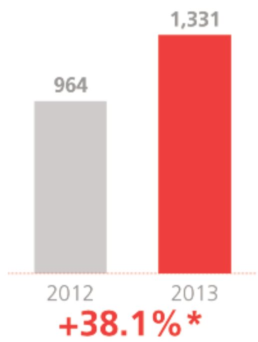
■ ACTIVITY
% var. 2013/2012 (zlotys)




■ NET INTEREST INCOME / ATAs
%




■ GROSS INCOME
Constant EUR Million




* In euros: +37.6%

Thanks to them, BZ WBK is the market leader in cards, electronic banking (more than two million users) and mobile banking (over 250,000 users). BZ WBK was recently awarded the Mobile Trends Awards in mobile banking, for its recognised application *BZWBK24* between experts and users.

As part of the integration process, the *Worth Recommending* account was launched in the second quarter. This was the first financial product marketed for all the customers of the branches of both banks (BZ WBK and KB), with the aim to increase customer loyalty in the future.

BZ WBK received the authorisation to reorganise its strategic co-operation with Aviva, which will serve to bolster the development of new insurance products and their distribution.

BZ WBK also announced the sale of its asset management business to Santander Asset Management. The operation is subject to approval by the corresponding authorities.

On the basis of the commitment acquired by Santander with the local authorities at the time of the merger with Kredyt Bank to restructure the Polish subsidiaries, it was agreed that BZ WBK would acquire from Santander Consumer Finance 60% of its subsidiary in Poland. The acquisition is expected to be completed in the second quarter of 2014 and is subject to approval by the corresponding authorities.

**Activity**

Poland had EUR 16,214 million of net loans at the end of 2013 and EUR 18,503 million of customer deposits, thereby maintaining a very solid funding structure underscored by its loan-to-deposit ratio of 88%. After the incorporation of Kredyt Bank, lending rose 73% and deposits 69%, in local currency.

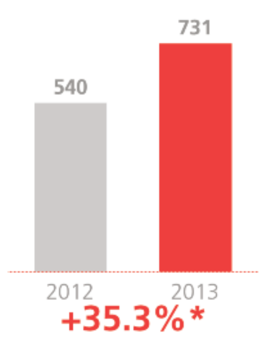
Excluding the perimeter impact, both loans and deposits increased 1%. The structure of the balance sheet, already mentioned, made it possible to focus on profitability, reducing the balances of expensive deposits and switching most of them to mutual funds (+12%).

**Results**

The comparison between 2013 and 2012 is not like-for-like because of the perimeter impact of the integration of Kredyt Bank. Attributable profit was EUR 334 million, 1.7% higher. Profit before minority interests was EUR 447 million (+31.3%), with growth of more than 30% throughout the income statement.

On a like-for-like basis, in local criteria and with the pro-forma of the two banks, net profit was 3.9% higher. Gross income performed well, underscored by good management of spreads, amid an environment of sharp drops in interest rates, and solid fee income. Operating expenses were 5.7% lower due to the synergies obtained ahead of schedule. Credit quality was also good.

**NET OPERATING INCOME**
Constant EUR Million




* In euros: +34.8%

**CONSOLIDATED PROFIT**
Constant EUR Million


* In euros: +30.9%

**Strategy and objectives in 2014**

- To become the bank of choice, while operating an optimum operational model taking advantage of synergies.
- In retail banking, multi distribution capability with value for money proposition in products and services.
- In corporate banking, a relationship banking proposition supporting the growth of SMEs.
- In Global Banking and Markets, sophisticated global and wholesale banking service working closely with large domestic and international clients.
- Continue to manage the capital and funding position to foster growth across all segments.

## SANTANDER CONSUMER FINANCE

EUR Million

| INCOME STATEMENT | 2013 | 2012 | Variation Amount | % |
|---|---|---|---|---|
| **Net interest income** | **2,333** | **2,389** | **(56)** | **(2.3)** |
| Net fees | 787 | 777 | 9 | 1.2 |
| Gains (losses) on financial transactions | (7) | (15) | 8 | (52.2) |
| Other operating income[1] | (2) | (10) | 9 | (82.4) |
| **Gross income** | **3,111** | **3,141** | **(30)** | **(1.0)** |
| Operating expenses | (1,391) | (1,381) | (10) | 0.7 |
| General administrative expenses | (1,172) | (1,216) | 44 | (3.6) |
| *Personnel* | *(646)* | *(624)* | *(22)* | *3.5* |
| *Other general administrative expenses* | *(526)* | *(592)* | *66* | *(11.1)* |
| Depreciation and amortisation | (219) | (166) | (54) | 32.5 |
| **Net operating income** | **1,720** | **1,760** | **(40)** | **(2.3)** |
| Net loan-loss provisions | (565) | (753) | 188 | (25.0) |
| Other income | (70) | (40) | (30) | 73.5 |
| **Profit before taxes** | **1,085** | **967** | **119** | **12.3** |
| Tax on profit | (255) | (201) | (54) | 26.8 |
| **Profit from continuing operations** | **830** | **765** | **65** | **8.5** |
| Net profit from discontinued operations | (6) | (7) | 1 | (15.0) |
| **Consolidated profit** | **824** | **759** | **66** | **8.7** |
| Minority interests | 31 | 34 | (4) | (10.5) |
| **Attributable profit to the Group** | **794** | **724** | **69** | **9.6** |

| BALANCE SHEET | | | | |
|---|---|---|---|---|
| Customer loans[2] | 56,024 | 56,683 | (659) | (1.2) |
| Trading portfolio (w/o loans) | 864 | 1,339 | (475) | (35.5) |
| Available-for-sale financial assets | 705 | 228 | 478 | 209.8 |
| Due from credit institutions[2] | 8,158 | 11,502 | (3,344) | (29.1) |
| Intangible assets and property and equipment | 934 | 999 | (65) | (6.5) |
| Other assets | 3,723 | 3,321 | 403 | 12.1 |
| **Total assets/liabilities & shareholders' equity** | **70,409** | **74,071** | **(3,662)** | **(4.9)** |
| Customer deposits[2] | 30,878 | 31,892 | (1,014) | (3.2) |
| Marketable debt securities[2] | 10,377 | 6,083 | 4,295 | 70.6 |
| Subordinated debt[2] | 64 | 10 | 54 | 526.3 |
| Insurance liabilities | — | — | — | — |
| Due to credit institutions[2] | 18,060 | 20,506 | (2,446) | (11.9) |
| Other liabilities | 3,901 | 4,530 | (629) | (13.9) |
| Shareholders' equity[3] | 7,128 | 11,050 | (3,921) | (35.5) |
| **Other customer funds under management** | **6** | **6** | **0** | **7.4** |
| Mutual and pension funds | 6 | 6 | 0 | 7.4 |
| Managed portfolios | — | — | — | — |
| **Customer funds under management** | **41,326** | **37,991** | **3,335** | **8.8** |

| RATIOS (%) AND OPERATING MEANS | | | | |
|---|---|---|---|---|
| ROE | 7.29 | 6.68 | 0.61 p. | |
| Efficiency ratio (with amortisations) | 44.7 | 44.0 | 0.7 p. | |
| NPL ratio | 4.01 | 3.90 | 0.11 p. | |
| NPL coverage | 105.3 | 109.5 | (4.2 p.) | |
| Number of employees | 11,695 | 12,282 | (4.8) | |
| Number of branches | 613 | 629 | (2.5) | |

1. Including dividends, income from equity-accounted method and other operating income/expenses
2. Including all on-balance sheet balances for this item
3. Not including profit of the year

## SANTANDER CONSUMER FINANCE

→ **Attributable profit of EUR 794 million,** 9.6% more than in 2012, in an environment of weak consumption and a fall in new car sales, with:

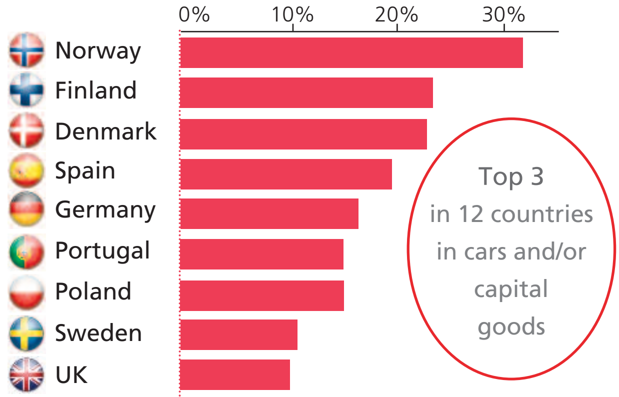
- Stable revenues (-1.0%), backed by higher fee income (+1.2%) and management of spreads.
- Flat costs (+0.7%).
- Lower loan-loss provisions (-25.0%).

→ **High credit quality** for the standards of the business: NPL ratio of 4.01% and coverage of 105%.

→ The area's strategy, penetration and diversification made possible further gains in market share in 2013.

### CAR FINANCING MARKET

Market share new business - new and used car




Source: Local Consumer Finance Assosiations or internal estimates based on the publics statistics

**Economic environment**

The units of Santander Consumer Finance (SCF) in Continental Europe conducted their business in a weak environment.

Despite the small recovery in the last few quarters, consumer finance business was hit throughout 2013 by negative year-on-year growth in private consumption (-1.2% in the first quarter and -0.4% in the third), falls which were higher in the peripheral European countries.

As a result, the area had to manage a decline in new car sales in its footprint (-4% for the whole year after a start to the year with double-digit declines) and the consequent impact on one of its main lines of business.

**Strategy**

SCF's good evolution is backed by a business model that is adapting well to this environment and enables it to gain profitable business market share. Its drivers are a wide geographic diversification and critical mass in key markets and products, a higher degree of efficiency than its peers and a common system of risk control and recoveries.

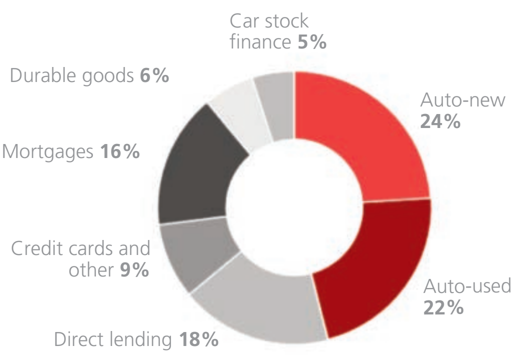
The main focal points in 2013 were:

- Cost management adjusted to the particular moment of the economic cycle, particularly in those markets undergoing deleveraging and whose economies are suffering the most.
- A locally autonomous funding model, based on recourse to wholesale markets and retail deposits.
- New lending impetus and cross-selling in accordance with the situation of each market (periphery, north and central Europe), backed by brand agreements and penetration of the used car market.

In Poland, under the agreements reached to acquire AIG Bank in 2010, SCF Poland bought in the last quarter of 2013 AIG's stake, making it the only shareholder.

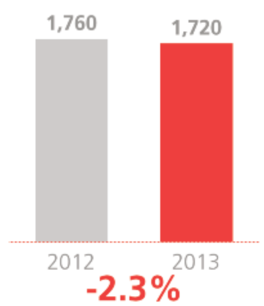
### PORTFOLIO DISTRIBUTION BY PRODUCTS

%



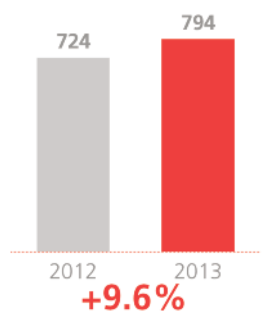

### NET OPERATING INCOME

EUR Million




### ATTRIBUTABLE PROFIT

EUR Million



### Activity

Gross lending remained at around EUR 58,500 million, slightly below 2012 (-1%). Growth in the units in Central and Northern Europe, particularly in the Nordic countries, and decline in periphery countries due to deleveraging.

New lending at December 2013 amounted to EUR 21,950 million (+1% y-o-y). Of note by product was the increased lending for durable goods (+6%), used vehicles (+4%), and in new vehicles (+2%) as against a 4% drop in new car sales in Santander's footprint.

Growth was concentrated in Poland (perimeter) and the Nordic countries (+20% in local currency), while Germany registered a 1% fall although this was better than the market. Spain and Portugal were more impacted by the environment and Italy accounted for the largest fall due to the new business focus.

On the liabilities side, SCF maintained a high volume of customer deposits (EUR 30,878 million), more so than its competitors and which confers stability on its funding.

As regards wholesale funding in the market, 10 securitisation and structured operations were made in 2013 (both private and public) in eight of the 12 countries where SCF operates for a total of more than EUR 4,200 million. These operations, together with those in the UK, made SCF Europe the largest issuer of auto securitisations. This underscores the attractiveness of the area's assets for the market and the high degree of diversification of its funding sources. Close to EUR 2,000 million of senior debt issues were also made.

At the end of 2013, customer deposits and medium and long-term issues-securitisations in the market covered 73% of the area's net lending, which, coupled with the permanent funds, enabled the area to be self-financed in net terms.

### Results

Attributable profit was 9.6% higher at EUR 794 million, with almost all units performing better.

Gross income was stable (-1.0%), absorbing the decline in lending and in official interest rates with management of spreads, a lower cost of funds and growth in fee income (+1.2%).

Costs were flat (+0.7%) absorbing the euro zone's average inflation (+1.4%). At the end of 2013, the efficiency ratio was 44.7%, an improvement over the start of the year when it was above 45%.

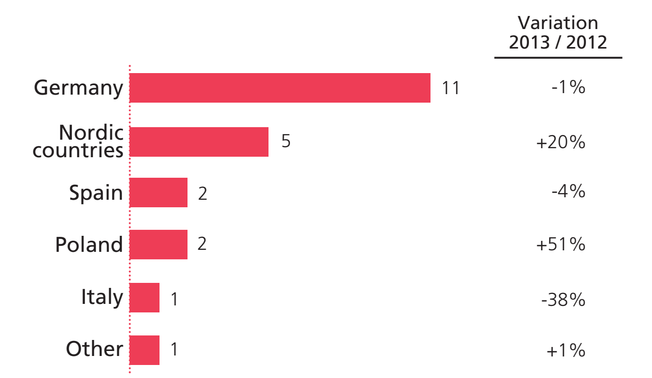
Loan-loss provisions were 25.0% lower than in 2012, and declined every quarter, bringing the cost of credit to the lowest level of the economic cycle. This trend reflects SCF's high credit quality for the standards of the business: NPL ratio of 4.01% and coverage of 105%, in line with the figures in 2012.

The fourth quarter profit was EUR 209 million, similar to the third quarter, and clearly above the other two quarters.

Of note was profit growth of more than 20% in local currency in the Nordic countries, backed by a rise in the volume of business and revenues. Germany also registered double-digit growth in profits (better fee income and lower loan-loss provisions) and Spain (reduced provisions). Poland's contribution on a like-for-like basis was solid, but weaker in Italy and Portugal, in line with the situation of their economies.

Lastly, the UK unit, which for accounting reasons is included in Santander UK, posted an attributable profit of EUR 101 million. Including this, SCF's total profit was EUR 895 million.

**NEW LENDING**
Constant EUR Billion




### Strategy and objectives in 2014

- The strategic lines of 2013 are fully maintained in 2014.

  This, coupled with strategic operations, such as the acquisition of 51% of the first independent financing company in Spain (already announced), will enable Santander Consumer Finance to keep on maximizing its competitive advantages in the European consumer business market, in order to maintain profitability above that of competitors.

## UNITED KINGDOM

EUR Million

| INCOME STATEMENT | 2013 | 2012 | Variation Amount | % | % w/o FX |
|---|---|---|---|---|---|
| **Net interest income** | **3,451** | **3,336** | **115** | **3.4** | **8.3** |
| Net fees | 992 | 1,190 | (198) | (16.6) | (12.7) |
| Gains (losses) on financial transactions | 403 | 361 | 42 | 11.7 | 17.0 |
| Other operating income[1] | 36 | 20 | 16 | 78.8 | 87.3 |
| **Gross income** | **4,881** | **4,906** | **(25)** | **(0.5)** | **4.2** |
| Operating expenses | (2,605) | (2,690) | 84 | (3.1) | 1.5 |
| General administrative expenses | (2,181) | (2,311) | 130 | (5.6) | (1.1) |
| *Personnel* | *(1,401)* | *(1,492)* | *91* | *(6.1)* | *(1.7)* |
| *Other general administrative expenses* | *(780)* | *(819)* | *39* | *(4.7)* | *(0.2)* |
| Depreciation and amortisation | (424) | (379) | (45) | 12.0 | 17.3 |
| **Net operating income** | **2,276** | **2,217** | **59** | **2.7** | **7.5** |
| Net loan-loss provisions | (580) | (806) | 226 | (28.1) | (24.6) |
| Other income | (236) | (167) | (69) | 41.3 | 48.0 |
| **Ordinary profit before taxes** | **1,460** | **1,244** | **216** | **17.4** | **23.0** |
| Tax on profit | (301) | (286) | (16) | 5.4 | 10.4 |
| **Ordinary profit from continuing operations** | **1,159** | **958** | **201** | **21.0** | **26.7** |
| Net profit from discontinued operations | (9) | 77 | (86) | — | — |
| **Ordinary consolidated profit** | **1,149** | **1,034** | **115** | **11.1** | **16.4** |
| Minority interests | — | 0 | (0) | (100.0) | (100.0) |
| **Ordinary attributable profit to the Group** | **1,149** | **1,034** | **115** | **11.1** | **16.4** |
| Net capital gains and provisions | — | 81 | (81) | (100.0) | (100.0) |
| **Attributable profit to the Group** | **1,149** | **1,115** | **34** | **3.1** | **8.0** |

| BALANCE SHEET | | | | | |
|---|---|---|---|---|---|
| Customer loans[2] | 231,046 | 249,157 | (18,111) | (7.3) | (5.3) |
| Trading portfolio (w/o loans) | 28,831 | 38,177 | (9,346) | (24.5) | (22.9) |
| Available-for-sale financial assets | 6,003 | 6,718 | (715) | (10.6) | (8.7) |
| Due from credit institutions[2] | 17,136 | 18,124 | (988) | (5.5) | (3.4) |
| Intangible assets and property and equipment | 2,498 | 2,561 | (63) | (2.5) | (0.4) |
| Other assets | 38,229 | 44,321 | (6,093) | (13.7) | (11.9) |
| **Total assets/liabilities & shareholders' equity** | **323,743** | **359,058** | **(35,315)** | **(9.8)** | **(7.9)** |
| Customer deposits[2] | 187,467 | 194,452 | (6,985) | (3.6) | (1.5) |
| Marketable debt securities[2] | 64,092 | 73,919 | (9,827) | (13.3) | (11.4) |
| Subordinated debt[2] | 5,805 | 5,534 | 272 | 4.9 | 7.2 |
| Insurance liabilities | — | — | — | — | — |
| Due to credit institutions[2] | 26,882 | 29,313 | (2,430) | (8.3) | (6.3) |
| Other liabilities | 26,855 | 42,689 | (15,834) | (37.1) | (35.7) |
| Shareholders' equity[3] | 12,642 | 13,152 | (510) | (3.9) | (1.8) |
| **Other customer funds under management** | **9,645** | **13,919** | **(4,273)** | **(30.7)** | **(29.2)** |
| Mutual and pension funds | 9,645 | 13,919 | (4,273) | (30.7) | (29.2) |
| Managed portfolios | — | — | — | — | — |
| **Customer funds under management** | **267,010** | **287,823** | **(20,814)** | **(7.2)** | **(5.2)** |

| RATIOS (%) AND OPERATING MEANS | | | |
|---|---|---|---|
| ROE | 8.84 | 7.78 | 1.06 p. |
| Efficiency ratio (with amortisations) | 53.4 | 54.8 | (1.4 p.) |
| NPL ratio | 1.98 | 2.05 | (0.07 p.) |
| NPL coverage | 41.6 | 44.1 | (2.5 p.) |
| Number of employees | 25,368 | 26,255 | (3.4) |
| Number of branches | 1,157 | 1,189 | (2.7) |

1. Including dividends, income from equity-accounted method and other operating income/expenses
2. Including all on-balance sheet balances for this item
3. Not including profit of the year

## UNITED KINGDOM (changes in local currency)

- **Profit from continued operations of £984 million,** 26.7% more than in 2012:
  - Net interest income growth of 8.3%, increasing for the fourth consecutive quarter.
  - Broadly stable costs (+1.5%), absorbing more investment in businesses.
  - Loan-loss provisions fell 24.6%, backed by better credit quality in retail and corporate banking.
- The **1|2|3 World** customers continued to grow with more loyal customers and increased business volumes.
- **Double-digit** growth in corporate loans and deposits.

### Economic environment

The pace of economic growth picked up in 2013. After growth of 0.1% in 2012, economic output is estimated to 1,9% increase in 2013.

Activity continued to be supported by the Monetary Policy Committee (MPC) with its programme of quantitative easing of £375 billion, and which is committed to not raising the base rate until the UK unemployment rate has fallen to a threshold of 7% (currently 7.1%), subject to certain conditions. The bank rate has remained at a record low of 0.5% since March 2009.

CPI inflation in 2013 of 2.0% and continued to run ahead of average earnings increase, maintaining the squeeze on real household income.

Borrowing growth remained subdued, with annual lending growth to households of around 1%, and that to non-financial companies continued to be negative.

### Strategy

Santander UK's strategy is built around three priorities: loyal and satisfied customers to become a stronger retail bank; the Bank of choice for UK companies and maintaining consistent profitability and a strong balance sheet.

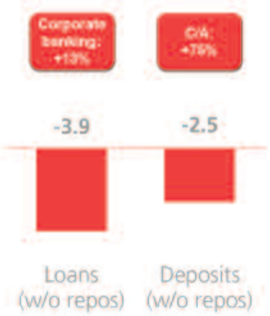
In line with this strategy and to grow its business, Santander UK continues to develop innovative products. Among these products, the *1|2|3 World* (current account, credit card, savings, etc) is designed to build closer customer relationships, greater transactionality and increased loyalty. This offering is one of the most successful in the market. The *Select* proposition for affluent customers continues to be developed, and will be promoted more strongly as part of the drive on customer segmentation.

Santander UK is becoming more diversified with the growth of its corporate business. Support for UK businesses continued with increased corporate lending. The ongoing enhancement of corporate banking systems and capabilities are expanding Santander UK's presence in this market. SMEs are supported through a network of 50 regional offices as well as by way of new initiatives such as *Breakthrough*.

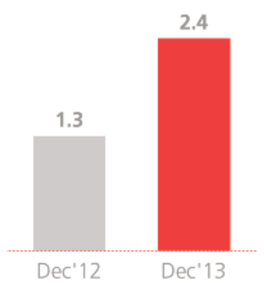
Balance sheet strength underpins this strategy; capital funding and liquidity are all robust. In June 2013, the Prudential Regulation Authority (PRA) confirmed Santander UK's strong capital position. Santander UK had the best capital ratio among the main banks and was one of three banks in the UK that was not required to increase its capital.

Wholesale funding of less than one year fell 13% and eligible liquid assets decreased 20%. Balances have been managed down given greater regulatory guidance, greater stability in the capital markets and as a consequence of the actions taken to strengthen the balance sheet over the last three years.

**ACTIVITY**
% var. 2013/2012 (pound sterling)

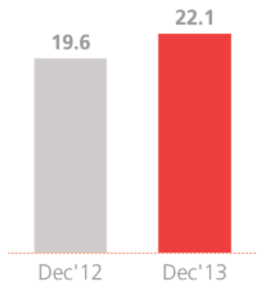



**1|2|3 WORLD CUSTOMERS**
Million



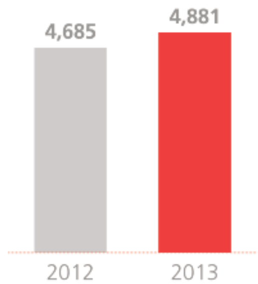

**x1,8**

**CORPORATE LOANS**
Pound sterling Billion




**+12.8%**

**GROSS INCOME**
Constant EUR Million




**+4.2%***

* In euros: -0.5%

## Activity

Santander UK is focused on the United Kingdom. Around 83% of customer loans are prime mortgages for homes in the UK. The portfolio of mortgages is of high quality, with no exposure to self-certified or subprime mortgages whilst buy to let loans are around 1% of customer loans. The loan to deposit ratio was 123%, five percentage points lower than in December 2012. This was a consequence of the managed reduction of loans exceeding the outflow of customer deposits.

In local criteria, customer loans amounted to £187,100 million, 4% lower than in 2012. This was largely due to a 5% reduction in mortgage loans (mainly interest only), partially offset by the growth of commercial loans (+13%).

Gross mortgage lending amounted to £18,483 million, 27% more than in 2012. The balance is expected to stabilise with the launch of the range of flexible mortgages (the Freedom range) and the planned participation in the UK Government's Help to Buy guarantee programme. Gross lending rose 13% in the fourth quarter.

Commercial banking lending increased 13% to £22,100 million, with growth in loans to SMEs up to £11,700 million.

Customer deposits of £146,400 million decreased 1% over 2012. The managed reduction of more rate sensitive and less stable deposits continued (mainly through maturities of higher rate eSaver products), and their replacement by those that offer a better relationship opportunity.

At the end of 2013, there were 2.4 million customers in *1|2|3 World*, an increase of 1.1 million customers in a year. The key *1|2|3 current account* attracts good quality and loyal customers, with 87% of these customers having their primary bank account with Santander. Current account balances grew by £12,000 million (+75%) in 2013.

## Results

Profit from continued operations of £984 million, 26.7% more than in 2012. Profit after tax from continuing operations (excluding 2012 significant items) was £976, 16.4% more than 2012.

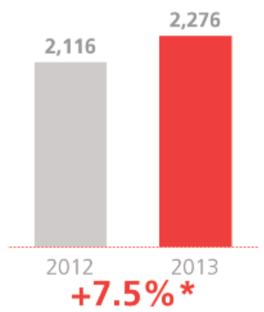
This growth was largely due to net interest income, which increased 8.3% and rose in every quarter, as the stock margin on mortgage loans improved and the maturity of high cost deposits in the second half of the year. Total commercial revenues were higher than in 2012, absorbing lower fee income, mainly due to reduced Global Banking & Markets activity.

Operating expenses increased by only 1.5% in a year (below inflation and revenues), despite investments in retail and corporate banking. These programmes continued to support the business transformation and provide the underpinning for future efficiency improvements. The efficiency ratio was 53.4% (1.4 p.p. better than in 2012).

Loan-loss provisions fell 24.6%, with improved credit quality across the product range. The NPL ratio of 1.98% was lower than in 2012 (2.05%). The stock of residential properties in possession remained vey low at 0.05% of the total portfolio, unchanged from 2012 and below the industry average.

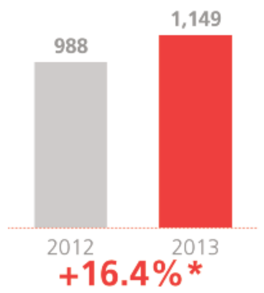
In short, the results demonstrate a further improvement in performance and continued the progress evident through the year, particularly in net interest income. Net interest income/average customer assets improved to 1.71% in the last quarter of 2013 from 1.27% in the last quarter of 2012.

**NET OPERATING INCOME**
Constant EUR Million




* In euros: +2.7%

**ORDINARY ATTRIB. PROFIT**
Constant EUR Million




### Strategy and objectives in 2014

The strategies and trends in 2013 will be maintained:

- Growth in commercial lending and mortgages. Increase the number of customers who have their primary account with Santander.
- Improve the efficiency ratio, with management of spreads that keeps revenues growing faster than costs.
- Maintain good credit quality both in retail and corporates.
- Further strengthening the capital base and maintaining prudent liquidity.

## LATIN AMERICA

EUR Million

| INCOME STATEMENT | 2013 | 2012 | Variation Amount | % | % w/o FX |
|---|---|---|---|---|---|
| **Net interest income** | **15,186** | **17,881** | **(2,695)** | **(15.1)** | **(5.5)** |
| Net fees | 4,874 | 5,097 | (224) | (4.4) | 6.2 |
| Gains (losses) on financial transactions | 1,039 | 1,071 | (33) | (3.1) | 8.0 |
| Other operating income[1] | (15) | (115) | 100 | (87.0) | (86.0) |
| **Gross income** | **21,083** | **23,934** | **(2,851)** | **(11.9)** | **(2.0)** |
| Operating expenses | (8,704) | (9,124) | 420 | (4.6) | 5.9 |
| General administrative expenses | (7,800) | (8,253) | 453 | (5.5) | 4.9 |
| *Personnel* | *(4,319)* | *(4,643)* | *324* | *(7.0)* | *3.2* |
| *Other general administrative expenses* | *(3,481)* | *(3,611)* | *129* | *(3.6)* | *7.1* |
| Depreciation and amortisation | (904) | (871) | (33) | 3.8 | 15.2 |
| **Net operating income** | **12,379** | **14,811** | **(2,432)** | **(16.4)** | **(6.8)** |
| Net loan-loss provisions | (6,483) | (7,380) | 897 | (12.2) | (1.4) |
| Other income | (551) | (818) | 267 | (32.7) | (22.3) |
| **Profit before taxes** | **5,345** | **6,612** | **(1,267)** | **(19.2)** | **(11.0)** |
| Tax on profit | (1,208) | (1,484) | 276 | (18.6) | (9.1) |
| **Profit from continuing operations** | **4,137** | **5,128** | **(991)** | **(19.3)** | **(11.5)** |
| Net profit from discontinued operations | 0 | — | 0 | — | — |
| **Consolidated profit** | **4,137** | **5,128** | **(991)** | **(19.3)** | **(11.5)** |
| Minority interests | 879 | 866 | 13 | 1.5 | 12.4 |
| **Attributable profit to the Group** | **3,257** | **4,262** | **(1,004)** | **(23.6)** | **(16.3)** |

| BALANCE SHEET | | | | | |
|---|---|---|---|---|---|
| Customer loans[2] | 132,542 | 140,090 | (7,547) | (5.4) | 10.0 |
| Trading portfolio (w/o loans) | 23,107 | 28,403 | (5,295) | (18.6) | (8.8) |
| Available-for-sale financial assets | 20,947 | 23,499 | (2,553) | (10.9) | 4.9 |
| Due from credit institutions[2] | 28,213 | 25,799 | 2,414 | 9.4 | 23.6 |
| Intangible assets and property and equipment | 3,930 | 4,490 | (559) | (12.5) | 4.2 |
| Other assets | 41,238 | 47,346 | (6,108) | (12.9) | 1.8 |
| **Total assets/liabilities & shareholders' equity** | **249,979** | **269,627** | **(19,648)** | **(7.3)** | **7.3** |
| Customer deposits[2] | 125,844 | 134,765 | (8,921) | (6.6) | 8.3 |
| Marketable debt securities[2] | 28,987 | 28,107 | 880 | 3.1 | 21.7 |
| Subordinated debt[2] | 4,833 | 5,734 | (901) | (15.7) | 0.1 |
| Insurance liabilities | — | — | — | — | — |
| Due to credit institutions[2] | 24,825 | 32,131 | (7,306) | (22.7) | (11.4) |
| Other liabilities | 45,252 | 48,481 | (3,228) | (6.7) | 6.8 |
| Shareholders' equity[3] | 20,237 | 20,409 | (172) | (0.8) | 14.8 |
| **Other customer funds under management** | **64,563** | **60,831** | **3,732** | **6.1** | **21.4** |
| Mutual and pension funds | 50,214 | 48,178 | 2,036 | 4.2 | 20.9 |
| Managed portfolios | 14,349 | 12,653 | 1,696 | 13.4 | 23.0 |
| **Customer funds under management** | **224,227** | **229,437** | **(5,210)** | **(2.3)** | **13.2** |

| RATIOS (%) AND OPERATING MEANS | | | |
|---|---|---|---|
| ROE | 13.84 | 19.24 | (5.41 p.) |
| Efficiency ratio (with amortisations) | 41.3 | 38.1 | 3.2 p. |
| NPL ratio | 5.03 | 5.42 | (0.39 p.) |
| NPL coverage | 84.6 | 87.5 | (2.9 p.) |
| Number of employees | 87,069 | 90,649 | (3.9) |
| Number of branches | 5,904 | 6,044 | (2.3) |

1. Including dividends, income from equity-accounted method and other operating income/expenses
2. Including all on-balance sheet balances for this item
3. Not including profit of the year

## LATIN AMERICA (changes in constant currency)

→ **Attributable profit of EUR 3,257 million,** 16,3% lower than in 2012.

- Gross income fell 2.0%, with net interest income affected by lower spreads (Brazil due to the change of business mix).
- Costs increased (+5.9%) because of investments in business development, mainly in Mexico, and inflationary pressures.
- Loan-loss provisions declined 1.4%, due to the improvement in Brazil.

→ **Loans** grew 9% and **deposits** (including *letras financeiras*) grew 8%.

Grupo Santander has the region's largest international franchise. It has 5,904 branches and points of attention, 27,109 ATMs, 46.9 million customers and market shares of 10.2% in loans and deposits.

Attributable profit was 16.3% lower at EUR 3,257 million. Excluding the perimeter effect (sale of the unit in Colombia, increase in minority interests in Mexico and corporate operation in insurance business), the decline was 10.9%.

### Economic environment

Latin America as a whole registered growth of 2.6% in 2013, moderate in Brazil and Mexico and expansion of more than 4% in the other countries.

Inflation remained stable, with average year-on-year rates of 5%.

Mexico and Chile cut their official interest rates, while Brazil's rose because of inflationary tensions.

Currencies depreciated by 8% on average against the dollar between May and December. The most affected were the Argentine peso and the Brazilian real, due to the volatility in markets following the Federal Reserve's tapering of its quantitative easing policy.

The region continued to have a cushion to meet possible bouts of volatility: a high level of reserves ($743,000 million), moderate budget deficits and low ratios of public and private external debt.

In the countries where Santander operates (Brazil, Mexico, Chile, Argentina, Uruguay, Peru and Puerto Rico), the systems' banking business (loans + deposits) grew 12%.

Lending rose 14%. Loans to individuals increased 15% (consumer credit and cards: +11%, mortgages: +22%), while loans to companies and institutions rose 13%. Deposits grew 9%, with demand deposits up 16% and time deposits 2%.

### Strategy

The strategy in 2013 continued to focus on expansion, consolidation and improvement in the business of the commercial franchise. The range of products and services was enhanced and tailored to suit customers' needs. This will spur long-term growth in business. A prudent watch on the quality of risks remained in place.

The Group's main developments and results are set out below. All percentage changes exclude the exchange rate impact.

### Activity

Lending (excluding repos) increased 9% over December 2012. By products: cards increased 12%, commercial credit (companies in all their range and institutions) 10% and mortgages rose 14%. Consumer credit was flat.

Deposits excluding repos increased 8% (including *letras financeiras*), with demand deposits up 16% and time deposits at levels very similar to those of 2012 (conditioned by the reduction strategy in Mexico). Mutual funds increased 21%.

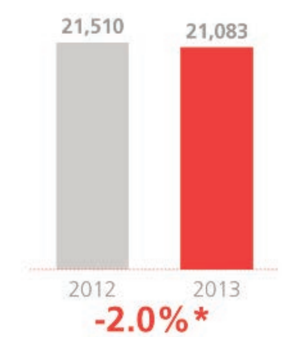
**ACTIVITY**
% var. 2013/12 (constant EUR)


* Including *letras financeiras*

**NET INTEREST INCOME - PROVISIONS / ATAs**
%


| | 4Q'12 | 1Q'13 | 2Q'13 | 3Q'13 | 4Q'13 |
|---|---|---|---|---|---|
| NII | 6.79 | 6.41 | 6.17 | 6.03 | 6.16 |
| LLP's | 2.83 | 2.83 | 2.71 | 2.60 | 2.44 |

**GROSS INCOME**
Constant EUR Million




* In euros: -11.9%

## LATIN AMERICA. INCOME STATEMENT

EUR Million

| | Gross income | | | Net operating income | | | Attributable profit | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2013 | % | % w/o FX | 2013 | % | % w/o FX | 2013 | % | % w/o FX |
| Brazil | 13,565 | (17.9) | (6.4) | 8,219 | (22.8) | (12.0) | 1,577 | (27.9) | (17.8) |
| Mexico | 3,040 | 8.0 | 8.3 | 1,804 | 7.0 | 7.2 | 713 | (29.3) | (29.2) |
| Chile | 2,261 | (2.0) | 3.0 | 1,324 | (3.6) | 1.4 | 435 | (11.2) | (6.6) |
| Argentina | 1,286 | 5.5 | 30.7 | 689 | 6.0 | 31.2 | 333 | 2.0 | 26.3 |
| Uruguay | 253 | 7.6 | 11.8 | 91 | 11.3 | 15.7 | 53 | 14.3 | 18.8 |
| Puerto Rico | 327 | (11.3) | (8.3) | 143 | (19.2) | (16.5) | 77 | 36.1 | 40.7 |
| Rest | 62 | (56.4) | (53.6) | (40) | — | — | (38) | 395.2 | 348.1 |
| **Subtotal** | **20,793** | **(11.9)** | **(1.9)** | **12,231** | **(16.4)** | **(6.7)** | **3,151** | **(23.3)** | **(15.9)** |
| Santander Private Banking | 290 | (12.0) | (9.0) | 149 | (20.2) | (17.5) | 107 | (30.2) | (27.8) |
| **Total** | **21,083** | **(11.9)** | **(2.0)** | **12,379** | **(16.4)** | **(6.8)** | **3,257** | **(23.6)** | **(16.3)** |

### Results

Gross income was EUR 21,083 million, 2.0% lower. The performance was as follows:

- Net interest income dropped 5.5%, mainly affected by the pressure on spreads and the change of mix toward lower cost credit products and also reduced spreads. These effects were partially offset by management of spreads and higher volumes.

- Net fee income increased 6.2%. Of note was the growth in that from cards (+17.9%) and foreign trade (+18.6%).

- Trading gains increased 8.0%, mainly due to lower interest rates, exchange rate changes and portfolio sales.

Operating expenses grew 5.9%, due to investment in networks and commercial projects (some traditional and others focused on priority customer segments), inflationary pressures on salary agreements and contracted services, and higher amortisations for technology. Net operating income was EUR 12,379 million.

Loan-loss provisions declined 1.4%, due to Brazil (-8.9%) which, after the change in trend at the beginning of 2013, reduced its provisions between March and the end of the year. This was offset by rises in Mexico and Chile.

The NPL ratio was 5.03%, 39 b.p. lower than at the end of 2012, positively impacted by Brazil. Coverage was 85%.

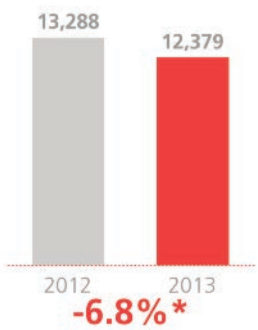
After incorporating loan-loss provisions and other provisions, profit before tax was EUR 5,345 million, 11.0% lower.

Including the larger minority interests in Mexico, attributable profit was 16.3% lower at EUR 3,257 million.

By business segments, Retail Banking's net profit was 15.8% lower and Global Wholesale Banking's 1.8%, while Asset Management and Insurance increased it 8.4%.

## NET OPERATING INCOME

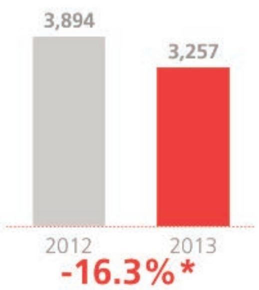
Constant EUR Million




* In euros: -16.4%

## ATTRIBUTABLE PROFIT

Constant EUR Million




### Strategy and objectives in 2014

Consolidation and improvement in the business of the commercial franchise:

- Enhanced customer transactions to ensure growth in recurring revenues.
- Focus on lower risk profile products and segments and high linkage capacity.
- Improvements in efficiency and service quality, which will be reflected in profitability.

All of it, while maintaining a permanent watch on risk quality.

## BRAZIL

EUR Million

| INCOME STATEMENT | 2013 | 2012 | Variation Amount | % | % w/o FX |
|---|---|---|---|---|---|
| **Net interest income** | **10,071** | **12,746** | **(2,674)** | **(21.0)** | **(9.9)** |
| Net fees | 2,943 | 3,137 | (194) | (6.2) | 7.0 |
| Gains (losses) on financial transactions | 540 | 716 | (175) | (24.5) | (13.9) |
| Other operating income[1] | 10 | (79) | 89 | — | — |
| **Gross income** | **13,565** | **16,520** | **(2,955)** | **(17.9)** | **(6.4)** |
| Operating expenses | (5,346) | (5,869) | 523 | (8.9) | 3.9 |
| General administrative expenses | (4,765) | (5,296) | 531 | (10.0) | 2.6 |
| *Personnel* | *(2,578)* | *(2,946)* | *368* | *(12.5)* | *(0.2)* |
| *Other general administrative expenses* | *(2,187)* | *(2,351)* | *164* | *(7.0)* | *6.1* |
| Depreciation and amortisation | (581) | (572) | (9) | 1.5 | 15.7 |
| **Net operating income** | **8,219** | **10,651** | **(2,432)** | **(22.8)** | **(12.0)** |
| Net loan-loss provisions | (4,894) | (6,124) | 1,231 | (20.1) | (8.9) |
| Other income | (500) | (811) | 311 | (38.4) | (29.7) |
| **Profit before taxes** | **2,826** | **3,716** | **(890)** | **(24.0)** | **(13.3)** |
| Tax on profit | (782) | (937) | 155 | (16.5) | (4.8) |
| **Profit from continuing operations** | **2,044** | **2,779** | **(735)** | **(26.5)** | **(16.2)** |
| Net profit from discontinued operations | — | — | — | — | — |
| **Consolidated profit** | **2,044** | **2,779** | **(735)** | **(26.5)** | **(16.2)** |
| Minority interests | 466 | 591 | (124) | (21.1) | (10.0) |
| **Attributable profit to the Group** | **1,577** | **2,188** | **(611)** | **(27.9)** | **(17.8)** |

| BALANCE SHEET | | | | | |
|---|---|---|---|---|---|
| Customer loans[2] | 66,446 | 74,511 | (8,065) | (10.8) | 7.4 |
| Trading portfolio (w/o loans) | 10,321 | 12,648 | (2,327) | (18.4) | (1.7) |
| Available-for-sale financial assets | 14,175 | 16,284 | (2,110) | (13.0) | 4.9 |
| Due from credit institutions[2] | 14,734 | 11,341 | 3,393 | 29.9 | 56.5 |
| Intangible assets and property and equipment | 2,793 | 3,357 | (565) | (16.8) | 0.2 |
| Other assets | 25,456 | 31,128 | (5,672) | (18.2) | (1.5) |
| **Total assets/liabilities & shareholders' equity** | **133,925** | **149,270** | **(15,345)** | **(10.3)** | **8.1** |
| Customer deposits[2] | 61,490 | 69,849 | (8,359) | (12.0) | 6.1 |
| Marketable debt securities[2] | 20,002 | 19,974 | 28 | 0.1 | 20.7 |
| Subordinated debt[2] | 2,734 | 4,409 | (1,675) | (38.0) | (25.3) |
| Insurance liabilities | — | — | — | — | — |
| Due to credit institutions[2] | 12,929 | 17,400 | (4,471) | (25.7) | (10.5) |
| Other liabilities | 25,229 | 25,808 | (579) | (2.2) | 17.8 |
| Shareholders' equity[3] | 11,542 | 11,830 | (289) | (2.4) | 17.5 |
| **Other customer funds under management** | **37,409** | **34,813** | **2,596** | **7.5** | **29.5** |
| Mutual and pension funds | 34,444 | 31,339 | 3,105 | 9.9 | 32.4 |
| Managed portfolios | 2,965 | 3,474 | (509) | (14.7) | 2.8 |
| **Customer funds under management** | **121,635** | **129,045** | **(7,410)** | **(5.7)** | **13.6** |

| RATIOS (%) AND OPERATING MEANS | | | |
|---|---|---|---|
| ROE | 11.88 | 17.66 | (5.78 p.) |
| Efficiency ratio (with amortisations) | 39.4 | 35.5 | 3.9 p. |
| NPL ratio | 5.64 | 6.86 | (1.22 p.) |
| NPL coverage | 95.1 | 90.2 | 4.9 p. |
| Number of employees | 49,459 | 53,752 | (8.0) |
| Number of branches | 3,566 | 3,788 | (5.9) |

1. Including dividends, income from equity-accounted method and other operating income/expenses
2. Including all on-balance sheet balances for this item
3. Not including profit of the year

## ■ BRAZIL (changes in local currency)

→ **Attributable profit of EUR 1,577 million**, 17.8% less in local currency.

- Fall of 6.4% in gross income mainly due to the change of mix in the portfolio and narrowing of lending spreads. Net spread and net interest income improved in the fourth quarter.
- Costs rose well below the inflation rate.
- Provisions fell 8.9% and were lower for the third straight quarter.

→ **Loans** rose 7%, above private sector banks. **Deposits** increased 6%, improving the growth rate from the beginning of the year.

→ Sharp **NPLs** reduction: from 6.86% in December 2012 to 5.64% at the end of 2013.

Santander Brazil is the country's third largest private sector bank by assets and the largest foreign bank in the country.

It operates in the main regions of the country, with 3,566 branches and points of banking attention, 16,958 ATMs and 29.5 million customers.

### Economic environment

Brazil is the world's seventh largest economy (in nominal GDP terms), according to IMF estimates. GDP grew by an estimated 2.3% in 2013.

The labour market is still firm, with the jobless rate at an historic low. In November, the rate was 4.6%. New jobs were created and real household incomes increased 3.0% in 12 months.

The central bank raised the Selic rate by 275 b.p. in 2013 and by an additional 50 b.p. in January 2014 to 10.5%, in order to better control inflation, which ended the year at 5.9%, below the maximum band of 6%.

Total bank lending rose 15% year-on-year in December. This growth was mainly spurred by directed lending (+25% in 12 months). The loans of state banks (excluding Bndes) grew 23%, private sector banks 7% and foreign banks 9%.

### Strategy

The strategy is based on the following objectives:

- Improve customer satisfaction: efficient services, adequate segmentation and multi channel platform.
- Boost efficiency: offer a simpler bank and increase commercial productivity.
- Business focus: greater revenue diversification (loans, savings and services) maintaining rigorous risk management at all moments of the cycle (from origination to recovery).
- Discipline and optimisation of capital, under which the replacement of capital by new instruments is framed.

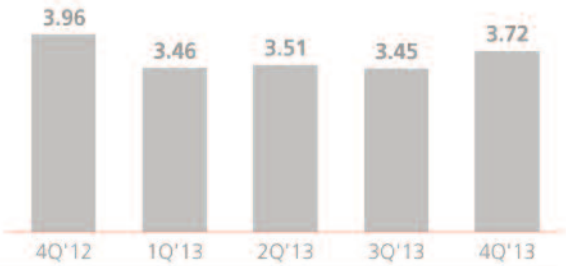
During 2013, progress was made in the Bank's strategic lines. Of note were:

1. Launch of the *Cuenta Combinada*, which is a packet of services that tends to different types of customers and seeks a greater number of transactions.
2. *Santander Select* was launched for the high-income segment in April 2013, following the model already developed in other countries by Grupo Santander. Specialised products and services were designed.
3. Agreement with the multinational iZettle. Santander Brazil's customers can conduct debit and credit transactions via smartphones and tablets, with a card

■ ACTIVITY
% var. 2013/2012 (brasilian real)

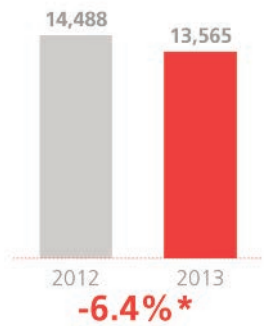

* Including *letras financeiras*

■ NET INTEREST INCOME - PROVISIONS / ATAs
%




| | 4Q'12 | 1Q'13 | 2Q'13 | 3Q'13 | 4Q'13 |
|---|---|---|---|---|---|
| NII | 7.67 | 7.29 | 7.10 | 6.56 | 6.59 |
| LLP's | 3.71 | 3.83 | 3.59 | 3.11 | 2.88 |

■ GROSS INCOME
Constant EUR Million




* In euros: -17.9%

reader and an application. This accord will help to encourage small businesses to improve their financial management and increase their sales in a safe way. This strengthens Santander link with this segment and its acquiring business in Brazil.

This is joined by the capital optimisation operation that replaces capital stock with new issuance instruments, eligible as regulatory capital for an equivalent value. The new structure improves the composition of the bank's capital by increasing the return on it, while maintaining the figure of regulatory capital and capital ratios higher than those of other commercial banks. As a result, the capacity to exploit growth opportunities remained intact.

**Activity**

Lending rose 7% year-on-year. During the year the bank's strategy was to prioritize growth of lower risk products, mainly of mortgage loans, where the market is still incipient, and large companies, the segments registering the largest growth. On the other hand, consumer finance dropped in the last 12 months.

This strategy is reflected in sharp improvement of the NPL ratio in 2013, closing the gap with peers, and returning to ratios registered at the beginning of 2012.

Total savings rose 15%. Deposits showed a better trend and rose 6% (excluding repos). At the beginning of 2013, their growth rate was close to zero. Demand and savings deposits performed better (+22%). Mutual funds increased 32%.

Santander Brazil's market share in total loans is 8.4% (12.2% for non-earmarked loans) and 7.9% in deposits.

**Results**

Gross income declined 6.4% to EUR 13,565 million, largely due to the fall in net interest income because of the change of mix of the portfolio and the narrowing of spreads on loans, particularly from the shift toward products with lower spreads and also a reduced cost of credit.

Fee income was 7.0% higher at EUR 2,943 million, backed by cards (+18.3%) and insurance (+21.2%).

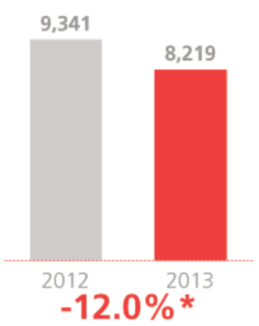
Operating expenses rose 3.9%, clearly below the inflation rate and absorbing the amortisations of the investments to expand business and the salary agreement. Excluding amortisations, costs grew 2.6%, reflecting the effort made in the last few quarters to control expenses.

Loan-loss provisions performed well and declined quarter on quarter throughout the year to drop 8.9% for the whole of 2013, bringing the cost of credit to 6.3%, well below the 7.4% registered at the end of 2012. This evolution enabled the net spread to improve for the second straight quarter.

After taxes and minority interests, attributable profit was EUR 1,577 million.

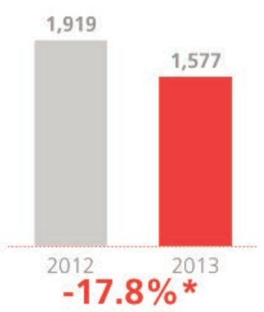
Net profit fell 25.9% in Retail Banking and rose 5.0% in Global Wholesale Banking.

**NET OPERATING INCOME**
Constant EUR Million




* In euros: -22.8%

**ATTRIBUTABLE PROFIT**
Constant EUR Million




* In euros: -27.9%

**Strategy and objectives in 2014**

- Grow the number of customers and enhance the linkage of current ones.
- Focus on lower risk profile products and segments and with a high linkage capacity, such as mortgages, payrolls, auto finance and SMEs.
- Increase commercial productivity and optimisation of costs.

All these measures should be reflected in improved efficiency and profitability.

## MEXICO

EUR Million

| INCOME STATEMENT | 2013 | 2012 | Variation Amount | % | % w/o FX |
|---|---|---|---|---|---|
| **Net interest income** | **2,120** | **2,007** | **114** | **5.7** | **5.9** |
| Net fees | 810 | 750 | 59 | 7.9 | 8.1 |
| Gains (losses) on financial transactions | 142 | 105 | 37 | 35.4 | 35.7 |
| Other operating income[1] | (32) | (48) | 16 | (33.4) | (33.2) |
| **Gross income** | **3,040** | **2,814** | **226** | **8.0** | **8.3** |
| Operating expenses | (1,236) | (1,128) | (108) | 9.6 | 9.9 |
| General administrative expenses | (1,115) | (1,015) | (101) | 9.9 | 10.2 |
| *Personnel* | *(598)* | *(535)* | *(64)* | *11.9* | *12.2* |
| *Other general administrative expenses* | *(517)* | *(480)* | *(37)* | *7.7* | *7.9* |
| Depreciation and amortisation | (121) | (113) | (8) | 6.7 | 7.0 |
| **Net operating income** | **1,804** | **1,686** | **118** | **7.0** | **7.2** |
| Net loan-loss provisions | (801) | (466) | (335) | 71.8 | 72.2 |
| Other income | 17 | 55 | (38) | (68.9) | (68.8) |
| **Profit before taxes** | **1,020** | **1,275** | **(255)** | **(20.0)** | **(19.8)** |
| Tax on profit | (84) | (207) | 123 | (59.4) | (59.3) |
| **Profit from continuing operations** | **936** | **1,068** | **(132)** | **(12.4)** | **(12.2)** |
| Net profit from discontinued operations | — | — | — | — | — |
| **Consolidated profit** | **936** | **1,068** | **(132)** | **(12.4)** | **(12.2)** |
| Minority interests | 223 | 59 | 164 | 276.9 | 277.7 |
| **Attributable profit to the Group** | **713** | **1,009** | **(296)** | **(29.3)** | **(29.2)** |

| BALANCE SHEET | 2013 | 2012 | Variation Amount | % | % w/o FX |
|---|---|---|---|---|---|
| Customer loans[2] | 22,269 | 20,384 | 1,886 | 9.3 | 14.9 |
| Trading portfolio (w/o loans) | 8,685 | 10,470 | (1,785) | (17.0) | (12.8) |
| Available-for-sale financial assets | 3,387 | 2,772 | 615 | 22.2 | 28.5 |
| Due from credit institutions[2] | 7,975 | 7,672 | 303 | 3.9 | 9.3 |
| Intangible assets and property and equipment | 402 | 380 | 22 | 5.8 | 11.2 |
| Other assets | 5,681 | 5,209 | 471 | 9.0 | 14.7 |
| **Total assets/liabilities & shareholders' equity** | **48,398** | **46,886** | **1,512** | **3.2** | **8.6** |
| Customer deposits[2] | 24,663 | 24,743 | (80) | (0.3) | 4.8 |
| Marketable debt securities[2] | 2,896 | 2,021 | 876 | 43.3 | 50.7 |
| Subordinated debt[2] | 931 | — | 931 | — | — |
| Insurance liabilities | — | — | — | — | — |
| Due to credit institutions[2] | 5,494 | 3,757 | 1,737 | 46.2 | 53.8 |
| Other liabilities | 11,601 | 13,026 | (1,425) | (10.9) | (6.3) |
| Shareholders' equity[3] | 2,814 | 3,340 | (526) | (15.7) | (11.4) |
| **Other customer funds under management** | **10,349** | **10,328** | **21** | **0.2** | **5.4** |
| Mutual funds | 10,349 | 10,328 | 21 | 0.2 | 5.4 |
| Managed portfolios | — | — | — | — | — |
| **Customer funds under management** | **38,838** | **37,091** | **1,748** | **4.7** | **10.1** |

| RATIOS (%) AND OPERATING MEANS | 2013 | 2012 | Variation Amount |
|---|---|---|---|
| ROE | 18.64 | 24.90 | (6.26 p.) |
| Efficiency ratio (with amortisations) | 40.7 | 40.1 | 0.6 p. |
| NPL ratio | 3.66 | 1.94 | 1.72 p. |
| NPL coverage | 97.5 | 157.3 | (59.8 p.) |
| Number of employees | 14,804 | 13,967 | 6.0 |
| Number of branches | 1,258 | 1,170 | 7.5 |

1. Including dividends, income from equity-accounted method and other operating income/expenses
2. Including all on-balance sheet balances for this item
3. Not including profit of the year

## MEXICO (changes in local currency)

→ **Net profit of EUR 936 million**, 12.2% lower than in 2012 **(**29.2% less after minority interests):

- Gross income rose 8.3%, backed by dynamic business activity and spreads management.
- Expenses were in line with the expansion plan. An increase of 88 branches in 2013 (+8%).
- Loan-loss provisions were 72.2% higher, mainly due to homebuilders.

→ Business **activity** accelerated. Loans increased 12% and deposits excluding repos 4% (+12% on a like-for-like basis).

Santander is the fourth largest banking group in Mexico by business volume, with a market share in loans of 13.9% and 15.1% in deposits. It has 1,258 branches and 10.5 million customers.

### Economic environment

The economy grew by an estimated 1.2% in 2013, lower than initially expected. Factors at play were the sharp shrinkage in construction and lower external demand in the first half of the year. The recovery in the US economy should stimulate activity in 2014 with greater exports.

Inflation was 4.0%, within the Bank of Mexico's target range (3%+/-1%). The low economic growth and stable inflation enabled the central bank to cut its benchmark rate by 100 b.p. to 3.50%.

The peso was very volatile during the year, moving between MXN 13.41/$1 and MXN 11.96/$1. The exchange rate at the end of 2013 was MXN 13.1, a depreciation of 1% against the dollar and of 4.9% against the euro to MXN 18.1.

The new government at the end of 2012 participated, in coordination with the main political forces, in the Pact of Mexico, which has served as a vehicle for dialogue and agreement on policies, enabling progress to be made in structural reforms. Of note were labour market, education, economics, telecoms, tax and energy reforms, which will have a very positive impact on economic growth in the medium term.

The financial system remains solid, liquid and with good credit quality indicators. The economic slowdown, however, impacted on the growth of banking business; lending grew at an annual rate of 10% in September 2013 and deposits 6%.

### Strategy

In this context, Santander Mexico continued to consolidate its franchise through a priority focus on customer relations and improving the quality of service. The strategy centred on consolidating retail banking, particularly the segments of high-income, SMEs and companies, and via linkage plans, multi channels and development of tailored offers.

The branch expansion plan begun in 2012 continued, with an increase of 88 branches in 2013 (8% of the network). This was joined by the opening of new ATMs and investments in specialised branches.

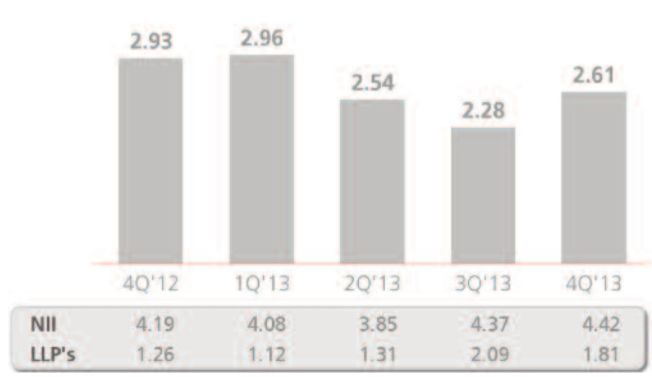
The targets in innovation and development of processes were also maintained, as well as in integral management of risks.

The range of products was increased in 2013. Of note was the launch of the *Elite* and *Select* families of mutual funds.

**ACTIVITY**
% var. 2013/2012 (mexican peso)


* On a like-for-like basis: +12.0%

**NET INTEREST INCOME - PROVISIONS / ATAs**
%




**GROSS INCOME**
Constant EUR Million


* In euros: +8.0%

In mortgages, the *Hipoteca Premier* was launched for high-income customers and the new credit card *Access* to meet the needs of SMEs.

Santander Mexico consolidated itself as the reference bank for SMEs, through a specialization model for value offer and customer attention.

The *Select* attention model was consolidated for high-income segments, with more than 100 specialised offices and a contact center *Select* to provide a value-differentiated service and offer.

Internet and mobile banking initiatives continued to be developed as part of the multi channel drive, as well as sales and service campaigns via the contact center.

Banco Santander Mexico placed a 10-year bond of $1,300 million in December. This was the first one by a Mexican bank compatible with Basel III criteria and will compute as Tier 2 supplementary capital. This operation, together with the distribution of an equivalent dividend, optimizes the Bank's regulatory capital structure by reducing the cost and increasing its profitability.

**Activity**

Lending grew 12%. Consumer finance rose 10%, cards 7% and mortgages 28%. There was also double-digit growth to SMEs (+26%).

Deposits without repos grew 4%, as the decline in time deposits was offset by the 21% increase in demand deposits (the increase was 12% on a like-for-like basis). Mutual funds rose 5%.

**Results**

Gross income rose 8.3% year-on-year, with good evolution of net interest income (+5.9%) and fee income (+8.1%), as well as growth in revenues from insurance (+12.5%), foreign trade (+9.5%) and cards (+31.3%).

Gross income performance was affected by lower economic growth than initially envisaged.

Operating expenses increased 9.9%, reflecting the new business projects and the increase in installed capacity. Net operating income was 7.2% higher.

Loan-loss provisions surged 72.2%, mainly because of the charge for homebuilders in accordance with IFRS regulations (in local criteria the charge was made against equity), and greater lending. Another factor was the release of provisions in the first quarter of 2012.

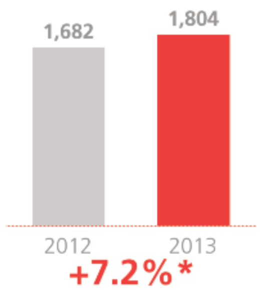
The NPL ratio stood at 3.66%, mainly impacted by homebuilders, which accounted for 1.51 p.p. of the rise in the NPL ratio, and by the entry of the ING portfolio in the fourth quarter, with an NPL ratio above that of recurring business. Coverage was 97%.

Pre-tax profit was EUR 1,020 million, 19.8% lower. And attributable profit was EUR 713 million.

The net profit of Retail Banking dropped 8.7%, while that of Global Wholesale Banking, impacted by markets, was down 36.6%.

The efficiency ratio was 40.7%, and the recurrence ratio 72.6%. The ROE was 18.6%.

**NET OPERATING INCOME**
Constant EUR Million




* In euros: +7.0%

**CONSOLIDATED PROFIT**
Constant EUR Million


* In euros: -12.4%

**Strategy and objectives in 2014**

- The Bank will continue to develop its franchise by consolidating the expansion of branches and developing the Select, SME and company segments.
- It will further strengthen the multi channel strategies via Internet, the contact centre, ATMs and correspondent banks in order to boost transaction linkage.
- It will continue the quality enhancement plans centred on customer experience, through greater efficiency in processes and development of new products and services.

## CHILE

EUR Million

| INCOME STATEMENT | 2013 | 2012 | Variation Amount | % | % w/o FX |
|---|---|---|---|---|---|
| **Net interest income** | **1,698** | **1,727** | **(29)** | **(1.7)** | **3.4** |
| Net fees | 383 | 447 | (65) | (14.4) | (10.0) |
| Gains (losses) on financial transactions | 168 | 124 | 44 | 35.8 | 42.8 |
| Other operating income[1] | 12 | 9 | 3 | 35.8 | 42.8 |
| **Gross income** | **2,261** | **2,307** | **(46)** | **(2.0)** | **3.0** |
| Operating expenses | (937) | (934) | (3) | 0.4 | 5.5 |
| General administrative expenses | (829) | (833) | 4 | (0.5) | 4.6 |
| *Personnel* | *(513)* | *(522)* | *9* | *(1.6)* | *3.4* |
| *Other general administrative expenses* | *(315)* | *(311)* | *(5)* | *1.5* | *6.7* |
| Depreciation and amortisation | (108) | (101) | (7) | 7.2 | 12.7 |
| **Net operating income** | **1,324** | **1,373** | **(49)** | **(3.6)** | **1.4** |
| Net loan-loss provisions | (597) | (573) | (24) | 4.1 | 9.5 |
| Other income | 4 | 5 | (1) | (25.2) | (21.4) |
| **Profit before taxes** | **731** | **805** | **(74)** | **(9.2)** | **(4.6)** |
| Tax on profit | (107) | (101) | (6) | 6.1 | 11.5 |
| **Profit from continuing operations** | **624** | **704** | **(80)** | **(11.4)** | **(6.9)** |
| Net profit from discontinued operations | — | — | — | — | — |
| **Consolidated profit** | **624** | **704** | **(80)** | **(11.4)** | **(6.9)** |
| Minority interests | 188 | 214 | (26) | (12.0) | (7.5) |
| **Attributable profit to the Group** | **435** | **490** | **(55)** | **(11.2)** | **(6.6)** |

| BALANCE SHEET | | | | | |
|---|---|---|---|---|---|
| Customer loans[2] | 28,783 | 29,677 | (894) | (3.0) | 11.2 |
| Trading portfolio (w/o loans) | 1,388 | 1,725 | (337) | (19.5) | (7.7) |
| Available-for-sale financial assets | 2,385 | 2,949 | (564) | (19.1) | (7.2) |
| Due from credit institutions[2] | 2,599 | 3,151 | (552) | (17.5) | (5.4) |
| Intangible assets and property and equipment | 327 | 373 | (46) | (12.3) | 0.6 |
| Other assets | 3,072 | 2,799 | 273 | 9.8 | 25.9 |
| **Total assets/liabilities & shareholders' equity** | **38,553** | **40,674** | **(2,121)** | **(5.2)** | **8.7** |
| Customer deposits[2] | 20,988 | 22,411 | (1,423) | (6.3) | 7.4 |
| Marketable debt securities[2] | 6,022 | 6,082 | (60) | (1.0) | 13.6 |
| Subordinated debt[2] | 1,147 | 1,151 | (3) | (0.3) | 14.4 |
| Insurance liabilities | — | — | — | — | — |
| Due to credit institutions[2] | 4,253 | 4,674 | (420) | (9.0) | 4.4 |
| Other liabilities | 4,021 | 4,286 | (265) | (6.2) | 7.6 |
| Shareholders' equity[3] | 2,122 | 2,071 | 51 | 2.5 | 17.5 |
| **Other customer funds under management** | **5,469** | **4,563** | **906** | **19.9** | **37.5** |
| Mutual and pension funds | 4,067 | 4,563 | (496) | (10.9) | 2.2 |
| Managed portfolios | 1,402 | — | 1,402 | — | — |
| **Customer funds under management** | **33,626** | **34,206** | **(580)** | **(1.7)** | **12.8** |

| RATIOS (%) AND OPERATING MEANS | | | |
|---|---|---|---|
| ROE | 18.47 | 21.73 | (3.27 p.) |
| Efficiency ratio (with amortisations) | 41.4 | 40.5 | 1.0 p. |
| NPL ratio | 5.91 | 5.17 | 0.74 p. |
| NPL coverage | 51.1 | 57.7 | (6.6 p.) |
| Number of employees | 12,290 | 12,364 | (0.6) |
| Number of branches | 493 | 504 | (2.2) |

1. Including dividends, income from equity-accounted method and other operating income/expenses
2. Including all on-balance sheet balances for this item
3. Not including profit of the year

## CHILE (changes in local currency)

→ **Attributable profit of EUR 435 million,** 6.6% less than in 2012.

- Gross income increased 3.0%, backed by net interest income and customer trading gains.
- Operating expenses rose 5.5% due to the commercial transformation plan and boost to target segments and products.
- Loan-loss provisions continued to slowdown. Cost of credit and NPLs were stable.

→ In business activity, **lending** up 11%, particularly in target segments: high-income, SMEs and companies.

**Deposits** rose 8%, particularly demand deposits, up 10%.

Santander is the leading bank in Chile in terms of assets and customers, with a marked focus on retail activity (individuals and SMEs). Its market share in loans is 19.1% and 16.8% in deposits. Of note is its share of loans to individuals; it is the leader in consumer finance (market share of 25.2%) and mortgages (20.8%).

The bank has 493 branches, 2,463 ATMs and 3.5 million customers.

### Economic environment

Economic growth slowed to between 4.0% and 4.5%, following a slowdown in consumption, but was still good (unemployment rate below 6% and rises in real wages), and more moderate investment.

As a result, the central bank cut its benchmark rate in October and November by 50 b.p. to 4.5%, while inflation rose in the second half of the year to 3.0% (within the central bank's target range). In line with the rest of Latin American economies, the peso depreciated 8.9% against the dollar in 2013 and 12.8% against the euro.

Lending grew at an annual rate in November of 14% and deposits 12%.

### Strategy

The Group continued to focus on ensuring long-term profitability in a scenario of lower spreads and higher NPLs. The Strategic Plan aims to consolidate the franchise and leadership positions in terms of size and profitability through four pillars: improve the quality of customer attention; focus on retail business, especially high-income clients, SMEs and companies; manage proactively and conservatively risks by very closely monitoring them and keep on improving processes to enhance operational efficiency.

In this regard, the *Santander Select* attention model has strengthened business growth in the high-income segment, while the Client Relationship Management model shows good results in growth in business and productivity.

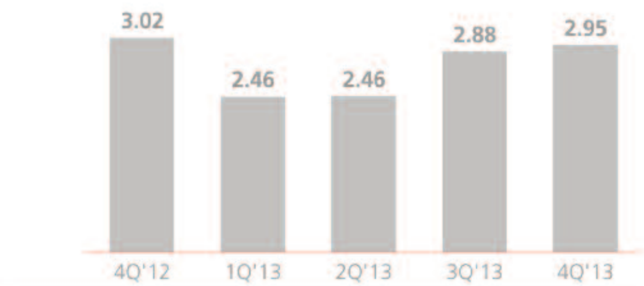
### Activity

Lending rose 11% (high-income clients: +16%; SMEs: +14% and companies: +15%. Deposits increased 8% (+10% demand deposits), as a result of the greater focus and the larger number of customers.

During 2013 management was focused on continuing to develop the *Strategic Plan* to 2016. The project of commercial transformation continued to make progress by implementing a deep restructuring of the customer base at the beginning of the year, simplifying segments and the range of products, and improving the quality of customer attention and post-sale.

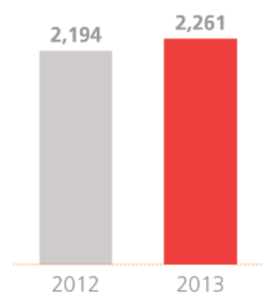
ACTIVITY
% var. 2013/2012 (chilean peso)


NET INTEREST INCOME - PROVISIONS / ATAs
%




| | 4Q'12 | 1Q'13 | 2Q'13 | 3Q'13 | 4Q'13 |
|---|---|---|---|---|---|
| NII | 4.52 | 3.95 | 3.87 | 4.40 | 4.38 |
| LLP's | 1.50 | 1.49 | 1.40 | 1.52 | 1.44 |

GROSS INCOME
Constant EUR Million




+3.0%*

* In euros: -2.0%

The high-income segment saw the launch of *Santander Select,* a specific value offer, and progress was made in the definition of a value offer for medium-income customers.

At the same time, the implementation of the new CRM across the retail network was completed. This model provides new applications to aid sales and customer relationships. A new system or commercial methodology was also implemented. This will improve productivity and effciency.

Additional channels were also enhanced (Internet, call centres and ATMs) providing them with greater commercial charateristics, as part of the strategy to boost multi channels and their importance in daily customer transactions and sales, to improve linkage and grow the customer base.

**Results**

Gross income rose 3.0%, backed by:

- Net interest income increased 3.4%, mainly due to larger volumes in target segments and a favourable impact of UF (accounting unit indexed to inflation), particularly in the second half of 2013 (of the 2.1% increase in the year, 2.0% corresponds to the second half).

- Fee income was 10.0% lower, with good performance of that from foreign trade (+12.3%), while that from insurance and cards continued to be affected by regulatory changes. Total fee income performed better in the fourth quarter, it rose 4.3% over the third quarter, as the impact of the larger customer base was registered across the income statement (current-account holders) in the second half of 2013.

- Trading gains rose 42.8%, due to the good performance of ALCO portfolios and the steady increase in customer business.

Operating expenses increased 5.5% and decelerated their growth pace as projects carried out in the last few years were completed (remodeling of branches to the new *Select* model and IT investments to strengthen the bank's transactions capacity.

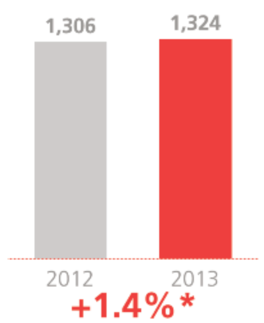
Loan-loss provisions increased 9.5%, below the 20.5% registered at the beginning of 2013. This was due to the sustained improvement of the individual customers portfolio, partly offset by some one-off positions of companies. The risk premium remained stable. NPL ratio was 5.91% and coverage 51%.

Attributable profit was 6.6% lower, pointing to a change of trend since the first half of 2013, when attributable profit was 22.9% lower.

The net profit of Retail Banking dropped 2.3%, while that of Global Wholesale Banking was down 22.4%.

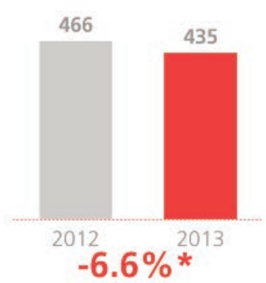
The efficiency ratio was 41.4%, the recurrence ratio 46.1% and ROE 18.5%.

**NET OPERATING INCOME**
Constant EUR Million




* In euros: -3.6%

**ATTRIBUTABLE PROFIT**
Constant EUR Million




* In euros: -11.2%

**Strategy and objectives in 2014**

Strategy and objectives in 2014 are framed in the 2013-2016 Plan including:

- Make the bank a reference in service quality.
- Offer the best retail banking in Chile, backed by a new commercial system and drive the use of remote channels to increase linkage and customer transactions.
- Become the best place to work, aided by innitiatives to improve the working environment and increase general satisfaction.

## ■ ARGENTINA (changes in local currency)

**Attributable profit was EUR 333 million** in 2013, 26.3% more than 2012 in local currency.

Santander Río is the country's leading private sector bank in terms of assets, customer funds and results, with market shares of 9.1% in lending and 9.6% in savings. It has 377 branches and 2.5 million customers.

The bank received various prizes in 2013: Best Bank in Argentina from *The Banker* and *Euromoney*; Best Bank in Argentina in Internet and Best Bank in Latin America in mobile banking from *Global Finance,* and Best Argentine Company to work for from the *Great Place to Work Institute*.

### Economic environment

The economy grew by around 3%, mainly due to agriculture, industry and services. The central bank reduced the growth of the main monetary aggregates to 23%, despite the growing increase in financing the Treasury, which was mainly explained by the bank's sale of dollars in the forex market.

In a context of a lower trade surplus and a small current account deficit, the depreciation of the peso accelerated, and at the end of 2013 was 6.5/$ (4.9/$ in 2012), a trend also seen at the beginning of 2014. The peso depreciated 27.8% against the euro in 2013. The private banks Badlar rate ended the year at 21.6% (+619 b.p.).

### Strategy

The strategy continued to focus on boosting penetration and linkage in the high-income and SME segments, developing improvements in the functionalities of key products and measures to enhance the quality of service.

An area for foreign trade products was created in 2013 in order to tend to the needs of wholesale and retail banking, coordinating the interaction of all sectors involved in the processes so as to provide a better value-added service.

The bank launched its *Infinity Black* products and services and *Select* areas within branches to tend to the needs of high-income segments. This resulted in greater cross selling, linkage and profitability of these clients.

### Activity

Lending rose 35%, with notable growth in SMEs and companies, both above 50%. Deposits grew 30% (+24% in demand and +42% in time).

### Results

The trend improved as the year progressed: the last two quarters were well above those in the six previous quarters. The ROE was 39.4%.

The bank maintained its focus on transactional services, collections and means of payment, through an offer tailored to the needs of each segment. The objective is to keep on increasing recurrent revenues, funding loans with low cost demand deposits and boosting revenues from services.

This strategy produced a 26.9% rise in net interest income and 20.6% in fee income, which coupled with the increase in trading gains resulted in growth of 30.7% in gross income.

Operating expenses (+30.0%) grew at a slower pace than gross income. Net operating income increased 31.2% and the efficiency ratio improved by 20 b.p. to 46.4%.

Provisions increased in line with the growth in lending, maintaining the cost of credit in the year. This was reflected in the high credit quality, with a NPL ratio of 1.42% and coverage of 140%.

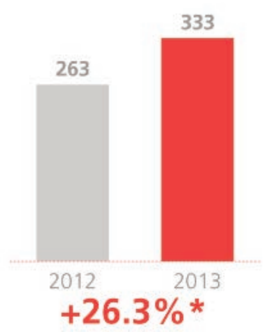
### Objectives

The strategy in 2014 remains focused on:

- Greater penetration of high-income individuals and SME segment.
- Increase the branch network, mainly in the country's interior which has a high growth potential.
- Continue to advance in transforming branches to make them more efficient and offer better quality service.
- Boost transaction products.

■ ARGENTINA. ACTIVITY
% var. 2013/12 (argentine peso)


■ ARGENTINA. ATTRIB. PROFIT
Constant EUR Million




* In euros: +2.0%

## ■ URUGUAY (changes in local currency)

**Attributable profit of EUR 53 million,** 18.8% more than in 2012. This was due to double-digit growth in net interest income (+12.6%) and fee income (+19.3%).

The Group maintained its leadership in Uruguay. Santander is the largest private sector bank in the country, with a market share in lending of 18.0% and 15.3% in deposits. The consumer finance company Creditel is the best positioned and with the highest brand awareness. Overall, the Group has 85 branches and 450,000 customers.

Santander Uruguay was awarded the Best Bank in Uruguay prize by *The Banker* for its business growth and results.

The economy grew at an annual rate of 3.3% in the third quarter. Growth for the whole year was estimated at close to 4%. Inflation was 8.5% for the last 12 months. The change of monetary policy instruments generated a rise in interest rates from 9.51% to 14.51% and made the interbank one-day rate (CALL rate) volatile (swinging between 3% and 35%).

Total bank lending increased 24% and deposits 20%. Santander growth in lending (+24%) and deposits (+17%) was higher than the market's, strongly backed by retail banking. This was combined with an excellent NPL ratio (0.93%) and coverage (264%).

Commercial banking is focusing on providing a differentiated service for each customer segment. The Group continues to develop retail banking with an emphasis on means of payment and products for SMEs. The bank increased its offer in 2013 with new and innovative products. We were the first bank in the country to introduce fraud insurance and we created the *Prestamo de Ahorro*, a consumer credit that rewards good performance in the payments and encourages responsible consumption.

Corporate and company banking also continued the strategy of providing a close and efficient service. Banco Santander Uruguay signed in 2013 an agreement, unheard of in the market, with the National Co-operative of Milk Producers (Conaprole), one of the country's main companies and leader in its sector, to finance investment in improving productivity. This enabled a large number of milk producers to access the financial system.

All of this strengthens the main elements of management: generation of recurrent revenues; customer business; efficiency improvement (-120 b.p.) and optimisation of costs. Fee-generating businesses continued to grow, with rises of more than 20% in revenues from insurance, custody and foreign trade, and a 19.3% rise in total fee income.

The Bank will maintain its strategy in 2014, centred on double-digit growth in retail business and on maintaining low levels of bad loans. Other priorities are to improve the efficiency ratio and focus on balance sheet liquidity.

■ URUGUAY. ACTIVITY
% var. 2013/2012 (uruguayan peso)


■ URUGUAY. ATTRIB. PROFIT
Constant EUR Million


* In euros: +14.3%

## ■ PUERTO RICO (changes in local currency)

**Attributable profit was EUR 77 million**, 40.7% more, largely due to the strategy of reducing the cost of funds, the good evolution of loan-loss provisions, control of costs and a positive one-off.

Santander Puerto Rico has 115 branches, 415,000 customers and market shares of 11.1% in loans and 13.7% in deposits. Its credit quality, high capital, liquidity and quality of service set it apart from its competitors.

Despite a complex economic environment, the product of a seven-year recession, Santander's business in Puerto Rico has been very positive. The bank has concentrated on selective growth. Of note was the 15% rise in credit cards, backed by *Santander JetBlue;* the recently launched *Select* customer attention model with initially positive results and the companies and large companies' segment, which continued to increase its number of clients and transaction volumes. Customer linkage and satisfaction also remained a priority.

Lending dropped 8%, as a result of the strategy to reduce mortgage loans, while deposits remained virtually unchanged. The loan-to-deposit ratio ended the year at 105% (111% in 2012).

Island Finance, Santander's consumer finance company in Puerto Rico, maintained an adequate pricing policy, rigorous risk management and strict control of costs. It contributed

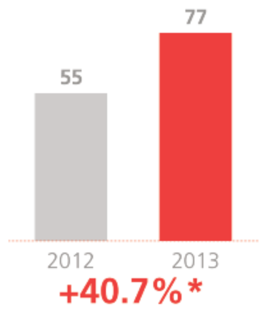
27% of profit before tax. The expansion of distribution channels, the creation of customer retention units and the integration of dual functions of sales and collection were key factors in meeting the goals.

The efficiency ratio was 56.2% and the recurrence ratio 37.4%. The NPL ratio was 6.29%, after improving 85 b.p. due to the rebalancing of credit portfolios and the positive performance of the commercial portfolio. The coverage ratio was 62%.

Santander Puerto Rico will remain focused on 2014 on a selective growth plan centred on high income, companies, consumer credit and insurance segments. The strategies are aimed at boosting linkage and transactions.

■ PUERTO RICO. ACTIVITY
% variation 2013 / 2012 (US$)


■ PUERTO RICO. ATTRIB. PROFIT
Constant EUR Million




* In euros: +36.1%

## ■ PERU (changes in local currency)

**Attributable profit was EUR 19 million**, 28.1% more in local currency and spurred by the 46.7% rise in net interest income. Gross income increased 43.3% and offset the 38.4% rise in costs related to the start up of the auto finance company Santander Consumer. Excluding this new business, gross income grew 36.8%, costs 14.8% and attributable profit 36.0%.

The efficiency ratio improved to 34.2%, the NPL ratio was 0.16% and coverage remained very high.

The economy grew by 5% in 2013, driven by domestic demand that rose by around 6%. Inflation was 2.9% at the end of 2013 and the central bank cut its benchmark rate to 4.0% and adopted supplementary measures to reduce cash reserve requirements in order to boost liquidity.

The sol depreciated 9% against the dollar, affected by the fall in metal prices and the Federal Reserve's tapering. Public debt stood at 18% of GDP, one of the lowest levels in the region and the country has foreign currency reserves of $66,000 million (more than 30% of GDP).

In this environment, Grupo Santander is focusing on retail banking with companies and the Group's global clients. Particular attention is paid to customer proximity, with quick and quality service and taking advantage of the synergies with the Group's other units.

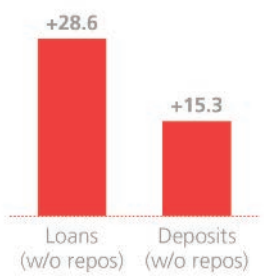
Lending rose 29% and deposits 15%, complementing the growth in medium-term funding.

A new auto finance company began to operate in 2013, together with a well-known international partner with large experience in Latin America. The company has a specialised business model, focused on service and with market shares that enable clients to acquire a new car via all the brands and dealers in Peru.

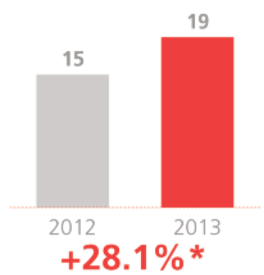
The buoyant economy, Grupo Santander's experience in this business and the positive performance of the auto sector encouraged us to enter this new activity.

The strategy in 2014 is to continue to focus on loans to large companies, as well as business with Santander's institutional and global clients. Auto finance will be further developed in an environment of a stable economy and sustained growth.

■ PERU. ACTIVITY
% var. 2013 / 2012 (peruvian sol)




■ PERU. ATTRIB. PROFIT
Constant EUR Million




* In euros: +21.2%

## UNITED STATES

EUR Million

| INCOME STATEMENT | 2013 | 2012 | Variation Amount | % | % w/o FX |
|---|---|---|---|---|---|
| **Net interest income** | **1,409** | **1,695** | **(286)** | **(16.9)** | **(14.1)** |
| Net fees | 393 | 378 | 15 | 4.0 | 7.5 |
| Gains (losses) on financial transactions | 69 | 244 | (175) | (71.7) | (70.8) |
| Other operating income[1] | 285 | 287 | (2) | (0.7) | 2.7 |
| **Gross income** | **2,157** | **2,605** | **(448)** | **(17.2)** | **(14.4)** |
| Operating expenses | (1,260) | (1,183) | (77) | 6.5 | 10.1 |
| General administrative expenses | (1,097) | (1,037) | (60) | 5.8 | 9.4 |
| *Personnel* | *(607)* | *(571)* | *(35)* | *6.1* | *9.7* |
| *Other general administrative expenses* | *(491)* | *(466)* | *(25)* | *5.4* | *8.9* |
| Depreciation and amortisation | (163) | (146) | (17) | 11.8 | 15.6 |
| **Net operating income** | **896** | **1,422** | **(525)** | **(37.0)** | **(34.8)** |
| Net loan-loss provisions | 5 | (265) | 269 | — | — |
| Other income | (64) | (187) | 122 | (65.5) | (64.3) |
| **Profit before taxes** | **836** | **970** | **(134)** | **(13.8)** | **(10.9)** |
| Tax on profit | (113) | (165) | 52 | (31.6) | (29.3) |
| **Profit from continuing operations** | **724** | **805** | **(82)** | **(10.1)** | **(7.1)** |
| Net profit from discontinued operations | — | — | — | — | — |
| **Consolidated profit** | **724** | **805** | **(82)** | **(10.1)** | **(7.1)** |
| Minority interests | — | — | — | — | — |
| **Attributable profit to the Group** | **724** | **805** | **(82)** | **(10.1)** | **(7.1)** |
| **BALANCE SHEET** | | | | | |
| Customer loans[2] | 37,682 | 41,331 | (3,649) | (8.8) | (4.7) |
| Trading portfolio (w/o loans) | 117 | 275 | (158) | (57.3) | (55.4) |
| Available-for-sale financial assets | 8,854 | 14,791 | (5,938) | (40.1) | (37.4) |
| Due from credit institutions[2] | 348 | 714 | (367) | (51.3) | (49.1) |
| Intangible assets and property and equipment | 585 | 560 | 24 | 4.3 | 9.1 |
| Other assets | 6,745 | 5,278 | 1,467 | 27.8 | 33.6 |
| **Total assets/liabilities & shareholders' equity** | **54,330** | **62,950** | **(8,620)** | **(13.7)** | **(9.8)** |
| Customer deposits[2] | 35,537 | 38,116 | (2,579) | (6.8) | (2.5) |
| Marketable debt securities[2] | 1,146 | 820 | 326 | 39.8 | 46.1 |
| Subordinated debt[2] | 1,225 | 1,986 | (762) | (38.4) | (35.6) |
| Insurance liabilities | — | — | — | — | — |
| Due to credit institutions[2] | 8,101 | 14,221 | (6,120) | (43.0) | (40.5) |
| Other liabilities | 2,649 | 2,629 | 21 | 0.8 | 5.4 |
| Shareholders' equity[3] | 5,673 | 5,179 | 494 | 9.5 | 14.5 |
| **Other customer funds under management** | **—** | **—** | **—** | **—** | **—** |
| Mutual and pension funds | — | — | — | — | — |
| Managed portfolios | — | — | — | — | — |
| **Customer funds under management** | **37,907** | **40,922** | **(3,015)** | **(7.4)** | **(3.2)** |
| **RATIOS (%) AND OPERATING MEANS** | | | | | |
| ROE | 12.42 | 15.42 | (3.00 p.) | | |
| Efficiency ratio (with amortisations) | 58.4 | 45.4 | 13.0 p. | | |
| NPL ratio | 2.23 | 2.29 | (0.06 p.) | | |
| NPL coverage | 93.6 | 105.9 | (12.3 p.) | | |
| Number of employees | 9,741 | 9,544 | 2.1 | | |
| Number of branches | 706 | 722 | (2.2) | | |

1. Including dividends, income from equity-accounted method and other operating income/expenses
2. Including all on-balance sheet balances for this item
3. Not including profit of the year

## SANTANDER BANK. INCOME STATEMENT

EUR Million

| | 2013 | 2012 | Variation Amount | % | % w/o FX |
|---|---|---|---|---|---|
| Gross income | 1,848 | 2,264 | (415) | (18.3) | (15.6) |
| Net operating income | 588 | 1,083 | (495) | (45.7) | (43.9) |
| Attributable profit to the Group | 413 | 466 | (53) | (11.5) | (8.5) |

■ **UNITED STATES (changes in local currency)**

→ **Attributable profit of $961 million,** 7.1% less than in 2012.

- Lower net interest income due to reduced volumes and sale of part of the investment portfolio.
- Higher costs related to the rebranding and investments to improve the IT infrastructure.
- Greater regulatory pressure that resulted in reduced fee income and higher compliance costs.
- Sharp reduction in provisions due to the high credit quality.

→ On October 17, Sovereign Bank changed its name to **Santander Bank**, successfully completing the rebranding.

→ Santander Bank strengthened its balance sheet to adapt it to the macroeconomic environment and, particularly, to an eventual rise in interest rates.

→ Notable growth of **SCUSA**, spurred by the strategic alliance with Chrysler.

The perimeter of Santander US corresponds to Santander Holdings USA (SHUSA), a bank holding company with two distinct lines of business: commercial banking, via its subsidiary Santander Bank, and consumer finance business through its stake in Santander Consumer USA Inc. (SCUSA).

The business model of Santander Bank, with 706 branches, 2,074 ATMs and 1.7 million customer-household, is focused on retail customers and companies. It conducts business in the north east of the US.

SCUSA, based in Dallas, specializes in consumer finance, mainly auto finance. The stake in it is recorded by the equity accounted method.

### Economic environment

Business was conducted in an environment of moderate growth. The Fed held its short-term interest rates at lows and implemented other unconventional stimulus such as quantitative easing. The market is already anticipating the effects of a future rise in interest rates and tapering.

Lending by banks rose 3%, while deposits increased 5%.

Car sales and finance continued to increase following the 2008 crisis. Competition has become stronger, exerting pressure on prices.

### Strategy

Sovereign Bank changed its name to Santander Bank and continued to capture new customers and expand its range of higher value-added products and services. The main strategy in the retail segment is to enhance customer attention via new ATMs, refurbish branches and give an impetus to alternative channels (mobile banking, etc).

Santander Bank strengthened its auto finance in 2013, with which it aims to obtain synergies via the Group's global experience of this activity and the local experience of SCUSA in order to offer loans to individuals, SMEs and companies.

As regards medium-sized companies, actions were taken to reduce the real estate portfolio, while growth in business with large companies continued to be the main focus in Global Banking & Markets.

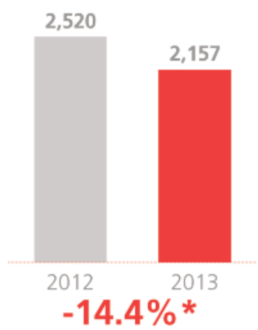
SCUSA's strategy is to continue to strengthen its auto finance franchise. The growth drivers are organic growth supported by commercial agreements with brands and dealers, strategic alliances (Chrysler), growth in the platform of direct credits to clients via Internet (Roadloans.com) and the opportunities of expansion offered by servicing.

Santander Consumer USA completed its initial public offering of shares at a price of $24 per share, and is now listed on the New York Stock Exchange. Demand was 10 times higher than the offering, valuing the company at $8,300 million. After this transaction, Banco Santander maintains a 60.7% stake.

■ ACTIVITY
% var. 2013/2012 (US$)


■ NET INTEREST INCOME / ATAs
%


■ GROSS INCOME
Constant EUR Million




* In euros: -17.2%

### Activity

Corporate business growth was consolidated through the change from a thrift to a national bank in 2012, which produced significant growth in this segment.

In retail business, the *Extra20 checking* product was launched in order to capture new customers, increase linkage and transactions and boost growth in demand deposits.

Of note in cards was the launch of a proprietary credit card platform in the US, which aims to be one of the main sources of growth.

Santander Bank's assets and liabilities performed similar to the market. On the assets side, lending dropped 5%, mainly due to the strategy of origination of mortgages for their subsequent sale. There was also a significant reduction in the investment portfolio in anticipation of a hike in interest rates.

On the liabilities side, customer deposits declined 3% due to the strategy of reducing the cost of funding, which was reflected in higher demand deposits (+9%) and a drop in time deposits (-36%).

As for SCUSA, new lending more than doubled that in 2012. Growth from origination in auto finance was spurred by the positive evolution of the market in general and, particularly, by the agreement with Chrysler in force since May.

### Results

Santander US posted an attributable profit of $961 million, 7.1% less than in 2012.

As for Santander Bank, the 13.2% decline in net interest income (in local currency) reflected the low interest rate environment, the reduction in the non-strategic loan portfolio and mainly the sharp fall in the investment portfolio.

Fee income increased 7.1%, largely due to GBM business and new products (cards and asset management).

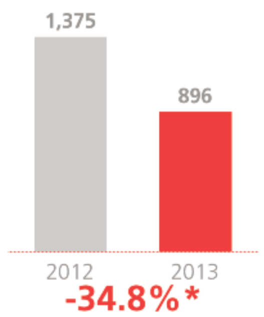
The rise in costs (+10.4%) reflects the investment in rebranding, technology (ATMs, mobile banking, cards) and higher spending on regulatory compliance.

Provisions fell sharply, thanks to the normalization of the cost of credit and the improvement in the economy. The NPL ratio was 2.23% and coverage 94%, reflecting the improvement in the portfolio's composition and strict management of credit risk.

After recording other results (including the Trust Piers charge made in 2012) and taxes, Santander Bank's attributable profit was $548 million, 8.5% lower than in 2012.

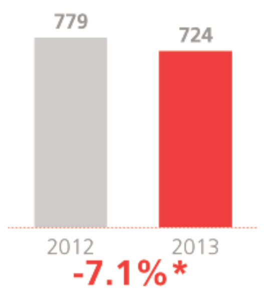
SCUSA's contribution was $413 million, 5.2% less than in 2012. Although SCUSA maintained a solid growth trend in business volumes (+35% in lending) and net interest income (+27%), partly due to the agreement with Chrysler, this growth has not yet fed through to profits because of the higher provisions required for the faster pace of lending in recent months.

**NET OPERATING INCOME**
Constant EUR Million




* In euros: -37.0%

**ATTRIBUTABLE PROFIT**
Constant EUR Million




* In euros: -10.1%

**Strategy and objectives in 2014**

Santander Bank's **main objectives** are:

- In the retail segment, focus on high and medium income clients. The *Select* initiative will be implemented.
- In cards, launch new products that increase penetration and linkage.
- In asset management, more personalized management, and recurring fee income products.
- In companies, the objective is to keep on growing in GBM.

SCUSA's **main goals** are:

- Continue the auto finance expansion plan, backed among others by the agreement with Chrysler.
- Further diversification of revenue sources, through expanding servicing business.
- Growth in consumer credit without guarantees.

## CORPORATE ACTIVITIES

EUR Million

| INCOME STATEMENT | 2013 | 2012 | Variation Amount | % |
|---|---|---|---|---|
| **Net interest income** | **(2,234)** | **(1,843)** | **(391)** | **21.2** |
| Net fees | (50) | (30) | (19) | 63.8 |
| Gains (losses) on financial transactions | 1,184 | 716 | 468 | 65.4 |
| Other operating income | 146 | 150 | (4) | (2.7) |
| Dividends | 35 | 53 | (18) | (34.0) |
| Income from equity-accounted method | (8) | (4) | (3) | 76.0 |
| Other operating income/expenses | 119 | 101 | 17 | 17.0 |
| **Gross income** | **(953)** | **(1,007)** | **54** | **(5.3)** |
| Operating expenses | (698) | (530) | (168) | 31.6 |
| General administrative expenses | (566) | (411) | (156) | 37.9 |
| *Personnel* | *(216)* | *(103)* | *(113)* | *109.9* |
| *Other general administrative expenses* | *(350)* | *(308)* | *(43)* | *13.8* |
| Depreciation and amortisation | (132) | (120) | (12) | 10.2 |
| **Net operating income** | **(1,651)** | **(1,537)** | **(114)** | **7.4** |
| Net loan-loss provisions | (201) | (85) | (116) | 136.7 |
| Other income | (173) | (555) | 382 | (68.8) |
| **Ordinary profit before taxes** | **(2,025)** | **(2,177)** | **152** | **(7.0)** |
| Tax on profit | 145 | 33 | 113 | 344.6 |
| **Ordinary profit from continuing operations** | **(1,880)** | **(2,144)** | **264** | **(12.3)** |
| Net profit from discontinued operations | (0) | 0 | (0) | — |
| **Ordinary consolidated profit** | **(1,880)** | **(2,144)** | **264** | **(12.3)** |
| Minority interests | 7 | (20) | 27 | — |
| **Ordinary attributable profit to the Group** | **(1,887)** | **(2,125)** | **238** | **(11.2)** |
| Net capital gains and provisions | — | 983 | (983) | (100.0) |
| **Attributable profit to the Group** | **(1,887)** | **(1,142)** | **(745)** | **65.3** |

| BALANCE SHEET | | | | |
|---|---|---|---|---|
| Trading portfolio (w/o loans) | 2,743 | 4,722 | (1,979) | (41.9) |
| Available-for-sale financial assets | 10,676 | 8,949 | 1,727 | 19.3 |
| Investments | 405 | 88 | 317 | 357.8 |
| Goodwill | 23,275 | 24,626 | (1,351) | (5.5) |
| Liquidity lent to the Group | 17,707 | 18,583 | (876) | (4.7) |
| Capital assigned to Group areas | 64,203 | 69,773 | (5,571) | (8.0) |
| Other assets | 62,714 | 116,712 | (53,997) | (46.3) |
| **Total assets/liabilities & shareholders' equity** | **181,722** | **243,453** | **(61,730)** | **(25.4)** |
| Customer deposits[1] | 2,851 | 3,152 | (301) | (9.5) |
| Marketable debt securities[1] | 64,470 | 82,002 | (17,532) | (21.4) |
| Subordinated debt[1] | 3,871 | 4,866 | (996) | (20.5) |
| Other liabilities | 29,755 | 73,744 | (43,989) | (59.7) |
| Group capital and reserves[2] | 80,776 | 79,689 | 1,087 | 1.4 |
| **Other customer funds under management** | **—** | **—** | **—** | **—** |
| Mutual and pension funds | — | — | — | — |
| Managed portfolios | — | — | — | — |
| **Customer funds under management** | **71,192** | **90,020** | **(18,828)** | **(20.9)** |

| OPERATING MEANS | | | | |
|---|---|---|---|---|
| Number of employees | 2,397 | 2,374 | 23 | 1.0 |

1. Including all on-balance sheet balances for this item
2. Not including profit of the year

## CORPORATE ACTIVITIES

→ Corporate Activities **registered a loss of EUR 1,887 million** compared to one in 2012 of EUR 2,125 million before capital gains and provisions.

→ Flat gross income and higher costs related to the liquidity buffer were offset by results from management of structural balance sheet risks.

Corporate activities recorded a negative attributable result of EUR 1,887 million in 2013 compared to a negative ordinary result in 2012 of EUR 2,125 million before extraordinary capital gains generated by the sale of the unit in Colombia and the insurance operations in Spain and Portugal. Including these capital gains, the attributable result was EUR 1,142 million negative.

Within corporate activities, the financial management area conducts the global functions of balance sheet management, both structural interest rate and liquidity risk (the latter via issues and securitizations), as well as the structural position of exchange rates:

- Interest rate risk is actively managed by taking market positions. This management seeks to soften the impact of interest rate changes on net interest income, and is done via bonds and derivatives of high credit quality and liquidity and low consumption of capital.

- The objective of structural liquidity management is to finance the Group's recurring activity in optimum conditions of maturity and cost, maintaining an appropriate profile (in volumes and maturities) by diversifying the funding sources.

- Management of the exposure to exchange rate movements is also carried out on a centralized basis. This management (which is dynamic) is conducted through exchange-rate derivatives, optimizing at all times the financial cost of hedging.

  Hedging of net investments in the capital of businesses abroad aims to neutralize the impact on capital of converting into euros the balances of the main institutions that are consolidated whose currency is not the euro.

  The Group's policy immunizes the impact, which, in situations of high volatility in the markets, sudden changes in interest rates would have on these exposures of a permanent nature. The investments that are currently hedged are those in Brazil, UK, Mexico, Chile, USA and Poland and the instruments used are spot, FX forwards or tunnel options. EUR 19,507 million are currently hedged.

  Exposures of a temporary nature – those regarding results that the Group's units will contribute in the next 12 months in non-euro currencies – are also managed on a centralized basis in order to limit their volatility in euros.

Meanwhile and separately from the financial management described here, Corporate Activities 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. The price at which these operations are carried out is the market rate (euribor or swap) plus the risk premium, which in concept of liquidity, the Group supports for immobilizing the funds during the life of the operation.

Lastly, and more marginally, the equity stakes of a financial nature that the Group takes within its policy of optimizing investments are reflected in Corporate Activities.

The main developments in the year were:

- Gross income was almost flat thanks to trading gains offsetting net interest income that was more negative in 2013.

  Net interest income was more negative because of the policy of strengthening liquidity that the Group has been implementing since the middle of 2012, and which, combined with the current low level of market interest rates, caused net interest income to deteriorate temporarily. It also includes the cost of credit of issues in wholesale markets, which was partly absorbed by lower recourse to these markets (directly related to the lower funding needs from the gap between lending and deposits).

  Net interest income was offset by trading gains, which reflects those derived from the centralized management of the interest rate and exchange rate risk of the parent bank as well as that from equities. The contribution was EUR 1,184 million positive compared to EUR 716 million in 2012.

- Operating expenses rose mainly because of the base effect, due to the adjustment made in the fourth quarter of 2012 related, in part, to delays in executing projects that were undertaken in 2013. General administrative costs increased, partly linked to higher indirect taxes.

- Loan-loss provisions were EUR 201 million and in line with other income, which includes various provisions and allowances (-EUR 173 million compared with –EUR 555 million in 2012). The difference was mainly due to charges made in the fourth quarter for goodwill in Italy, real estate provisions and for the integration costs of SEB in Germany.

- Lastly, the tax line records a recovery of EUR 145 million compared EUR 33 million in 2012, as a result of adjustments in the Group's accounting consolidation process.

## RETAIL BANKING

- **Attributable profit of EUR 5,077 million,** 13.8% less than in 2012, and 8.9% lower excluding exchange rate:
  - Lower gross income in an environment of reduced business and low interest rates in mature markets and change of business mix in emerging ones.
  - Partly offset by lower provisions need.
  - Costs growing below the inflation rate.
- **Loans** declined 1% and **deposits** increased 2%.
- **New Retail Banking division** to maximise the Group's international position, and enhance the relationship between local units and global areas.

Retail Banking accounted for 85% of the Group's operating areas gross income and 74% of attributable profit in 2013.

### Strategy

A new global retail banking division was created in 2013 in order to lead the Group's global retail banking strategy and better exploit the opportunities offered by its international positioning.

The aim is to achieve a business model built around customers, with a focus on segments, greater specialization, a multi channel business strategy and fostering lasting relations that strengthen customer linkage.

The Bank's commitment to develop retail banking close to customers is seen in many of the activities conducted during 2013:

- **Strengthen the affluent segment –** *Santander Select.* Following its success in Spain, it began to be implemented in Mexico, Chile and, recently, the UK and Brazil, through the design of a differentiated value proposal for these clients. The opening of specialized branches and the offer of products designed specifically for this segment are some of its elements. In the coming months, other countries will be added gradually to *Santander Select.*

- **Give global support to SMEs.** In order to back this key segment of the economy and increase our penetration and market share, various initiatives were launched, including:

  – The *10.000 Plan* in Spain aiming to increase lending to SMEs and large companies.
  – *Santander Pymes* in Latin America, particularly in Mexico, where Banco Santander was recognized by the government for its support of SMEs.

### RETAIL BANKING

EUR Million

| INCOME STATEMENT | 2013 | 2012 | Variation Amount | % | % w/o FX |
|---|---|---|---|---|---|
| **Net interest income** | **25,553** | **28,865** | **(3,312)** | **(11.5)** | **(5.3)** |
| Net fees | 8,193 | 8,471 | (278) | (3.3) | 2.7 |
| Gains (losses) on financial transactions | 1,119 | 1,134 | (15) | (1.3) | 6.4 |
| Other operating income[1] | (75) | (144) | 69 | (48.0) | (42.1) |
| **Gross income** | **34,790** | **38,326** | **(3,536)** | **(9.2)** | **(3.1)** |
| Operating expenses | (16,917) | (17,190) | 274 | (1.6) | 4.4 |
| **Net operating income** | **17,873** | **21,136** | **(3,263)** | **(15.4)** | **(9.2)** |
| Net loan-loss provisions | (9,448) | (11,763) | 2,315 | (19.7) | (13.5) |
| Other income | (1,055) | (1,296) | 241 | (18.6) | (10.1) |
| **Ordinary profit before taxes** | **7,370** | **8,076** | **(707)** | **(8.7)** | **(2.9)** |
| Tax on profit | (1,509) | (1,649) | 140 | (8.5) | (1.6) |
| **Ordinary profit from continuing operations** | **5,861** | **6,428** | **(567)** | **(8.8)** | **(3.2)** |
| Net profit from discontinued operations | (15) | 70 | (85) | — | — |
| **Ordinary consolidated profit** | **5,845** | **6,497** | **(652)** | **(10.0)** | **(4.5)** |
| Minority interests | 768 | 686 | 83 | 12.0 | 22.9 |
| **Ordinary attributable profit to the Group** | **5,077** | **5,812** | **(734)** | **(12.6)** | **(7.6)** |
| Net capital gains and provisions | — | 81 | (81) | (100.0) | (100.0) |
| **Attributable profit to the Group** | **5,077** | **5,892** | **(815)** | **(13.8)** | **(8.9)** |
| **BUSINESS VOLUMES** | | | | | |
| Customer loans | 584,137 | 618,523 | (34,386) | (5.6) | (1.9) |
| Customer deposits | 537,408 | 533,978 | 3,429 | 0.6 | 4.6 |

1. Including dividends, income from equity-accounted method and other operating income/expenses

– The *Breakthrough* programme in the UK, which aims to identify the best small firms and support them to achieve their full potential.
– The agreement between Banco Santander and the European Investment Bank to launch a EUR 400 million fund for the securitisation of the assets of SMEs and the self-employed in order to finance the long-term investments and working capital needs of SMEs and mid cap companies.

- **Strengthen proximity to customers,** through the traditional route of opening branches in countries such as Mexico and Argentina, but above all boosting multi channel interactions.

  Santander Río in Argentina was named by the magazine Global Finance best online bank in the country and best mobile bank in the region; Santander Spain launched a line of exclusive deposits for the online channel; Santander Brazil is the country's bank with the largest number of responses from its followers in social networks, and Santander Poland and Santander US have developed advanced mobile banking services.

- **Develop attractive value offers**. Examples include:

– The launch of *Santander Trade,* a unique portal in the financial system that helps to internationalise company business thanks to bringing business opportunities close to the business community.
– Santander US's new product, *Extra20 checking,* an account that credits clients $20 each month for having a minimum deposit balance and domiciling receipts via Santander's online banking.
– In Brazil the investment in the Swedish company iZettle, the precursor in Europe of payment acceptance with cards via smartphones and tablets.
– Consolidation of the success of the *1|2|3 World* in the UK which in October, 18 months after its launch, had two million customers thanks to its unique benefits for customers.

**Results and activity**

The results in 2013 were determined by the 11.5% fall in net interest income (-5.3% excluding the exchange rate impact). This reflected the environment of low growth and interest rates, the Group's strategy of giving priority to liquidity and balance sheet strength and the strategy of the change of business mix toward lower risk products.

Due to the better performance of fee income and trading gains, gross income fell by 9.2% (-3.1% in constant currency).

Operating expenses were 1.6% lower (+4.4% excluding the exchange rate impact) and provisions were lower than in 2012. Ordinary profit before tax dropped 8.7% (-2.9% in constant currency) to EUR 7,370 million.

Including taxes, discontinued operations (cards in the UK) and higher minority interests in Poland and Mexico, attributable profit was 13.8% lower (-8.9% in constant currency).

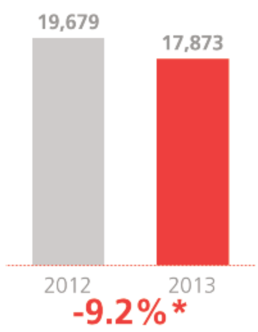
By geographic area the main features were as follows:

- Continental Europe posted a profit before minority interests 3.7% higher than in 2012, due to lower provisions and, to a lesser extent, the perimeter effect (Poland). Attributable profit was down 3.1% (Poland's minority interests).

- Attributable profit in the UK (in sterling) increased 24.0%. Before discontinued operations, profit rose 54.8%, backed by net interest income (+7.3%), almost flat costs (+1.5%) and reduced provisions needs.

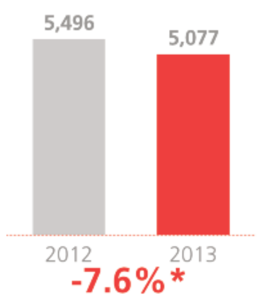
- Latin America's attributable profit (in constant currency) decreased 21.0%, due to lower net interest income (lower spreads), higher costs (investment in business

NET OPERATING INCOME
Constant EUR Million




* In euros: -15.4%

ORDINARY ATTRIB. PROFIT
Constant EUR Million




* In euros: -12.6%

**Strategy and objectives in 2014**

Continue the transformation of the Group's retail banking aimed to:

- Model more focused on customers, offering tailored products and improving their experience with the bank.
- Specialisation by segment, different types of customers need different solutions and management models.
- Develop a multi channel distribution model which is more efficient and adjusted to customers' needs.
- Promote colaboration between countries and units, in order to fully exploit the Group's strengths.

development and inflation pressure) and higher minority interests. Provisions, on the other hand, declined.

- Attributable profit in the US (in dollars) dropped 7.5% because of lower gross income (reduction in the portfolio) and higher costs (rebranding and technology). Lower provisions.

Lending (in constant currency) dropped 1%, with that to mature markets down 5% and to emerging markets up 14%, partly due to Poland's perimeter effect. Deposits without repos grew 2%, spurred by Spain, Latin America and Poland.

The **Private Banking** area offers integral solutions for high income clients' financial needs. It includes Santander Private Banking in Latin America and Italy and the private banking units in Spain, Portugal, Italy, Brazil, Mexico, Chile and the US, jointly managed with local banks.

The business model combines market knowledge at the local level with a global vision that requires professional investment management. In 2013, Santander deepened the advisory model and the commercial strategy policy defined for this segment.

The business environment was characterized by greater regulatory pressure in all markets, with the entry into force in the countries where we operate of new regulations: MiFID II, FATCA, Dodd-Frank, Retail Distribution Review and others.

Managed assets rose 11% to EUR 111,000 million and the efficiency ratio remained at around 50%, a reference for the sector.

Santander continued to receive in 2013 recognition of the quality of its offer for private banking clients. It was named by the magazine *Euromoney* the Best Private Bank in Spain, Portugal and Chile. *The Banker* and *Private Banker International* awarded Santander the prize for Best Private Bank in Latin America.

**The Private Banking goals for 2014** are to deepen client linkage, increase the volume of managed assets, strive for a greater share of wallet and strengthen the capturing of new clients. The following strategies are being developed:

- Bolster the client linkage policy.

- Strengthen commercial activity with the younger generation.

- Design a new digital strategy to satisfy clients needs.

All these measures are part of the objective of developing a specialized and differentiated business model, which makes Santander one of the world's leading private banks.

## RETAIL BANKING. INCOME STATEMENT

EUR Million

| | Gross income | | | Net operating income | | | Attributable profit | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2013 | % | % w/o FX | 2013 | % | % w/o FX | 2013 | % | % w/o FX |
| **Continental Europe** | **10,106** | **(3.8)** | **(3.7)** | **4,637** | **(10.4)** | **(10.2)** | **1,212** | **(3.1)** | **(2.8)** |
| o/w: Spain | 5,043 | (11.9) | (11.9) | 2,001 | (24.4) | (24.4) | 134 | (53.3) | (53.3) |
| Portugal | 728 | (13.4) | (13.4) | 271 | (27.0) | (27.0) | 20 | (38.4) | (38.4) |
| Poland | 1,204 | 47.8 | 48.3 | 652 | 48.7 | 49.2 | 276 | 10.3 | 10.7 |
| Santander Consumer Finance | 3,111 | (1.0) | (1.0) | 1,720 | (2.3) | (2.3) | 794 | 9.6 | 9.6 |
| **United Kingdom*** | **4,372** | **2.9** | **7.7** | **2,035** | **10.6** | **15.9** | **972** | **31.2** | **37.5** |
| **Latin America** | **18,315** | **(13.3)** | **(3.5)** | **10,412** | **(18.7)** | **(9.4)** | **2,248** | **(27.5)** | **(21.0)** |
| o/w: Brazil | 11,945 | (19.3) | (8.0) | 7,009 | (25.2) | (14.7) | 937 | (36.3) | (27.4) |
| Mexico | 2,548 | 8.7 | 8.9 | 1,443 | 7.8 | 8.1 | 567 | (27.2) | (27.1) |
| Chile | 1,979 | (1.4) | 3.7 | 1,138 | (2.5) | 2.5 | 333 | (6.7) | (1.9) |
| **USA** | **1,997** | **(18.3)** | **(15.5)** | **789** | **(39.6)** | **(37.6)** | **645** | **(10.5)** | **(7.5)** |
| **Total Retail Banking*** | **34,790** | **(9.2)** | **(3.1)** | **17,873** | **(15.4)** | **(9.2)** | **5,077** | **(12.6)** | **(7.6)** |

*.- Excluding net capital gains and provisions

## GLOBAL WHOLESALE BANKING

- **Attributable profit of EUR 1,503 million,** 21.4% less than in 2012 due to higher provisions.
- **Solid revenues,** which increased 4.9% in constant euros (87% generated by clients).
- **Strict management of costs,** absorbing expansion in core markets, in order to maintain efficiency levels that are benchmarks for the sector (33.7%).
- **Activity** in the year was marked by active management of risks, liquidity and capital.

Santander Global Banking & Markets (SGB&M) contributed 13% of the operating areas' gross income and 22% of attributable profit.

### Strategy

SGB&M maintained in 2013 the key pillars of its business model, focused largely on the corporate client, the global product capabilities and its interconnection with local units.

From a strategic point of view, the area focused on boosting results from clients, with active management of risks, capital and liquidity, adjusted to the new regulatory and competitive environment. Of note by country was the greater effort in the UK, with the consequent reduction in markets and capital consumption, as well as in the US and Poland, in line with the Group's retail banking expansion.

These investments in transaction capacity and distribution of treasury products was carried out without sacrificing the efficiency ratio, that remained a benchmark for our international peers.

### Results and activity

Santander Global Banking and Markets conducted its business in an environment of markets that were more stable and with increased regulatory requirements. Attributable profit was EUR 1,503 million, 21.4% less than in 2012. Higher minority interests in the Latin American units, the depreciation of their currencies and, above all, higher loan-loss provisions offset the solid revenues and good management of costs.

Gross income rose 4.9% year-on-year, excluding the exchange rate impact (-0.6% in current euros), while costs rose 2.9% (-1.6% in current euros), after absorbing the investments in building up franchises in key markets. The combination of both factors, brought the efficiency ratio to 33.7% from 34.1% in 2012 and net operating income was 5.9% higher excluding the exchange rate impact.

This trend was offset by higher loan-loss provisions, mainly in Spain and Mexico. In the first case, they were related to specific companies, and in the second mainly to homebuilders.

Higher provisions and minority interests at the two largest Latin American units were the main reasons for the lower profits (-16.7% excluding exchange rate impact).

## GLOBAL WHOLESALE BANKING

EUR Million

| INCOME STATEMENT | 2013 | 2012 | Variation Amount | % | % w/o FX |
|---|---|---|---|---|---|
| **Net interest income** | **2,464** | **2,708** | **(245)** | **(9.0)** | **(3.6)** |
| Net fees | 1,254 | 1,360 | (106) | (7.8) | (3.4) |
| Gains (losses) on financial transactions | 1,159 | 840 | 319 | 38.0 | 47.0 |
| Other operating income[1] | 271 | 268 | 3 | 1.2 | 1.8 |
| **Gross income** | **5,148** | **5,176** | **(29)** | **(0.6)** | **4.9** |
| Operating expenses | (1,736) | (1,764) | 29 | (1.6) | 2.9 |
| **Net operating income** | **3,412** | **3,412** | **(0)** | **(0.0)** | **5.9** |
| Net loan-loss provisions | (952) | (420) | (532) | 126.7 | 131.3 |
| Other income | (72) | (45) | (27) | 58.7 | 58.7 |
| **Profit before taxes** | **2,388** | **2,947** | **(559)** | **(19.0)** | **(13.6)** |
| Tax on profit | (661) | (827) | 166 | (20.1) | (14.6) |
| **Profit from continuing operations** | **1,727** | **2,120** | **(393)** | **(18.5)** | **(13.3)** |
| Net profit from discontinued operations | — | — | — | — | — |
| **Consolidated profit** | **1,727** | **2,120** | **(393)** | **(18.5)** | **(13.3)** |
| Minority interests | 225 | 209 | 15 | 7.2 | 19.1 |
| **Attributable profit to the Group** | **1,503** | **1,911** | **(408)** | **(21.4)** | **(16.7)** |
| **BUSINESS VOLUMES** | | | | | |
| Customer loans | 77,511 | 87,897 | (10,386) | (11.8) | (7.7) |
| Customer deposits | 58,366 | 82,023 | (23,657) | (28.8) | (24.9) |

1. Including dividends, income from equity-accounted method and other operating income/expenses

From a management point of view, profit before provisions was backed by client revenues, which accounted for 87% of the area's total were 1.1% higher in constant euros. Those generated by the global customer relation model rose 2% excluding the exchange rate impact.

Of note by geographic areas and in local currency was year-on-year growth in client revenues in Latin America (+10%), backed by Brazil (+16%) and the small countries, and the change of trend in Spain (+3%). On the other hand, sharp decline in the UK (-20%) due to lower revenues in markets with interest rates at their lowest.

The performance of the business sub-areas and their contribution to revenue generation was as follows:

**Transaction Banking**
Global Transaction Banking[1], maintained solid client revenues: +1% year-on-year without the exchange-rate effect (-3% in current euros).

By business, trade finance was stable, underpinned by Santander's solid position in its natural markets. Of note was the growth in the UK and the US, in contrast to the weak performance of Brazil. Similar performance of cash management due to weak evolution in Europe offset by Latin America and the US.

Basic financing registered the higher increase in client revenues, thanks to active management of spreads that offset the disintermediation and containment of risk assets in European markets. Stable revenues in custody and settlement due to the pick up in Latin America offsetting the weak performance in Europe.

**Corporate Finance**
Reduced client revenues from Corporate Finance[2] (-17% year-on-year and -16% in constant euros), due to sluggish activity in Latin America in the second half of the year.

Santander was an active player in M&A[2] in the advisory services for investors in the Spanish market, particularly those from Asia and the US: the purchase of Veolia Environment; the entry into the capital of NH; the acquisition of 5% of CLH, etc. Also noteworthy was Santander's involvement in the purchase-sale of assets in countries in Latin America (the sale of 40% of Telefonica's operations in Central America; the sale of part of Dalkia businesses, etc).

Of note in Equity Capital Markets (ECM) was Santander's role in the main Spanish issues of convertible bonds (ACS, Indra and IAG), as well as in the first issue of "CoCo" bonds of a Spanish bank, and in Latin America the capital increases of Fibra Uno in Mexico and Enersis in Chile (subsidiary of Endesa) of $7,700 million overall.

CED[2] activity grew for the third year running, underscoring its potential as an alternative source of funding, investment or coverage for corporate clients.

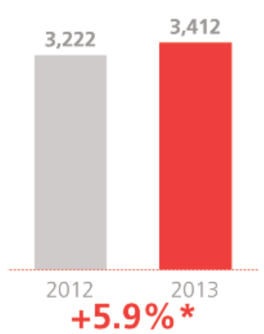
**Credit**
Credit markets[3] increased their client revenues (+1% year-on-year; +5% in constant euros). Better performance in the US, the UK and Brazil, offsetting the decline in Spain.

Of note in syndicated corporate loans was Santander's participation as co-arranger in the $63,000 million loan for Verizon-Vodafone's operation, and as active bookrunner in Glencore's EUR13,000 million loan operation.

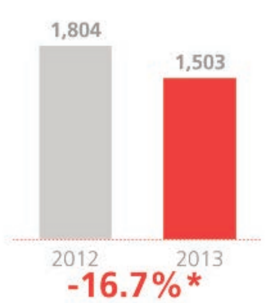
In project finance, Santander was the only bank as a bookrunner in the first two project bonds in Europe under the *Europe 2020 Project Bond initiative* of the European Union and the European Investment Bank for a total of EUR 1,800 million. In Latin America, Santander was the bookrunner in the $1,700 million project bond for Brazil's Odebrecht in the US market which refinances two project finance for the construction of oil drilling ships. There were also various project bonds in Mexico for close to MXN 12,000 million for infrastructure and concession-holder companies, as well as structures in Chile.

In the primary bond market, Santander led as joint bookrunner two Kingdom of Spain issues of EUR 7,000 million each, and it also was senior co-manager in Verizon's $49,000 million issue, the largest ever, to acquire 49% of Verizon Wireless from Vodafone. Furthermore, Santander

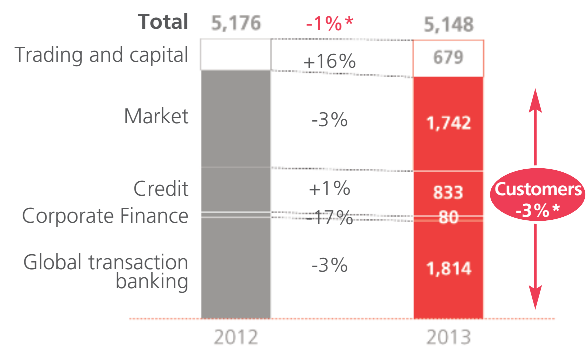
NET OPERATING INCOME
Constant EUR Million




ATTRIBUTABLE PROFIT
Constant EUR Million




GROSS INCOME. BREAKDOWN
EUR Million




* Excluding exchange rate impact: total: +5%; customers: +1%

remains as one of the main participants in the Latin American bond market.

The gross income of *Asset and Capital Structuring* (AC&S) continued to register high double-digit growth, backed by significant rises in portfolios and revenues in Latin America, the UK and the US.

**Global Markets**

Global markets[4] maintained their client revenues in constant euros (-3% in current euros) in an environment adjusting to the new regulations.

Solid evolution of revenues from sales (+11% in constant euros) in a context of limited opportunities. Most of the large units performed well, with double-digit growth in Brazil, Portugal and the US, which offset the fall in the UK.

All segments registered positive growth excluding the exchange-rate impact, especially retail and institutional (around 10%), backed by business in interest rate, exchange rate inflation and money market.

The management of books also benefited from inflows of capital and volatility scenarios, as well as from the recovery in equity markets. This resulted in a positive contribution for the year which offset the declines in previous quarters.

In equities, including derivatives, the year-on-year decline in client revenues softened (-1% without the exchange-rate effect compared to double-digit falls at the start of the year). The recovery of the Spanish stock market, particularly in the second half of the year, was the main reason for this change of trend.

Mixed trends in derivatives for lending and hedging: good progress in Latin America in local currency, especially in Mexico and Brazil, as against a slowdown in Europe where volumes were lower than in 2012.

**Strategy and objectives in 2014**

Business model adjusted to the new regulatory and market environment in order to gain market share in products of low capital and liquidity consumption by selling them to SGBM clients and at the networks.

The basic actions in 2014 will focus on:

- Develop, together with retail banking, the sale of SGBM products for all the bank's customers.
- Boost transactions with customers in the UK, the US and Poland.
- Strengthen customers' results to gain market share in other geographic areas.
- Maintain active management of capital and liquidity.

RANKING IN 2013

| | Activity | Area | Country / region | Source |
|---|---|---|---|---|
| Award | Best Trade & Supply Chain Bank in Latin America | GTB | Latin America | Trade Finance |
| Award | Best Overall Trade Bank in Latin America | GTB | Latin America | Trade Finance |
| Award | Best Trade Bank in Latin America | GTB | Latin America | Trade Finance Review |
| Award | Best Trade finance bank in Latin America (including Caribean) | GTB | Latin America | GTR |
| Award | Best Trade Finance Bank 2013: Spain | GTB | Spain | Global Finance |
| Award | Best Trade Advisor in Latin America | GTB | Latin America | Trade Finance |
| Award | Best Project/Infrastructure Finance Deal: Odebrecht Drilling Norbe | CM | Brazil | LatinFinance |
| Award | EMEA Loan Glencore Xstrata's US$17.34bn loan | CM | Europe | IFR |
| Award | Europe Telecoms Deal of the Year: Arqiva | CM | Europe | Project Finance Magazine |
| Award | Europe Transmissions Deal of the Year: Greater Gabbard | CM | Europe | Project Finance Magazine |
| Award | Infrastructure Bank of The Year In Latin America | CM | Latin America | Infrastructure Investor |
| N1.* | Equities Research en Iberia | GM | Iberia | Institutional Investors |
| N1.* | Equities Research en Iberia | GM | Iberia | Extel |
| Award | ECP/EMTN Hybrid Funding Platform | GM | Europe | Mtn-i |

*.- Ranking according to survey selection criteria

1. **Global transaction banking (GTB):** includes cash management, trade finance, basic financing and custody.
2. **Corporate finance:** includes mergers and acquisitions –M&A–, equity capital markets –ECM–, and investment solutions for corporate clients via derivatives –CED-.
3. **Credit markets (CM):** include units for the origination and distribution of corporate loans or structurerd finance, bond origination and securitisation teams and asset and capital structuring.
4. **Global markets (GM):** include the sale and distribution of fixed income and equity derivatives, interest rates and inflation, the trading and hedging of exchange rates, short-term money markets for the Group's wholesale and retail clients, managemento of books associated with distribution, brokeage of equities, and derivatives for investment and hedging solutions.

## ASSET MANAGEMENT AND INSURANCE

- **Attributable profit of EUR 313 million,** (-22.3%).
  - Impact of the corporate operations on insurance in Spain and Portugal, and of exchange rates. Excluding their impact, profit was 7.1% lower.
- Gross income accounted for 9% of the operating areas' total (+3% on a like-for-like basis).
- **Asset Management:** 2% growth in gross income in constant euros.
  - Strategic agreement to drive global business (goal of doubling the volume in five years).
- **Insurance:** gross income (+4% on a like-for-like basis) plus value of business recognized from corporate operations.

Attributable profit was EUR 313 million, 22.3% lower year-on-year, and accounted for 4% of the operating areas' total.

Excluding the corporate insurance operations recorded in 2012 (reinsurance of life-risk assurance operations in Spain and Portugal) and in 2013 (strategic alliance in bancassurance -life-risk and general- in Spain) attributable profit would have been 7.1% lower in constant euros.

### Strategy and activity

**Asset Management** business revolves around three specialized business areas: Santander Asset Management, in mutual and pension funds, companies and discretional portfolios; Santander Real Estate, in management of real estate investment products; and Santander Private Equity, in venture capital.

Santander Asset Management (SAM) continued to develop its global business model which is supported by the strength and market knowledge of local managers. As part of this, SAM reached a strategic agreement with Warburg Pincus and General Atlantic to drive its global business through improvements in the range of products and services and strengthen institutional business where there is a high growth potential.

SAM's aim is to double its business volume in the next five years and participate in the process of consolidating the asset management industry at the international level.

As regards products, the segmented range of mutual funds was extended to four countries following the launch of profiled funds in Mexico and Chile for *Select* clients. New local institutional mandates were also won to manage various types of assets such as fixed income, multi-strategy and structured products in Brazil and Spain.

Lastly, the structure of global teams was consolidated, after completing the management structures for Latin American and global European mandates, which benefits institutional business.

Santander **Insurance** provided protection and savings solutions to more than 17 million clients in 20 countries, with a segmented offer via multichannel.

### ASSET MANAGEMENT AND INSURANCE

EUR Million

| INCOME STATEMENT | 2013 | 2012 | Variation Amount | % | % w/o FX |
|---|---|---|---|---|---|
| **Net interest income** | **115** | **118** | **(3)** | **(2.7)** | **1.8** |
| Net fees | 348 | 418 | (69) | (16.6) | (11.8) |
| Gains (losses) on financial transactions | 6 | 3 | 3 | 109.1 | 165.6 |
| Other operating income[1] | 293 | 355 | (62) | (17.4) | (13.6) |
| **Gross income** | **763** | **894** | **(131)** | **(14.6)** | **(10.2)** |
| Operating expenses | (318) | (306) | (12) | 3.9 | 7.5 |
| **Net operating income** | **444** | **587** | **(143)** | **(24.3)** | **(19.7)** |
| Net loan-loss provisions | 0 | (2) | 2 | — | — |
| Other income | (8) | (10) | 2 | (19.9) | (10.2) |
| **Profit before taxes** | **437** | **576** | **(139)** | **(24.1)** | **(19.6)** |
| Tax on profit | (101) | (154) | 53 | (34.6) | (31.3) |
| **Profit from continuing operations** | **336** | **422** | **(86)** | **(20.3)** | **(15.2)** |
| Net profit from discontinued operations | 0 | — | 0 | — | — |
| **Consolidated profit** | **336** | **422** | **(86)** | **(20.3)** | **(15.2)** |
| Minority interests | 24 | 20 | 4 | 21.0 | 36.7 |
| **Attributable profit to the Group** | **313** | **402** | **(90)** | **(22.3)** | **(17.6)** |

1. Including dividends, income from equity-accounted method and other operating income/expenses

In 2013, Santander Insurance advanced in its global business model in order to meet the needs of local networks and their clients, with a low risk profile and a high degree of efficiency and quality of service in their operations. Their business focused on:

- Completing the insurance range with solutions tailored to each customer segment, with a particular focus on *Select* and SMEs.
- Strengthen the multi channel strategy with specific products for channels that supplement the branch network.
- Strengthen bancassurance business thanks to the strategic alliance reached in Spain with Aegon, added to that in 2011 with Zurich for Latin America. The agreement between Bank Zachodni WBK and Aviva in Poland to distribute insurance via the bank's branches was also pushed.

Of note was the development in Europe of insurance not linked to lending, with strong growth in all networks. Savings business, an area of great potential because of the ageing of the population and the greater demand for retirement-savings products, also performed well.

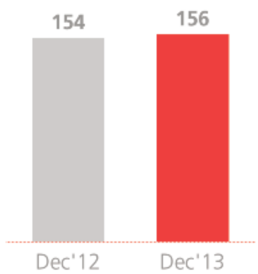
In Latin America, further progress was made in developing recurring business, with less dependence on lending and focus on quality of service for customers. *Autocompara*, the auto insurance comparison company for the whole region, was also consolidated.

**Results**

Gross income declined 14.6%, which fed through to net operating income (-24.3%) and attributable profit (-22.3%) from the costs of developing the franchise. Discounting the perimeter and exchange rate effects, gross income, net operating income and profit declined 3.6%, 9.7% and 7.1%, respectively.

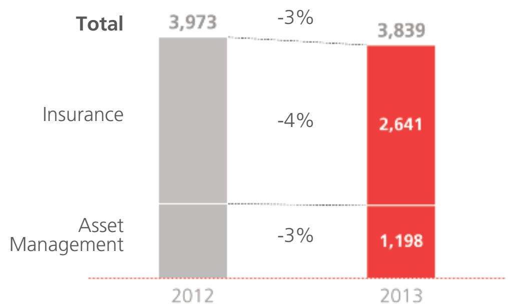
The area's total contribution to the Group including revenues recorded by the distribution networks amounted to EUR 3,839 million (-3.4% y-o-y; +3.5% on a like-for-like basis and constant exchange rates). These revenues accounted for 9% of the operating areas' total. The total results for the Group (profit before tax plus fees paid to the networks) were EUR 3,513 million (-3.9% y-o-y and +3.3% excluding the perimeter and exchange rate effects).

ASSET UNDER MANAGEM.
EUR Billion




ATTRIBUTABLE PROFIT
Constant EUR Million


TOTAL GROUP REVENUES
EUR Million




* Year-on-year change at constant perimeter and exchange rates.
Total: +3%; Insurance: +4%; Asset Management: +2%

ASSET MANAGEMENT AND INSURANCE. INCOME STATEMENT
EUR Million

| | Gross income | | | Net operating income | | | Attributable profit | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2013 | % | % w/o FX | 2013 | % | % w/o FX | 2013 | % | % w/o FX |
| Mutual funds | 338 | 1.1 | 5.7 | 138 | (17.0) | (12.3) | 76 | (24.1) | (20.3) |
| Pension funds | 2 | (92.5) | (92.5) | 6 | (57.9) | (57.9) | 4 | (57.6) | (57.6) |
| Insurance | 423 | (21.3) | (16.7) | 301 | (26.2) | (21.4) | 233 | (20.5) | (15.2) |
| **Total Asset Management and Insurance** | **763** | **(14.6)** | **(10.2)** | **444** | **(24.3)** | **(19.7)** | **313** | **(22.3)** | **(17.6)** |

## Asset Management

Attributable profit in 2013 was EUR 80 million, 27.2% lower than in the same period of 2012, following a fall of 4.6% in gross income affected by exchange rates, higher costs and minority interests after the strategic agreement that redefined the business. Excluding the exchange rate impact, gross income was virtually unchanged (-0.6%) and attributable profit dropped 23.8%.

Including the fees recorded by the networks, total gross income was EUR 1,198 million (-2.7% y-o-y; +2.2% in constant euros) and the total result for the Group was EUR 1,003 million (-4.2% y-o-y; +0.9% in constant euros).

The total volume of managed funds was EUR 156,400 million, (+2% y-o-y and +8% in constant euros). Of this, EUR 104,200 million were mutual and pension funds, EUR 9,000 million were client portfolios other than funds, including institutional mandates. The rest was management mandates on behalf of other Group units.

The main developments by units and countries were as follows:

- In traditional management of assets, the Group managed EUR 153,600 million, which accounted for 89% of the total and is concentrated in the four large markets of Spain, Brazil, the UK, and Mexico.

  In Spain, Santander Asset Management took advantage of the revitalization of mutual fund business (2013, first year with net subscriptions and revaluation of assets since 2005) to consolidate its leadership in funds and increase its market share (+148 b.p. so far this year to 16.6%, according to Inverco). Management is focused on profiled funds, money market and short-term fixed income funds.

  Funds under traditional management, including pension funds and mandates, amounted to EUR 63,400 million (+22% more than at the end of 2012).

  Brazil has EUR 38,700 million under management (+8% in local currency), spurred by retail and corporate clients, and with stability in institutional mandates.

  The UK, with a more selective focus, due to new regulation, reduced its balances under management to EUR 23,700 million (-6% in sterling).

  In Mexico, we continued to improve the mix of the EUR 10,400 million under management (+5% in pesos this year) by launching profiled funds for *Select* clients.

  In the rest of countries, growth in Poland (+12%), Chile (+2%) and declines in the balances in Portugal (-19% with pension funds) and Puerto Rico (-38%). All changes in local currency.

- 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. Managed funds remained at around EUR 3,000 million.

### Strategy and objectives in 2014

- Complete segmented offer for *Select* clients in Brazil, Portugal and Poland.
- Progress in selective access to institutional business, and in improving value proposals for clients and networks.

### Insurance

Santander Insurance posted an attributable profit of EUR 233 million, 20.5% less than in 2012, following the corporate operations in Spain and Portugal. Eliminating this effect and the impact of exchange rates, attributable profit was almost the same (-1.0%).

Including the fees paid to the networks, insurance business generated total revenues of EUR 2,641 million for the Group (3.7% less year-on-year; +4.2% at constant perimeter and exchange rates). The total result for the Group (income before taxes of insurers and brokers plus fee income paid to the networks) was EUR 2,510 million (-3.8% y-o-y; +4.3% on a like-for-like basis and constant euros).

Continental Europe's total results were 3.5% lower because of the change in perimeter, but 1.8% higher on a like-for-like basis, supported by Portugal and faster growth in consumer business.

Spain's results grew at a slower pace (-2.9% y-o-y on a like-for-like basis). In Portugal, the nominal fall of 12.0% was the equivalent of a rise of 4.0% without the reinsurance operation, thanks to the good evolution of savings-investment products.

Growing contribution of Santander Consumer Finance. Profit before tax and fee income rose 5.1% year-on-year, backed by growth in Germany and the Nordic countries. Poland's trend improved in the year, but its contribution in local currency was lower than in 2012 (-2.2%).

The UK's total results continued to fall (-33.7%), in line with the market as a whole, within the process of tailoring the offer of products to clients' needs.

Latin America's total result was 12.1% higher in constant euros and on a like-for-like basis, backed by the distribution of protection products via banking networks and intensive use of alternative channels. In local currency, noteworthy double digit growth in all countries, Brazil (+13.1%), Mexico (+18.8%), as well as Argentina, Uruguay and Puerto Rico with growth rates of more than 15%. Only Chile's result was lower (-15.3%) because of the reduced contracting of protection products, although there was a change of trend in the fourth quarter.

Lastly, the notable rise over 2012 in the US. Fee income from the distribution of third party insurance almost doubled in dollars.

**Strategy and objectives in 2014**

- Widen the *open market* insurance range (more segmented, multi channel, focused on *Select* and SMEs), as a key linking element.
- Consolidate the implementation of the *Programme for Excellence and Customer Satisfaction* in insurance, enhancing client experience and strengthening trust in the long term.

# 5

# RISK MANAGEMENT REPORT

Santander headquarters, São Paulo, Brazil.

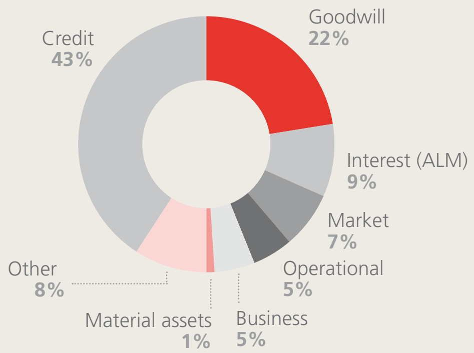
# EXECUTIVE SUMMARY

## GRUPO SANTANDER'S RISK MANAGEMENT PRINCIPLES Pages 168 to 173

- Independence of the risk function from the business.
- Involvement of senior management in decision-taking.
- Collegiate decisions that ensure opinions are contrasted.
- Clear definition of attributions.
- Control and management of risks via a corporate structure, adapted to local reality, covering all risks, all businesses and all countries.
- Consolidated framework of risk appetite.

## ECONOMIC CAPITAL Pages 262 to 269

### DISTRIBUTION OF ECONOMIC CAPITAL

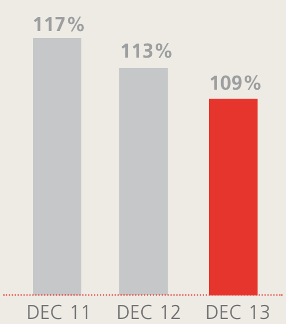



- The Group's consumption of economic capital at the end of 2013 was EUR 60,663 million compared to a capital base of EUR 79,048 million.
- Of note by operating area was Continental Europe, which accounted for 40%, Brazil 23% and the UK 15%.
- The Group's diversification enables economic capital savings to be obtained.

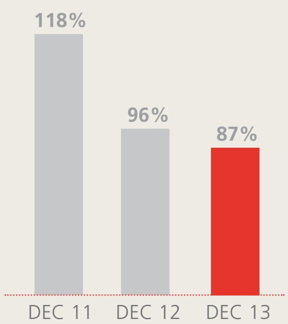
## LIQUIDITY RISK AND FUNDING Pages 234 to 246

### NET LOAN-TO-DEPOSIT RATIO

GROUP TOTAL



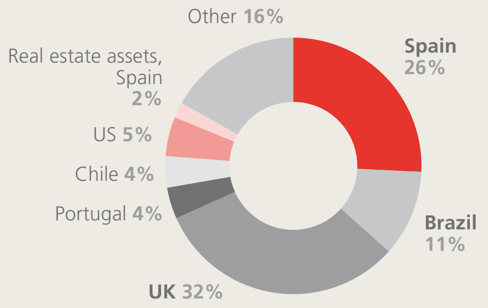

SPAIN




- Model with subsidiaries autonomous in liquidity and commercial strength, with a high weight of customer deposits, enabling a comfortable liquidity position.
- Further improvement in liquidity in 2013 enabled the parent bank to return all the balances available in the European Central Bank.
- High generation of liquidity from business in the Group (EUR 23,500 million), which improved the net loan-to-deposit ratio to 109%.
- Wide access to medium and long term funding in wholesale markets: 17 relevant issuers in 14 countries and in 11 currencies.

## GEOGRAPHICALLY DIVERSIFIED CREDIT RISK Pages 180 to 211

### CREDIT RISK EXPOSURE BY COUNTRIES
%

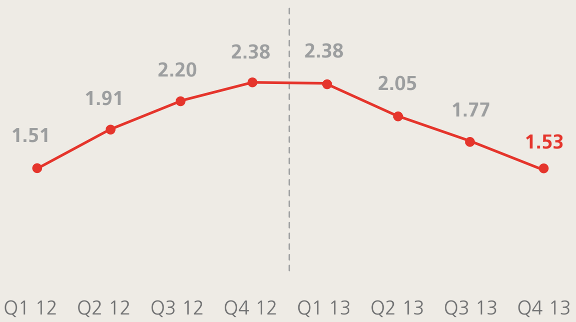



- Medium-low risk profile:
  - Retail banking generates more than 80% of risk.
  - High geographic diversification and by sector.
  - Adequate level of coverage (61.7%) and guarantees (60% of the portfolio has real guarantees).
- The NPL rate was 5.64% in 2013.
- Grupo Santander's exposure to cross-border credit risk is very limited, in line with its model of subsidiaries autonomous in capital and liquidity.
- The Group reduced its total sovereign risk exposure by 13% in 2013.

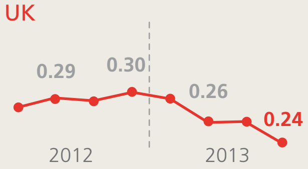
## COST OF CREDIT[1] IN PHASE OF NORMALISATION Pages 180 to 211

- Sustained trend in improving cost of credit a consequence of generalised reduction in provisions.

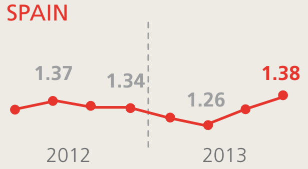
### GRUPO SANTANDER



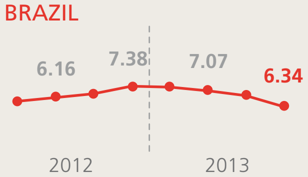

### UK



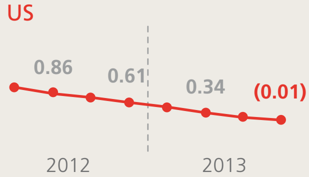

### SPAIN




### BRAZIL



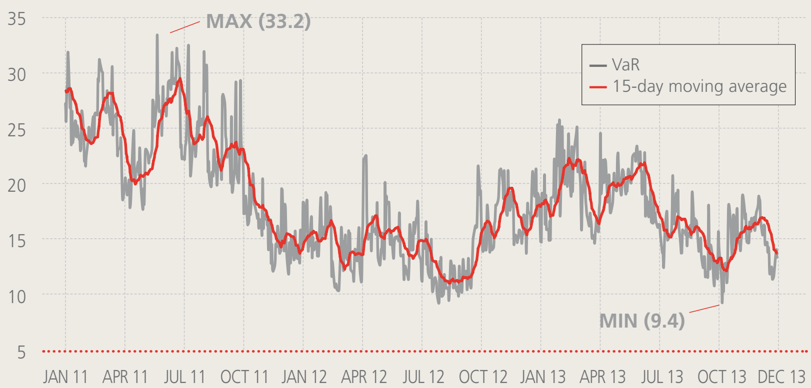

### US




1. Cost of credit = 12 months' loan-loss provisions/average lending.

## MARKET RISK Pages 212 to 233

### VAR EVOLUTION 2011-2013
Million euros. VaR at 99% with a time frame of one day.




- Santander maintains a moderate exposure to market risk.
- The average VaR in trading activity remained within the low range of the Group's peers at the international level.
- The Group continued to reduce in 2013 its already low level of exposure related to complex structured assets.

# 1. INTRODUCTION

This management report provides a lot of information on the risks facing the Group, the way in which they are managed and how they are affecting the Group's activity and results. The actions taken by the Bank to minimise their occurrence and mitigate their severity are also set out.

Banco Santander has traditionally maintained a clear commitment to transparency. In virtue of this, it has actively participated in the Enhanced Disclosure Task Force (EDTF) promoted by the Financial Stability Board (FSB), which aims to improve the quality and comparability of the risks information that banks provide to the market. Various studies that have analysed the degree of adoption of the 32 recommendations formulated by the EDTF in October 2012 coincide in highlighting Santander as one of the banks which is leading the world in the practical application of this initiative.

This introduction, in line with the best market practices, includes a map for navigating that enables the reader to track the main issues discussed in this risk management report through various documents published by the Group: Management Report, Auditors' Report, Annual Financial Statements, Information of Prudential Relevance (IPR or Pillar 3). In this same line of fostering transparency, the IPR includes a glossary of terms that set out the basic terminology of risks used in this chapter, as well as in the IPR itself.

The map for navigating is shown below:

## MAP FOR NAVIGATING GRUPO SANTANDER'S DOCUMENTS WITH RISK MANAGEMENT INFORMATION

| BLOCK | POINTS | ANNUAL REPORT | AUDIT REPORT & ANNUAL ACCOUNTS | IPR (PILLAR III) |
|---|---|---|---|---|
| **Introduction** | Introduction. Risk focuses | PP. 166, 178 | Note 54.4 | Section 2 |
| **Management principles and corporate governance** | Corporate principles of risk management, control and appetite | P. 168 | Note 54 (54.1, 54.2, 54.3) and other notes and related information | Section 6 |
| | Corporate governance of the risks function | P. 174 | | |
| | Integral control and internal validation of risks | P. 176 | | |
| **Credit risk** | Introduction to the treatment of credit risk | P. 180 | Note 54.5 and other notes and related information | Sections 7 & 8 |
| | Main magnitudes and evolution (risk map, evolution, conciliation, geographic distribution, management metrics) | P. 180 | | |
| | Geographic areas with the largest concentration of risk: UK, Spain, Brazil | P. 190 | | |
| | Other credit risk optics (credit risk by activities in financial markets, concentration risk, country risk, sovereign risk and environmental risk) | P. 198 | | |
| | Credit risk cycle (pre-sale, sale and post-sale) | P. 206 | | |
| | Study of risk and credit rating process, and planning and setting limits (analysis of scenarios) | P. 206 | | |
| | Decisions on operations (credit risk mitigation techniques) | P. 208 | | |
| | Monitoring, measurement and control | PP. 209, 210 | | |
| | Recovery management | P. 211 | | |
| **Market risk** | Activities subject to market risk (market risk factors) | P. 212 | Note 54.6 and other notes and related information | Section 9 |
| | Risks and results in 2013 | P. 214 | | |
| | Trading activity (VaR, stress testing, backtesting, etc.) | P. 214 | | |
| | Structural market risk | P. 223 | | |
| | Methodologies | P. 227 | | |
| | Management framework (organisational and governance structure, policy of limits) | P. 230 | | |
| | Internal model | P. 233 | | |
| **Liquidity risk and funding** | Introduction to liquidity risk treatment and funding | P. 234 | Note 54.7 and other notes and related information | Section 10 |
| | Liquidity management framework. Monitoring and control of liquidity risk (organisational and governance model, analysis of the balance sheet and liquidity risk management, management adapted to business needs) | P. 235 | | |
| | Funding strategy and 2013 liquidity evolution | P. 239 | | |
| | 2014 funding outlook | P. 246 | | |
| **Operational risk** | Definition and objectives. Corporate governance and organisational model | P. 247 | Note 54.8 and other notes and related information | Section 11 |
| | Risk management model. Measurement model and risk assessment | P. 248 | | |
| | Evolution of the main metrics. Mitigation measures. Business Continuity plan | P. 250 | | |
| | Other aspects of control and monitoring of operational risk | P. 253 | | |
| **Compliance and reputational risk** | Definition and objectives | P. 256 | Note 54.9 and other notes and related information | Section 12 |
| | Corporate governance and organisational model | P. 256 | | |
| | Risk management model (prevention of money laundering and financing of terrorism, marketing of products and services, compliance with rules) | P. 257 | | |
| **Capital** | Adjustment to the new regulatory framework | P. 262 | Note 54.10 and other notes and related information | Sections 1, 3, 4 & 5 |
| | Economic capital: analysis of the global risk profile, capital planning and stress exercises | P. 263 | | |
| | RORAC and value creation | P. 268 | | |

# 2. CORPORATE PRINCIPLES OF RISK MANAGEMENT, CONTROL AND APPETITE

## 2.1. Corporate principles

High quality management of risk is one of Grupo Santander's 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.

Grupo Santander's risk policy focuses on maintaining a medium-low and predictable profile for all its risks. Its risk management model is a key factor for achieving the Group's strategic objectives.

The economic crisis during the last few years has particularly tested all the models of risk admission, monitoring and recovery. In this context, management of the various risks was positive when compared to the performance of the sector in these markets, which, combined with the high international diversification of the Group's businesses, enabled it to produce globally satisfactory results.
The experience of confronting this adverse economic environment served to reaffirm the principles on which the Group's risk management model is based, as well as improve those aspects of the risk management systems which are necessary to ensure their adequate contribution to the Group's global results.

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### Grupo Santander's banking business model from the risk standpoint

The Group's risk management and control systems are adapted to the risk appetite framework approved by its top governance bodies and to the banking business model:

- Santander focuses on retail banking, ensuring an internationally diversified presence characterised by high market shares (more than 10%) in the main markets where it operates. Wholesale banking business is developed particularly in the core markets.

- Santander operates through subsidiaries that are autonomous in terms of capital and liquidity, with corporate control. The corporate structure has to be simple, minimising the use of instrumental companies.

- The business model enables a high degree of recurrence in results and a strong capital and liquidity base backs its development.

- Santander develops its operational and technological integration model via corporate platforms and tools. This allows information to be steadily aggregated.

- All the Group's activity is conducted within its social and reputational commitment, in accordance with its strategic objectives.

## RISK DISTRIBUTION BY BUSINESSES (ECONOMIC CAPITAL)

**GRUPO SANTANDER**

### CONTINENTAL EUROPE

| All risks: | |
|---|---|
| Credit | 69% |
| Operational | 7% |
| Business | 7% |
| Market | 5% |
| Other | 12% |

| Only Pillar 1 risks: | |
|---|---|
| Credit | 83% |
| Operational | 8% |
| Market | 6% |
| Material assets | 3% |

### UK

| All risks: | |
|---|---|
| Credit | 58% |
| Pensions | 19% |
| Interest | 8% |
| Operational | 7% |
| Business | 6% |
| Other | 2% |

| Only Pillar 1 risks: | |
|---|---|
| Credit | 87% |
| Operational | 10% |
| Material assets | 2% |
| Market | 1% |

### LATIN AMERICA

| All risks: | |
|---|---|
| Credit | 58% |
| Pensions | 10% |
| Business | 9% |
| Interest | 9% |
| Other | 14% |

| Only Pillar 1 risks: | |
|---|---|
| Credit | 80% |
| Operational | 14% |
| Market | 4% |
| Material assets | 2% |

### US

| All risks: | |
|---|---|
| Credit | 71% |
| Pensions | 9% |
| Business | 7% |
| Market | 6% |
| Interest | 5% |
| Other | 2% |

| Only Pillar 1 risks: | |
|---|---|
| Credit | 81% |
| Operational | 11% |
| Market | 7% |
| Material assets | 1% |

The operating areas account for most of the credit risk, as befits the nature of the Group's retail banking model. The distribution of economic capital among the areas reflects the diversified nature of Santander's business. The goodwill and structural exchange rate risks are assigned to the corporate centre.

Section 11 has more detail on everything to do with capital.

**Santander's management model,** underpinning the business model, is based on the following principles:

- **Independence of the risk function from the business areas.** The Group's 2nd vice-chairman and chairman of the board's risk committee heads the risk division and reports directly to the executive committee and to the board. The establishment of separate functions between the business areas and the risk areas responsible for admission, 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,** ensuring a variety of opinions without making results dependent on decisions solely taken by individuals, including at the branch level. Joint responsibility for decisions on credit operations between risk and business areas, with the former having the last word in the event of disagreement.
- **Delegated authorities.** Each risk acceptance and management unit has clearly defined the types of activities, segments, risks it can face and decisions it might make in the sphere of risks, in accordance with delegated powers. Contracting and management procedures, and where operations are recorded, are also defined.
- **Corporate control.** Risk control and management are conducted on an integrated basis through a corporate structure, with global scope responsibilities (all risk, all businesses, all countries).

Risk management and control is done in the following way:

- **Set 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 course of business.
- **Establish risk policies and procedures.** They constitute the basic framework for regulating risk activities and processes. At the local level, the risk units, through "mirror" structures they have established, incorporate the corporate risk rules in 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, on a daily basis 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.

## 2.2. Risk culture

The importance and attention attached by senior management to risk management is deeply rooted in Santander's DNA. This risk culture is based on the principles of Santander's risk management model and is transmitted to all business and management units and is supported, among other things, by the following drivers:

- **Santander's risk function is independent of the business units.** This enables their criteria and opinions to be taken into account in the various instances where businesses are developed.

- **Santander's structure for delegating powers** requires a large number of operations to be submitted to the validation of the risk committees of the Bank's central services, be it the global committee of the Risk division, the board's risk committee or the Group's executive committee. The high frequency with which these risk validation and monitoring bodies meet (twice a week in the case of the board's risk committee; once a week for the executive committee) guarantees great agility in resolving the proposals while ensuring senior management's intense participation in the daily management of the Bank's various risks.

- Santander has detailed **risk management manuals and policies.** Risk and business teams hold regular meetings about the business, which produce actions in accordance with the Group's risk culture. In addition, the risk and business executives participate in the different bodies for resolving operations of the Group's central services, and this facilitates transmission of criteria and focuses that emanate from senior management, both to the teams of executives as well as the rest of the risk committees. The lack of powers in any one individual means that all the decisions are resolved by collegiate bodies. This confers greater rigour and transparency on decisions.

- **Risk limits plan.** Santander has established a full system of risk limits which is updated at least annually and covers both credit risk as well as the different market risk exposures, including trading, liquidity and structural (for each business unit and risk factor). Credit risk management is supported by credit management programmes (individuals and small businesses), rating systems (exposures to medium and large companies) and pre-classification (large corporate clients and financial counterparties). There are also limits for operational risks.

- **Santander's information systems and aggregation of exposures' systems** enable daily monitoring of exposures, verifying systematic compliance with the limits approved, as well as adopting, where necessary, the pertinent corrective measures.

- **Main risks are not only analysed at the time of their origination** or when irregular situations arise in the process of ordinary recovery. They are overseen permanently for all clients. In addition, the Group's main portfolios are monitored systematically during the month of August.

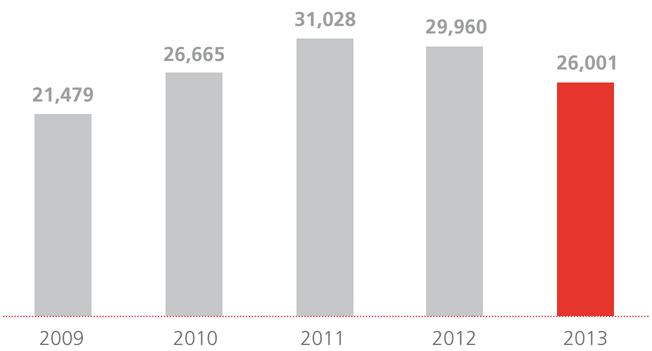
- **Other procedures** supporting the dissemination of Santander's risk culture are the training sessions carried out by the risks corporate school, the remuneration and incentives policy, which always includes performance variables that take into account the quality of risk and the Group's results over the long term, strict compliance by staff with the general codes of conduct and systematic and independent action by the internal auditing services.

### Risk training activities

Santander's corporate school of risk management's aim is to help consolidate the risk management culture and ensure that all employees in the risks area are trained under the same criteria.

The school, which gave a total of 26,001 hours of training to 3,778 employees in 2013 in 77 activities, is considered a key element to enhance Santander's leadership in this sphere and strengthen the skills of our staff.

TRAINING HOURS




Furthermore, the risks corporate school trains professionals from other business areas, particularly retail banking, so as to align the demanding risk management criteria to business goals.

## 2.3. Grupo Santander's risk appetite

Santander defines risk appetite 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 circumstances that could have a negative impact on its levels of capital, profitability and/or its share price.

The board is responsible for annually setting and updating the risk appetite, monitoring the Bank's risk profile and ensuring the consistency between both of them. Risk appetite is set for the whole of the Group as well as for each of the main business units in accordance with a corporate methodology adapted to the circumstances of each unit/market. At the local level, the boards of the subsidiaries are responsible for approving the respective risk appetite proposals once they have been validated by the Group's executive committee.

Senior management is responsible for achieving the desired risk profile – which is reflected in the annual budget approved and in the medium-term strategic plan – as well as for daily risk management, so that the usual limit structures set for each risk are adequately connected to the metrics established for the risk appetite.

These structures of limits for each risk are in addition to the risk appetite and essential for articulating effective risk management in the daily course of business. In the event that the risk appetite levels set are met, the necessary management measures have to be adopted for effectively adjusting the risk profile.

The board's risk committee and the Group's executive committee verify compliance with the risk appetite at the Group level and business units on a quarterly basis.

Effective implementation of the risk appetite framework was deepened in 2013 through the corresponding quarterly reviews as well as its development in some of the Group's main units.

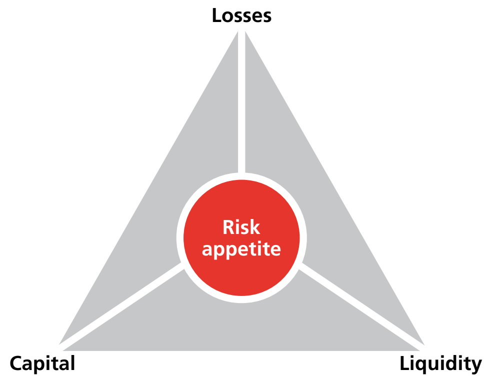
### Risk appetite framework

Santander's risk appetite framework contains quantitative and qualitative elements integrated into series of primary and other metrics.

**Quantitative elements of the risk appetite**

The primary quantitative metrics of the risk appetite are:

- The maximum **losses** that the Group is willing to assume.
- The minimum **capital** position that the Group wants to have.
- The minimum **liquidity** position that the Group wants to keep.




These metrics are calculated using severe stress scenarios unlikely to occur but plausible.

In addition, the Group has a series of transversal metrics to limit the excessive concentration of the risk profile, both by risk factors as well as in terms of clients, businesses, countries and products.

**+ QUALITATIVE ASPECTS**

**PRIMARY METRICS**

| LOSS | CAPITAL | LIQUIDITY |
|---|---|---|
| • Maximum loss that the Group is prepared to assume in a harsh scenario. | • Minimum capital position that the Group is prepared to assume in a harsh scenario.<br>• Minimum return on capital required. | • Minimum structural liquidity position.<br>• Minimum position of liquidity horizons that the Group is prepared to assume in various harsh scenarios. |

**SUPPLEMENTARY METRICS**

| CONCENTRATION | NON-FIN. RISK |
|---|---|
| • Concentration by individual client (in absolute and relative terms).<br>• Concentration by Top-N (in relative terms).<br>• Concentration in non-investment grade counterparties.<br>• Concentration by sectors.<br>• Concentration in portfolios with high volatility profile. | • Max. losses through operational and technological risk (OTR, in relative terms).<br>• Min. evaluation of OTR management state.<br>• Compliance and reputational risk indicator. |

**Losses**

One of the three primary metrics used to formulate Santander's risk appetite is the maximum unexpected impact on results the Group is prepared to assume in unfavourable scenarios, with a low, but possible, probability of occurring.

These scenarios mainly affect both the losses from the exposure to retail and wholesale credit risk (both the direct credit loss as well as the reduced revenue), as well as the potential unfavourable impact from the exposure to market risk. After applying these credit and market impacts to budgeted results, in the context of monitoring risk appetite, senior management ensures that the resulting spread is sufficient to absorb the unexpected impacts from operational and technological risk, and from compliance and reputational risk.

The time frame in which the negative impacts for all risks considered materialise is normally 12 months, except in the case of credit risk where an additional impact analysis is conducted with a three-year time frame. The time frame for formulating risk appetite is annual.

As regards the metric of losses, according to Santander's risk appetite the combined impact in all risks from these scenarios must be less than net operating income after ordinary provisions (i.e. ordinary profit before tax).

#### Capital position

Santander operates with a comfortable capital base that enables it not only to fulfil regulatory requirements but also have a reasonable surplus of capital.

In addition and in the face of the aforementioned unfavourable scenarios, Santander's risk appetite establishes that its risk profile must be such that the unexpected impact of these scenarios does not involve a deterioration of more than 100 basis points in the core capital ratio.

This capital focus included in the risk appetite is consistent with the Group's capital objective approved within the capital planning process (Pillar 2) implemented in the Group and covering a three-year period.

#### Liquidity position

Grupo Santander has developed a funding model based on autonomous subsidiaries that are responsible for covering their own liquidity needs. On this basis, liquidity management is conducted by each subsidiary within a corporate framework of management that develops its basic principles (decentralisation, equilibrium in the medium and long term of sources-applications, high weight of customer deposits, diversification of wholesale sources, reduced recourse to short-term funds, sufficient reserve of liquidity) and revolves around three main pillars (governance model, balance sheet analysis and measurement of liquidity risk, with management adapted to business needs). The section on liquidity risk and funding has more information on the corporate framework of management, its principles and main pillars.

Santander's liquidity risk appetite establishes a structural funding ratio of more than 100%, i.e. customer deposits, equity and medium and long term issues have to exceed the structural funding needs defined basically as lending plus the Group's stakes in companies. In addition, demanding objectives are set with respect to the position and horizons of liquidity in the face of systemic stress and idiosyncratic scenarios, both local and global.

#### Additional quantitative metrics of risk appetite concentration

Santander wants to maintain a widely diversified risk profile 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 retail banking focus with a high degree of international diversification.

**Concentration risk:** this is measured by the following metrics upon which risk appetite thresholds are established in terms of the proportion of equity or of lending (general character):

- **Client** (as a proportion of equity): a) net individual maximum exposure to corporate clients (additionally, clients with internal ratings below investment grade and exceeding a certain exposure are also monitored); b) net maximum aggregate exposure with the Group's 20 largest corporate clients (Top 20); c) net maximum aggregate exposure of the exposures considered as large risks (corporate and financial clients); d) maximum impact on profit before tax of a simultaneous failure of the five largest corporate exposures (jump to default Top 5).

- **Sector:** maximum percentages of the exposure of the portfolio of companies in an economic sector, in relation to lending (at both the total level as well as for the segment of companies).

- **Portfolios with high-risk profile** (defined as those retail portfolios with a percentage of risk premium that exceed an established threshold): maximum percentages of exposure to this type of portfolio in proportion to lending (at both the total and retail levels) and for different business units.

#### Non-financial risks

- **Operational risk:** a maximum ratio of net operational risk losses over gross income (for both the Group as well as each unit) is established. In addition, the state of management is assessed, which is based on the results of indicators on various matters, including governance and management, budgetary compliance, the quality of databases of events, indicators and self-evaluation corporate questionnaires on the control environment. In line with Basel specifications, the net losses figure includes those that can be derived from compliance risk.

- **Compliance and reputational risk:** zero risk appetite. As a result, the Group's objective is to minimise this type of risk and monitor it through the parent bank's resulting compliance and reputational risk indicator.

### Qualitative elements of risk appetite

The qualitative elements of the risk appetite framework define, in general and for the main risk factors, the positioning that Santander's senior management wishes to adopt or maintain in the course of its business model. Generally speaking, the framework is based on maintaining the following qualitative objectives:

- A medium-low and predictable risk profile based on a diversified business model, focused on retail banking and with an internationally diversified presence and significant market shares, and a wholesale banking model centred on relations with clients in the Group's main markets.

- A rating objective in a range of between AA- and A-, both at Group level as well as in local units (in local scale), on the basis of both the environment as well as the sovereign risk performance.

- A stable and recurring policy to generate earnings and remunerate shareholders, on a strong capital and liquidity base and a strategy of diversification by sources and maturities.

- An organisational structure based on subsidiaries that are autonomous and self-sufficient in capital and liquidity, minimising the use of instrumental companies, and ensuring that no subsidiary has a risk profile that jeopardises the Group's solvency.

- An independent risk function with very active involvement of senior management that guarantees a strong risk culture focused on protecting and ensuring an adequate return on capital.

- A management model that ensures a global and inter-related view of all risks, through an environment of control and robust monitoring of risks, with global scope responsibilities: all risk, all businesses, all countries.

- Focus in the business model on those products that the Group knows sufficiently well and has the management capacity (systems, processes and equity).

- The confidence of clients, shareholders, employees and professional counterparties, ensuring that activity is carried out in line with Santander's social and reputational commitment, in accordance with the Group's strategic objectives.

- Adequate and sufficient availability of staff, systems and the tools that guarantee maintaining a risk profile compatible with the established risk appetite, both at the global and local levels.

- A remuneration policy that has the necessary incentives to ensure that the individual interests of employees and executives are aligned with the corporate framework of risk appetite and that these are consistent with the evolution of the Bank's long-term results.

The Group's risk appetite framework also covers other specific qualitative objectives for the various types of risk.

**Viability and resolution plans**

The Group has an organisational structure based on subsidiaries that are autonomous and self-sufficient in terms of capital and liquidity, 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 viability plans and corporate resolution (living will). Furthermore, and even though not required, more summarised individual plans were drawn up for the main geographic units, including Brazil, Mexico, Chile, Portugal and the UK.

A fourth version of the corporate plan was drawn up in 2013. As with the first three versions in 2010, 2011 and 2012, the Group presented the fourth version of its recovery plan to its crisis management group in September 2013. This plan consists of the corporate plan (for Banco Santander) and individual plans for many of its most important local units (UK, Brazil, Mexico, United States – Santander USA – Germany and Portugal). It is important to point out that in the cases of the UK, Germany and Portugal, independent of their obligation to form part of the corporate plan, their full development is equally due to local regulatory initiatives.

The significant contribution of these viability and resolution plans to the conceptual delimitation of the risk appetite, and the Group's risk profile, should also be noted.

# 3. CORPORATE GOVERNANCE OF THE RISK FUNCTION

The board's risk committee is responsible for proposing to the board the Group's risk policy. Its approval 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 2nd vice-chairman of Grupo Santander and four other board members are also members of the committee.

The committee met 97 times during 2013, underscoring the importance that Grupo Santander attaches to appropriate management of its risks.

The main responsibilities of the board's risk committee are to:

- Propose to the board the Group's risk policy, which must particularly 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.
  - The level of risk considered acceptable.
  - The measures envisaged to mitigate the impact of identified risks, in the event that they materialise.
- Review systematically exposures to the main customers, economic sectors, geographic areas and types of risk.
- Authorise 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.

Both the executive committee and the Bank's board also pay particular attention to management of the Group's risks.

The board will propose to the 2014 general shareholders' meeting a change in the corporate Bylaws under which, in compliance with the recent CRD IV directive, a new committee is established entrusted with helping the board in matters of risks supervision. Once constituted, the delegated risks committee will keep its powers in the sphere of risk management.

The Group's 2nd vice-chairman is the maximum executive in risk management. He is a member of the board and chairman of the risk committee. Two general directorates of risks, which are independent of the business areas, both from the hierarchical and functional standpoint, report to the 2nd vice-chairman. The organisational and functional framework is as follows:

- **The general directorate of risks (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 configured in three blocks:

- **A structure of financial risk management and control (credit, market and structural risk),** and control of other risks. Thus block includes the areas of: loans to individuals, credit to companies, admission and monitoring of lending, market and structural risks and control of non-financial risks.

- **A business structure,** focused on executing the risks function in the Group's global and local businesses. This block includes the areas of: risk management of Santander Consumer Finance's risks, management of the risks of global businesses and recovery and write-down of assets.

- **A structure for setting frameworks, the development and implementation of models and information infrastructure.** The block includes the areas of: risk policies, methodology and management of information for risks.

Complementing this structure is an area of planning and governance responsible for coordinating new projects and the internal management of units, and an area of supervision and consolidation of risks responsible for oversight.

These functions have a global action sphere, i.e. they intervene in all the units where the risk division acts and the same structure is reflected 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 GDR 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 within and outside 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.** This is of corporate nature, supporting the Group's governance bodies, with the following global reach responsibilities:

    - 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, the mission of which 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.

# 4. INTEGRAL CONTROL AND INTERNAL VALIDATION OF RISKS

The functions of integral control and internal validation of risks are located at the corporate level in the general directorate of integral control and internal validation of risks which reports directly to the Group's 2nd vice-chairman and chairman of the risk committee, and is configured as a support for the Group's governance bodies in the sphere of control and risk management.

## 4.1 Function of integral control of risks

Grupo Santander launched in 2008 the function of integral control of risks in order to provide a fully rounded view of management of all risks that affect development of the Group's ordinary activity. These risks are: credit risk (including those of concentration and counterparty); market risk (including liquidity as well as the structural risks of interest rates and exchange rates); operational and technological risks and compliance and reputational risks.

Integral control of risks is based on three complementary activities:

1. Guaranteeing 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. Ensuring that the Bank's 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.

3. Supervising 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.

The function has global and corporate scope and covers all risks, all businesses and all countries and is configured as a third layer of control, after that in the first instance by the executive responsible for control and management of each risk in the sphere of each business or functional unit (first layer) as well as by each executive responsible for the control of each risk (second layer). This ensures the vision and thus the integral supervision of all the risks that Santander incurs in the course of its activity.

### 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 set 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 in the process is assessed and enables the parameters of control of the various risks to be homogenised, is done every 12 months. New tests are incorporated on the basis of the best practices most recently observed in the industry and/or required by regulators. The support tool is a repository of the results of each test and of 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**

There is a tool to monitor proactively the recommendations made by internal auditing and by the supervisors regarding risk control and management. 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.

### Activity during 2013

(a) The fifth 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 turned 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 2012.

(b) The board and executive committee were regularly informed with an integral vision of all risks. The risk committee and the audit and compliance committee were also kept in the picture.

(c) Work continued on extending the risk appetite framework to the Group's main units, also coordinating the initiatives in integral control in the various countries.

(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), the IIF and the Enhanced Disclosure Task Force (EDTF, sponsored by the FSB) in matters such as transparency in information on risks. The improvements arising in this process were subsequently incorporated to the Group.

## 4.2. Internal independent validation of risk models

As well as being a regulatory requirement, the function of internal validation of risk models constitutes a fundamental support for the risk committee and for local committees and corporate risk committees, in their responsibilities of authorisation of the use (management and regulatory) of models and their regular review.

Internal validation of models consists of a specialised unit, with sufficient independence, obtaining a technical opinion on the adequacy of the internal models for the purposes used, whether they be internal management and/or of a regulatory nature (calculation of the regulatory capital, levels of provisions, etc.), and concluding on their robustness, use and effectiveness.

Santander's internal validation of models covers credit risk models, market risk models and those for setting the price 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 technological systems and the quality of the data that enable and support their effective functioning and, in general, all relevant aspects in management (controls, reporting, uses, involvement of senior management, etc.).

The function is global and corporate, in order to ensure homogeneous application, and is conducted via five regional centres in Madrid, London, São Paulo, New York and Wroclaw (Poland). These centres have full functional dependence of the corporate centre, which ensures uniformity in the development of activities. This facilitates implementation of a corporate methodology that is supported by a series of tools developed internally in Santander, which provide a robust corporate framework for all the Group's units, computerising certain verifications in order to ensure that the reviews are carried out efficiently.

This corporate framework of internal validation is fully aligned with the criteria on internal validation of the advanced models issued by the Bank of Spain and by the rest of supervisors to whom the Group is subjected. In this respect, the criterion is maintained of separating functions between the units of internal validation and internal auditing, which is the last layer of control in the Group charged with reviewing the methodology, tools and work conducted by internal validation and expressing its opinion on its degree of effective independence.

# 5. RISK FOCUSES

Regardless of the risks treated in the various sections of this risk management report, Santander's senior management believes there are focal points affecting business development and consequently the risks derived from them. These focal points and the corresponding measures to mitigate being adopted are:

- **Macroeconomic environment.** In times of crisis it is particularly important to pay attention to the volatility of the macroeconomic environment. Geographic diversification protects the Group's results, minimising the impact of volatility, and enables a medium-low risk profile to be maintained.

  In addition, the Group uses techniques for analysing scenarios in order to ensure the risk profile is maintained within the risk appetite established, as well as guarantee the balance sheet's capacity to withstand possible adverse macroeconomic scenarios. The analyses are presented regularly to senior management, and include the potential impact on the income statement of the effect of the scenarios on margins, credit risk and counterparty loss, as well as on the trading portfolio. The impact of adverse scenarios on the Group's liquidity position is also studied.

  Section 2.3 on risk appetite gives a more detailed explanation of the way in which the analysis of scenarios is incorporated in the Group's corporate principles of management, control and risk appetite, including the corresponding corporate governance. Furthermore, this risk management report develops additional contents on the analysis of scenarios in the following chapters: 6. Credit risk (6.5.2), 7. Market risk (7.2.1.6 and others), 8. Liquidity and funding risk (8.2.2) and 11. Capital (11.2).

- **Regulatory changes.** In response to the financial crisis of the last few years, bank regulators and authorities are designing a series of measures to avoid future crises and mitigate, if this happens, their impact. Compliance with these measures by banks, especially those designated as systemic, is affecting various spheres: capital and liquidity needs, transparency, etc.

  Constant monitoring of changes in the regulatory framework and anticipating them in order to facilitate rapid adjustment to the new requirements are basic pillars of the focus with which the Bank tackles these issues.

  The Public Policy department, part of the division of Communication, Corporate Marketing and Research, assumes the monitoring and management of regulatory alerts, in coordination with the General Secretariat, General Auditing, Financial and Risks division, as well as with the support and business areas affected by these alerts. Public policy executives of the divisions meet once a month, and the countries have a monthly teleconference to ensure coordination at Group level.

  This focus is promoted and supported by the Bank's senior management. The public policy committee, chaired by the chief executive officer, is the organ where the main regulatory changes are reported, their impact analysed and the strategy designed to tackle these issues.

- **Reputational and conduct risk.** In order to mitigate the frequency of these risks, Santander has notably strengthened in the last few years control of all the aspects related to marketing of products – including subsequent monitoring – and customer relations. At the moment, supervisors as well as public opinion pay great attention to this sphere not only in relation to lending products but also banking and financial services in general.

Section 10 on compliance and reputational risk explains the way in which Grupo Santander manages and controls this risk.

* * * *

**We now set out the Group's main types of risk: credit, market, liquidity and funding, operational, compliance and reputational**.

# 6. CREDIT RISK

## 6.0 Organisation of the section

After an **introduction** to the concept of credit risk and the segmentation that the Group uses for its treatment, the **main metrics** of 2013 and their evolution are presented (pages 180-190).

This is followed by a look at the **countries with the largest concentration**, setting out the main features from the credit risk standpoint (pages 190-198).

The qualitative and quantitative aspects of **other credit risk matters** are then presented, including information on financial markets, risk concentration, country risk, sovereign risk and environmental risk (pages 198-205).

Lastly, there is a description of the Group's **credit risk cycle**, with a detailed explanation of the various stages that form part of the phases of pre-sale, sale and post-sale (pages 206-211).

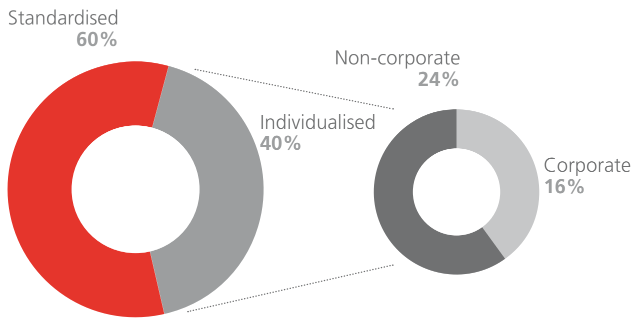
## 6.1 Introduction to the treatment of credit risk

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 two types of customers:

- Those under **individualised** management are assigned a risk analyst. This category includes the global wholesale banking companies (corporations, financial institutions and sovereigns), companies within the retail banking scope with a risk level above the exposure threshold set by each unit. Risk management is conducted through expert analysis backed up by tools that support decision-making.
- The segment of **standardised** risks covers those clients who have not been assigned a risk analyst. This category includes individuals, the self-employed and retail banking companies that are not under individualised management. Management of these risks is based on internal models of assessment and automatic decisions, complemented when necessary by expert teams of analysts.

The following chart shows the distribution of credit risk on the basis of the management model.




The Group's risk profile is mainly retail, accounting for over 80% of total risk generated by the retail banking business.

## 6.2 Main magnitudes and evolution

### 6.2.1. Global map of credit risk, 2013

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 31 December 2013.

## GRUPO SANTANDER - GROSS EXPOSURE TO CREDIT RISK CLASSIFIED IN ACCORDANCE WITH LEGAL COMPANY CRITERIA

Million euros. Data at 31 December 2013

| | Customers | | Entities[2] | | Fixed income[3] | | Deriv. & Repos | |
|---|---|---|---|---|---|---|---|---|
| | Outstanding[1] | Commitments | Outstanding | Commitments | Sovereign | Private | ECR[4] | Total |
| **Europe** | **301,471** | **53,172** | **33,996** | **1,899** | **37,826** | **13,480** | **31,423** | **473,267** |
| Spain | 191,881 | 41,454 | 26,472 | 1,760 | 28,620 | 9,932 | 27,782 | **327,900** |
| Germany | 30,883 | 665 | 1,870 | - | - | 30 | 33 | **33,481** |
| Portugal | 24,179 | 4,758 | 2,219 | 99 | 4,113 | 2,510 | 3,137 | **41,013** |
| UK | 54,528 | 6,294 | 3,436 | 41 | 5,093 | 1,009 | 471 | **70,872** |
| **Others** | **227,193** | **36,675** | **32,073** | **-** | **3,489** | **4,432** | **16,709** | **320,571** |
| **Latin America** | **142,976** | **46,221** | **21,676** | **-** | **14,258** | **6,653** | **9,808** | **241,592** |
| Brazil | 76,888 | 30,866 | 13,503 | - | 9,010 | 4,826 | 6,025 | **141,119** |
| Chile | 31,151 | 7,162 | 1,801 | - | 905 | 1,443 | 1,686 | **44,147** |
| Mexico | 22,722 | 7,267 | 3,512 | - | 3,354 | 362 | 1,850 | **39,066** |
| Others | 12,215 | 926 | 2,861 | - | 988 | 22 | 247 | **17,260** |
| **United States** | **40,101** | **18,654** | **6,300** | **-** | **2,682** | **5,723** | **485** | **73,945** |
| **Rest of world** | **123** | **13** | **128** | **-** | **-** | **2** | **-** | **265** |
| **Total Group** | **711,865** | **154,734** | **94,173** | **1,899** | **58,254** | **30,290** | **58,425** | **1,109,640** |
| % of total | 64.2% | 13.9% | 8.5% | 0.2% | 5.2% | 2.7% | 5.3% | **100.0%** |
| % change/Dec 12 | -6.4% | -15.6% | -28.3% | -53.0% | -6.3% | -9.6% | 4.2% | **-9.9%** |

## EVOLUTION OF GROSS EXPOSURE TO CREDIT RISK

Million euros. Data at 31 December 2013

| | 2013 | 2012 | 2011 | Var. on 12 | Var. on 11 |
|---|---|---|---|---|---|
| **Europe** | **473,267** | **540,435** | **541,575** | **-12.4%** | **-12.6%** |
| Spain | 327,900 | 396,474 | 400,002 | -17.3% | -18.0% |
| Germany | 33,481 | 40,659 | 33,541 | -17.7% | -0.2% |
| Portugal | 41,013 | 39,243 | 41,241 | 4.5% | -0.6% |
| Others | 70,872 | 64,059 | 66,791 | 10.6% | 6.1% |
| **UK** | **320,571** | **344,413** | **327,321** | **-6.9%** | **-2.1%** |
| **Latin America** | **241,592** | **266,304** | **272,297** | **-9.3%** | **-11.3%** |
| Brazil | 141,119 | 163,915 | 176,317 | -13.9% | -20.0% |
| Chile | 44,147 | 46,722 | 43,406 | -5.5% | 1.7% |
| Mexico | 39,066 | 37,836 | 32,777 | 3.3% | 19.2% |
| Others | 17,260 | 17,832 | 19,797 | -3.2% | -12.8% |
| **United States** | **73,945** | **79,707** | **73,717** | **-7.2%** | **0.3%** |
| **Rest of world** | **265** | **539** | **964** | **-50.8%** | **-72.5%** |
| **Total Group** | **1,109,640** | **1,231,398** | **1,215,874** | **-9.9%** | **-8.7%** |

1. Balances with customers include contingent risks (see the auditor's report and annual consolidates statements, note 35) and exclude Repos (EUR 2,368 million, nominal value) and other customer financial assets (EUR 18,820 million).
2. Balances with credit entities and central banks include contingent risks and exclude repos, the trading portfolio and other financial assets. Of the total, EUR 65,826 million are deposits in central banks.
3. Total fixed income excludes the trading and investment portfolio of third party takers of insurers.
4. ECR (equivalent credit risk: net value of replacement plus the maximum potential value. Includes mitigants).

The credit exposure in 2013 was EUR 1,109,640 million, most of it with customers and credit entities (86% of the total).

Risk is diversified among the main regions where the Group operates: Continental Europe (43%), UK (29%), Latin America (22%) and the US (7%).

Credit risk exposure dropped 9.9% in 2013, largely due to the combined impact of the drop in lending in Europe and the reduction in Spain of the amounts deposited in the European Central Bank.

Excluding the exchange-rate impact of the main currencies against the euro, the reduction of the exposure in 2013 was 6%.

## 6.2.2. Performance of magnitudes in 2013

The table below sets out the main items related to credit risk derived from our activity with customers.

### GRUPO SANTANDER - RISK, NPLS, COVERAGE, PROVISIONS AND COST OF CREDIT*

| | Credit risk with customers[1] (million euros) | | | Non-performing loans (million euros) | | | NPL ratio % | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2013 | 2012 | 2011 | 2013 | 2012 | 2011 | 2013 | 2012 | 2011 |
| **Continental Europe** | **312,167** | **332,261** | **353,506** | **28,496** | **20,904** | **18,509** | **9.13** | **6.29** | **5.24** |
| Spain | 189,783 | 210,536 | 223,456 | 14,223 | 8,093 | 7,372 | 7.49 | 3.84 | 3.30 |
| Santander Consumer Finance | 58,628 | 59,387 | 59,442 | 2,351 | 2,315 | 2,361 | 4.01 | 3.90 | 3.97 |
| Portugal | 26,810 | 28,188 | 30,607 | 2,177 | 1,849 | 1,244 | 8.12 | 6.56 | 4.06 |
| Poland | 18,101 | 10,601 | 9,120 | 1,419 | 500 | 446 | 7.84 | 4.72 | 4.89 |
| **United Kingdom** | **235,627** | **254,066** | **257,698** | **4,663** | **5,202** | **4,763** | **1.98** | **2.05** | **1.85** |
| **Latin America** | **150,979** | **160,413** | **159,445** | **7,595** | **8,695** | **6,881** | **5.03** | **5.42** | **4.32** |
| Brazil | 79,216 | 89,142 | 91,035 | 4,469 | 6,113 | 4,902 | 5.64 | 6.86 | 5.38 |
| Mexico | 24,024 | 22,038 | 19,446 | 878 | 428 | 354 | 3.66 | 1.94 | 1.82 |
| Chile | 31,645 | 32,697 | 28,462 | 1,872 | 1,691 | 1,096 | 5.91 | 5.17 | 3.85 |
| Puerto Rico | 4,023 | 4,567 | 4,559 | 253 | 326 | 394 | 6.29 | 7.14 | 8.64 |
| Argentina | 5,283 | 5,378 | 4,957 | 75 | 92 | 57 | 1.42 | 1.71 | 1.15 |
| **United States** | **40,349** | **44,678** | **43,052** | **898** | **1,025** | **1,229** | **2.23** | **2.29** | **2.85** |
| **Total Group** | **738,558** | **793,448** | **820,968** | **41,652** | **36,061** | **32,036** | **5.64** | **4.54** | **3.90** |

| | Coverage (%) | | | Spec. provs. net of recovered write-offs[2] (million euros) | | | Credit cost (% of risk)[3] | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2013 | 2012 | 2011 | 2013 | 2012 | 2011 | 2013 | 2012 | 2011[4] |
| **Continental Europe** | **57.3** | **73.0** | **55.2** | **3,603** | **4,104** | **3,405** | **1.23** | **3.16** | **1.10** |
| Spain | 44.0 | 50.0 | 50.9 | 2,411 | 2,473 | 1,861 | 1.38 | 1.34 | 1.03 |
| Santander Consumer Finance | 105.3 | 109.5 | 109.3 | 565 | 753 | 853 | 0.96 | 1.27 | 1.43 |
| Portugal | 50.0 | 53.1 | 54.9 | 192 | 393 | 206 | 0.73 | 1.40 | 0.90 |
| Poland | 61.8 | 68.3 | 65 | 167 | 112 | 60 | 1.01 | 1.17 | — |
| **United Kingdom** | **41.6** | **44.1** | **37.5** | **580** | **806** | **633** | **0.24** | **0.30** | **0.32** |
| **Latin America** | **84.6** | **87.5** | **97.0** | **6,483** | **7,380** | **5,447** | **4.43** | **4.93** | **3.57** |
| Brazil | 95.1 | 90.2 | 95.2 | 4,894 | 6,124 | 4,508 | 6.34 | 7.38 | 5.28 |
| Mexico | 97.5 | 157.3 | 175.7 | 801 | 466 | 337 | 3.47 | 2.23 | 1.63 |
| Chile | 51.1 | 57.7 | 73.4 | 597 | 573 | 380 | 1.92 | 1.90 | 1.40 |
| Puerto Rico | 61.6 | 62.0 | 51.4 | 48 | 81 | 91 | 1.13 | 1.80 | 2.25 |
| Argentina | 140.4 | 143.3 | 206.9 | 119 | 108 | 64 | 2.12 | 2.05 | 0.67 |
| **United States** | **93.6** | **105.9** | **96.2** | **(5)** | **265** | **374** | **(0.01)** | **0.61** | **1.04** |
| **Total Group** | **61.7** | **72.4** | **61.0** | **10,863** | **12,640** | **9,900** | **1.53** | **2.38** | **1.41** |

* To enable like-for-like comparisons, the data relating to 2012 and 2011 has been restated using equivalent parameters.
1. Includes gross loans to customers, guarantees, documentary credits and BCO parent derivatives (EUR 5,505 million).
2. Bad debts recovered (EUR 1,068 million).
3. Credit cost = 12 months' loan-loss provisions /average lending.
4. Excludes the incorporation of Bank Zachodni WBK.

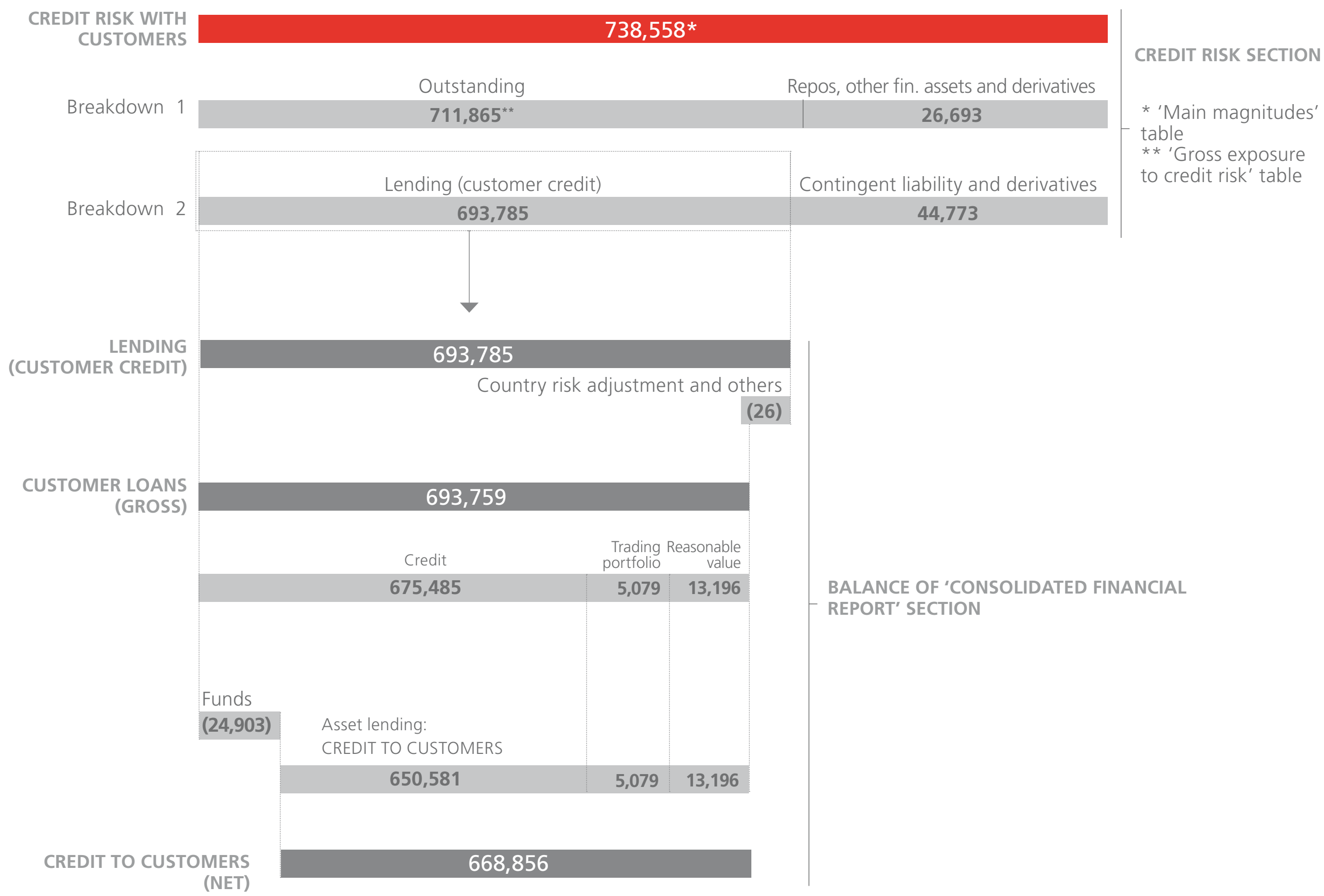
At the end of 2013, credit risk with customers was 7% lower. This decline occurred in all countries except for Brazil, Mexico, Chile and Poland where there was growth in local currency terms. These levels of lending, coupled with non-performing loans (NPLs) of EUR 41,652 million, gave the Group a NPL ratio of 5.64% (+110 b.p. higher than in 2012). It is relevant to highlight that this ratio includes the impact of the reclassification of substandard loans in Spain carried out in June (26 b.p.).

For the coverage of these NPLs, the Group recorded net credit losses of EUR 10,863 million, 14% less than in 2012 after deducting write-off recoveries. This reduction is materialised in a fall in the cost of credit to 1.53%, 85 b.p. less than in 2012.

Total loan-loss provisions were EUR 25,681 million, bringing the Group's coverage ratio to 62%. It is important to bear in mind that this ratio is affected downwards by the weight of mortgage portfolios (particularly in the UK and Spain), which require fewer provisions as they have collateral.

**Conciliation of the main magnitudes**

The consolidated financial report details the portfolio of customer loans, both gross and net of funds. The following chart shows the relation between the concepts that comprise these magnitudes.



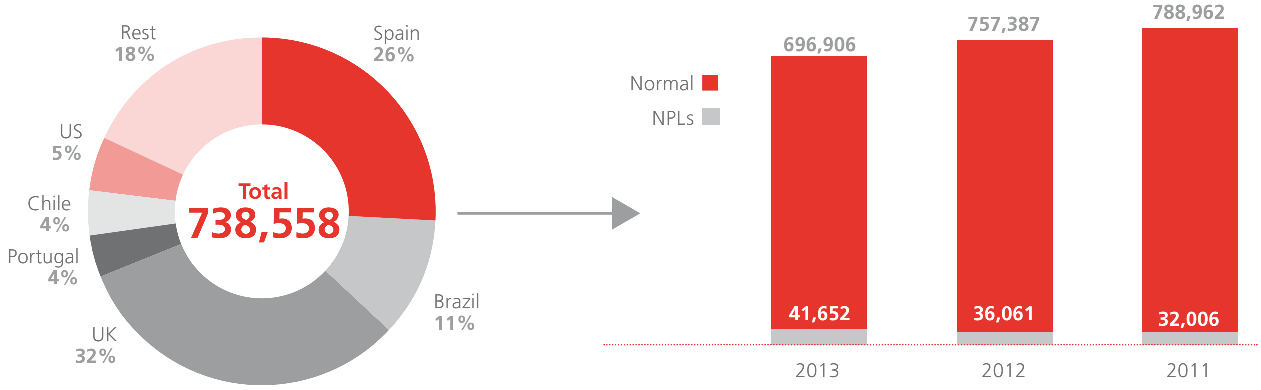

Figures in million euros.

**Geographic distribution and segmentation**

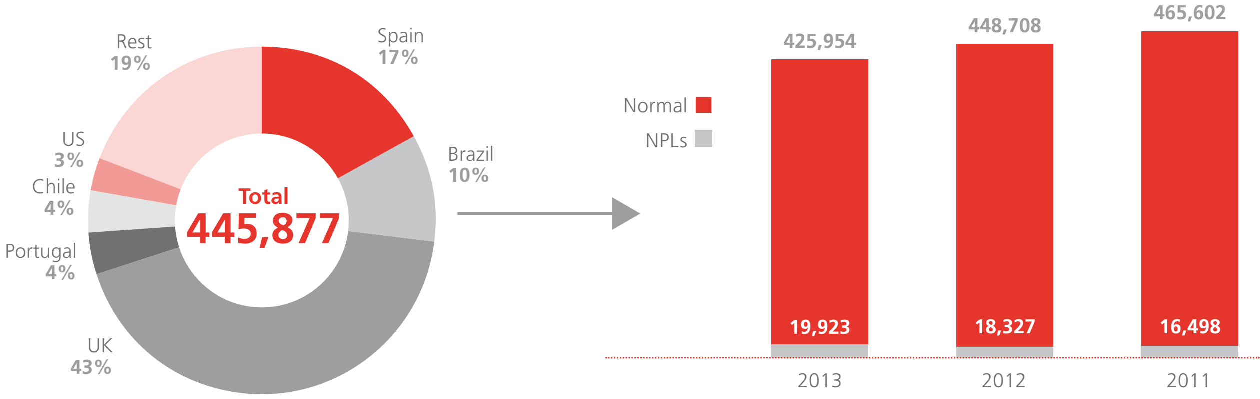
On the basis of the aforementioned segmentation, the geographic distribution and situation of the portfolio is shown in the following charts. The distribution is as follows:

Million euros

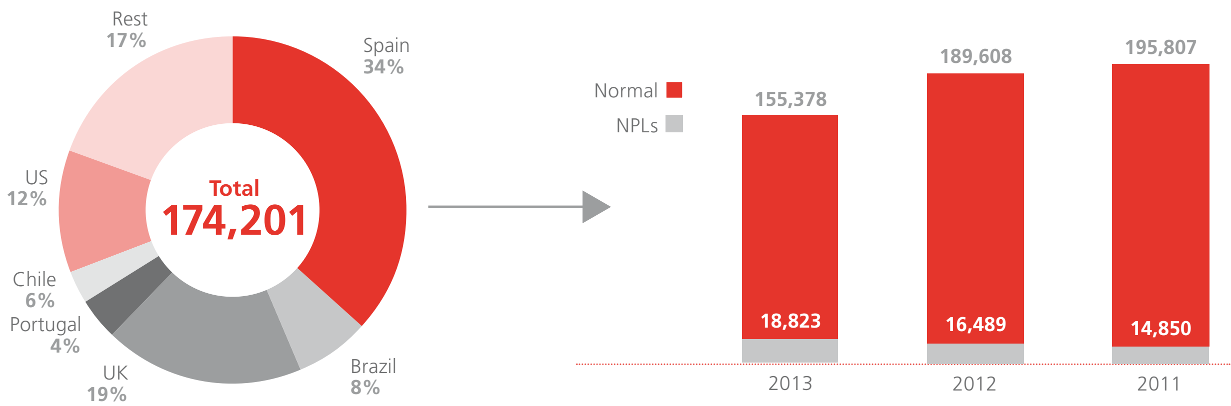
TOTAL



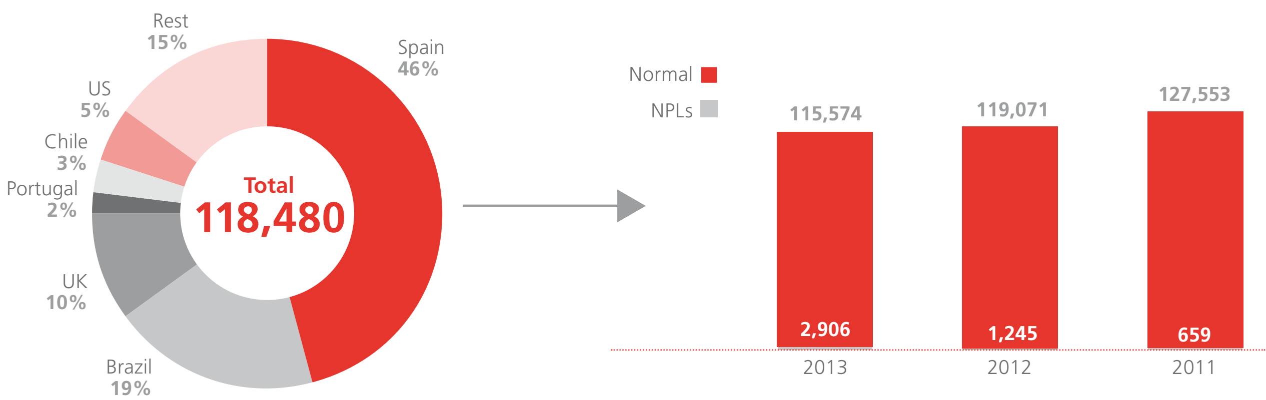

STANDARDISED




INDIVIDUALISED




GLOBAL WHOLESALE



The structure of the main magnitudes by geographic area:

- **Continental Europe**

  - **Spain's** NPL ratio[1] was 7.49%, mainly affected by the reclassification of substandard loans in June, and the fall in lending due to the country's recession. Coverage was 44%.

  - **Portugal's** lending dropped to 5% due to deleveraging throughout the banking system, which resulted in the rise of NPL ratio to 8.12%, with coverage of 50%. Of note was the good performance of the individual mortgage portfolio, where the Bank anticipated the protection regulations for clients with payment difficulties (PARI *Plano de Acção para o Risco de Incumprimento, PERSI Procedimento Extrajudicial de Regularização de Situações de Incumprimento*).

  - **Poland's** NPL ratio was 7.84%, affected by the integration of Kredyt Bank's businesses. Coverage was 61.8%.

- The **UK**[2] recorded a NPL ratio of 1.98% (-7 b.p.) and a coverage ratio of 41.6%.

- **Brazil's** NPL ratio[3] was 5.64% (-122 b.p.) and coverage of 95.1%.

- Lending in **Chile** grew 11% in local currency, in line with the country's banking system, maintaining a balanced mix between individuals and companies. The NPL ratio was 5.91% and coverage 51.1%.

- **Mexico** continued to accompany the system's sustained growth in lending with an increase of 14.7% in its loans in local currency, despite the country's slower economic growth. The NPL ratio was 3.66%, higher than in 2012, affected by the extraordinary reclassification of loans to the social housing sector. Coverage (97.5%) was also impacted.

- The **United States'** NPL ratio was 2.33% and coverage 93.6%.

### Portfolio in normal situation: matured amounts pending collection

The amounts matured pending collection of three months or less accounted for 0.5% of total credit risk with customers. The following table shows the structure at December 31 2013, classified on the basis of the maturity of the first maturity:

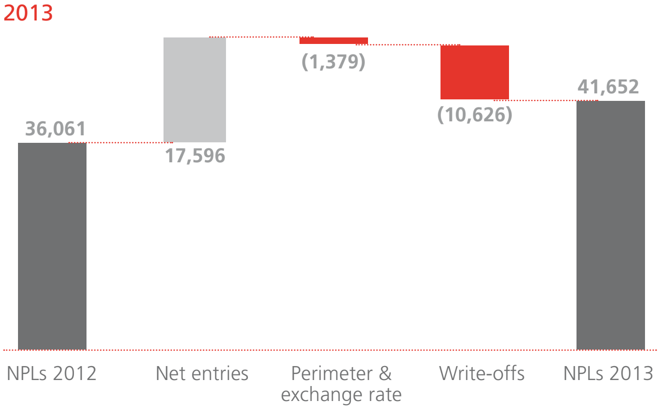
**MATURED AMOUNTS PENDING**
Million euros

| | Less than 1 month | 1-2 months | 2-3 months |
|---|---|---|---|
| Deposits in credit entities | 25 | - | - |
| Customer loans | 2,450 | 631 | 416 |
| Public administrations | 5 | - | 1 |
| Other private sectors | 2,445 | 631 | 415 |
| Securities representing debt | - | | - |
| **Total** | **2,475** | **631** | **416** |

### Doubtful loans and provisions: performance and structure

The table below shows the performance of doubtful balances by the concepts that comprise them:

**EVOLUTION OF NON-PERFORMING LOANS BY THE CONCEPTS THAT COMPRISE THEM**
Million euros



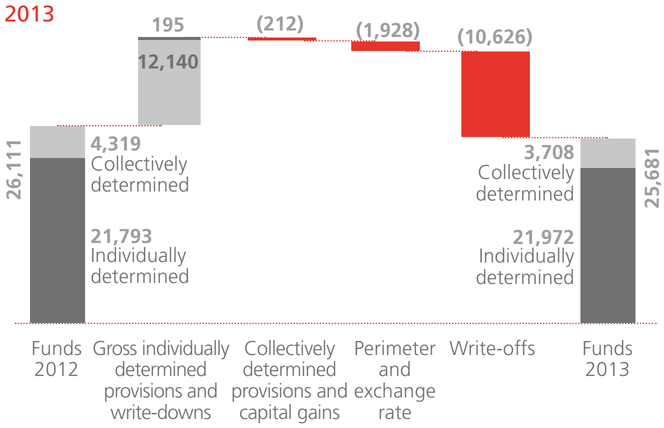

**2011-2013 EVOLUTION**

| | 2011 | 2012 | Jun 2013 |
|---|---|---|---|
| **NPLs (start of the period)** | **28,478** | **32,006** | **36,061** |
| Entries | 16,122 | 16,539 | 17,596 |
| Perimeter | 69 | (628) | 743 |
| Exchange rate | (370) | (509) | (2,122) |
| Write-offs | (12,293) | (11,347) | (10,626) |
| **NPLs (end of period)** | **32,006** | **36,061** | **41,652** |

1. Excluding run-off real estate activity. More details at 6.3.2. Spain.
2. More detail at 6.3.1. United Kingdom.
3. More detail at 6.3.3. Brazil.

## EVOLUTION OF FUNDS BY THE CONCEPTS THAT COMPRISE THEM

Million euros




## 2011-2013 EVOLUTION

| | 2011 | 2012 | 2013 |
|---|---|---|---|
| **Funds (start of period)** | **20,748** | **19,531** | **26,111** |
| Collectively determined | 5,846 | 4,058 | 4,319 |
| Individually determined | 14,901 | 15,474 | 21,793 |
| **Gross individually determined provisions and write-downs** | **12,446** | **19,508** | **12,335** |
| Specific provisions | 11,844 | 13,869 | 12,140 |
| Write-downs | 603 | 5,639 | 195 |
| **Collectively determined provisions** | **(520)** | **358** | **(212)** |
| **Perimeter and exchange rate** | **(850)** | **(1,939)** | **(1,928)** |
| **Write-offs** | **(12,293)** | **(11,347)** | **(10,626)** |
| **Funds (end of period)** | **19,531** | **26,111** | **25,681** |

### Forbearance portfolio

The term forbearance portfolio refers for the purposes of the Group's risk management to defined concepts such as restructuring/refinancing in accordance with Bank of Spain Circular 6/2012 and which correspond to those operations in which the client has experienced, or it is envisaged might experience, financial difficulties in meeting their payment obligations in the prevailing contractual terms and, for this reason, steps were taken to modify, cancel or even formalise a new transaction.

Grupo Santander has a detailed corporate policy for forbearance applicable to all countries, which comply with Bank of Spain Circular 6/2012 and share the general principles recently published by the European Banking Authority for this type of operation.

This corporate policy sets rigorous criteria of prudence for assessing these risks:

- There must be restrictive use of restructurings, avoiding actions that delay recognising deterioration.
- The main aim must be to recover all the amounts owed, which entails recognising as soon as possible the amounts that it is estimated cannot be recovered.
- The restructuring must always envisage maintaining the existing guarantees and, if possible, improving them. Effective guarantees can not only serve to mitigate the severity, but also reduce the probability of default.
- This practice must not involve granting additional financing to the client, serve to refinance the debt of other banks, or be used as an instrument of cross-selling.
- It is necessary to assess all the forbearance alternatives and their effects, ensuring that the results would be better than those likely to be achieved in the event of not doing it.
- The new operation cannot mean an improvement in the classification as long as satisfactory experience with the client does not exist. On the contrary, operations, which in origin were classified in normal situation, can be classified as doubtful, if a series of circumstances makes it advisable.
- In addition, in the case of individualised clients, an individualised analysis of each case is particularly important, both for their correct identification as well as subsequent classification, monitoring and adequate provisions.

It also establishes various criteria related to determining the perimeter of operations considered as forbearance, through defining a detailed series of objective indicators that enable situations of financial difficulty to be identified.

In this way, operations not classified as doubtful at the date of forbearance are generally considered as being in financial difficulties if at this date non-payment exceeds a month. If there is not non-payment or if this does not exceed the month of maturity, other indicators are taken into account including:

- Operations of clients who already have problems with other transactions.
- When the modification is made necessary prematurely, without there yet existing a previous and satisfactory experience with the client.
- In the event that the necessary modifications involve granting special conditions such as the need to have to establish a temporary grace period in the payment, or, when these new conditions are regarded as more favourable for the client than those granted in an ordinary admission.
- Request for successive modifications over an unreasonable period of time.
- In any case, once the modification is made, if any irregularity arises in the payment during an established

period of observation, even if there are no other symptoms, the operation will be considered within the perimeter of forbearance (backtesting).

As soon as it is determined that the reasons giving rise to the modification are due to financial difficulties, a more precise typology is established on the basis of the degree of deterioration and the management situation of the original operations, distinguishing the following types:

- **Ex-ante forbearance.** When the original operation has not been considered a doubtful risk and there is some non-payment with more than a month of being unpaid at the time of formalisation, but without exceeding three months. If there is any amount with a month of maturity or less, or even when the operation is on track, ex-ante forbearance will be considered if there is any sign of financial difficulties.

- **Ex-post forbearance.** The concept of ex-post is used to refer to risk forbearance operations which have reached a doubtful situation at the moment of forbearance, be it for becoming a non-performing loan or for other reasons (subjective doubtful or a cause different to that of non-performing).

  In addition, within this typology of operations, there is treatment applied to cases of advanced deterioration. The requirements and classification criteria for this type of operation are even more severe that for the rest of forbearance.

As for the strategies to be applied, the corporate policy requires analysis of the client's payment capacity and disposition, differentiating, in turn, the seriousness and estimated duration of the deterioration. On the basis of the results of this analysis, the forbearance decision is established as well as the most appropriate framework for each case:

- When the payment capacity suffers a severe but temporary deterioration (the recovery of the capacity is estimated to take a short time), short-term strategies are applied such as granting a grace period on the principal or adapting the payment quotas for a limited and reduced amount of time until the payment capacity is recovered.

- When the payment capacity has deteriorated slightly but an early recovery is not expected, longer term strategies are applied, such as reducing the payment quota by deferring the maturity date or part of the principal, which will be paid together with the quota, and always ensuring payment through the contribution of affective guarantees.

In any case, via individualised study those changes of clients with a slight and prolonged deterioration are given precedence as those with a temporary but severe deterioration incorporate a greater risk, as they depend on the success in estimating their future recovery, and ruling out for forbearance the cases of serious deterioration and with a duration estimated to be prolonged.

The corporate policy also establishes management and control mechanisms for these operations, which enable the rest of operations to be treated differently, among which are included monitoring the processes of:

- Planning and budgeting, through drawing up the corresponding business forecasting plans and limits in the most relevant magnitudes.

- Monitoring the evolution of the portfolio, assessing the degree of compliance with the forecasts made in the planning phase.

Once the forbearance is done, those operations that remain classified as doubtful risk for not meeting at the time of forbearance the requirements for their reclassification to another category[4], must fulfil a schedule of prudent payments in order to ensure with reasonable certainty that the client has recovered his payment capacity.

If there is any irregularity (non-technical) in payments during this period, the observation period is begun again.

Once this period is over, conditioned by the customer's situation and by the operation's features (maturity and guarantees granted), the operation is no longer considered doubtful, although it continues to be monitored and managed appropriately.

This specific tracking of the forbearance is maintained while a series of requirements are not met, including: a minimum period of two years from the start of the forbearance, amortisation of 20% of the principal of the loan and having met the unpaid amounts at the time of forbearance.

If, after formalising the forbearance, payments do not improve the possibility of a new forbearance will be assessed, applying the most demanding classification/ normalisation criteria.

The forbearance of a doubtful operation, regardless of whether, as a result of it, the transaction remains current in payment, does not modify the date of non-payment considered for determining the provisions. At the same time, the forbearance of a doubtful operation does not give rise to any release of the corresponding provisions.

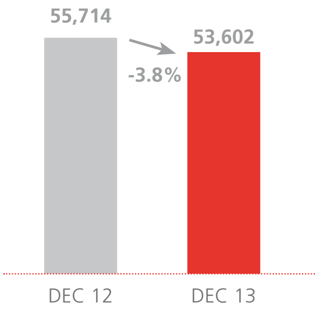
4 Bank of Spain Circular 6/12: The refinancing or restructuring of transactions not current in payment does not interrupt their arrears and nor will it give rise to their reclassification to one of the foregoing categories unless there is reasonable certainty that the customer can make payment on schedule, or unless new effective guarantees or collateral are provided and, in both cases, unless at least the current interest receivable, disregarding interest for late payment, is paid.

The total volume of forbearance stood at EUR 53,602 million at the end of 2013 (7.3% of the Group's total customer loans), with the following structure[5]:

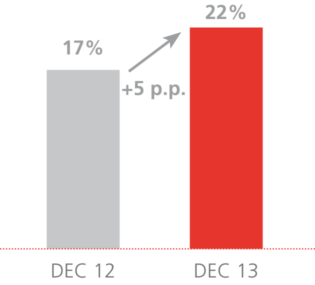
*Million euros*

| | Non-doubtful | Doubtful | Risk | |
|---|---|---|---|---|
| | | | Total | |
| | Amount | Amount | Amount | % spec. cov. |
| Ex-ante forbearance | 19,839 | 15,755 | 35,594 | 21% |
| Ex-post forbearance | 10,122 | 7,886 | 18,008 | 25% |
| **Total** | **29,961** | **23,641** | **53,602** | **22%** |

FORBEARANCE PORTFOLIO
Million euros




SPECIFIC COVERAGE OF THE FORBEARANCE PORTFOLIO
Million euros

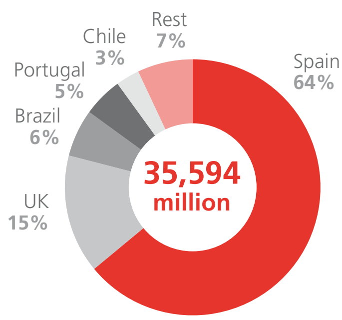



The Group's level of forbearance declined by 3.8% (-EUR 2,112 million), as a result of the recovery effort made, the exchange rate impact and deleveraging in Spain's real estate sector. The Bank of Spain's recommendation in April 2013 in this area did not affect the total figure of the forbearance portfolio. Specific coverage of the total portfolio increased 5 p.p. to 22%. The chart below shows the evolution:

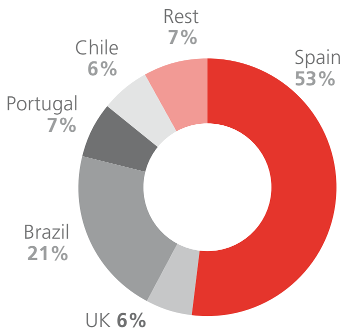
As regards loan classification, 56% is non-doubtful. Of note is the high level of guarantees (70% with real guarantees) and adequate coverage through specific provisions (specific coverage of the doubtful portfolio: 43%).

The geographic distribution by type of forbearance is as follows:

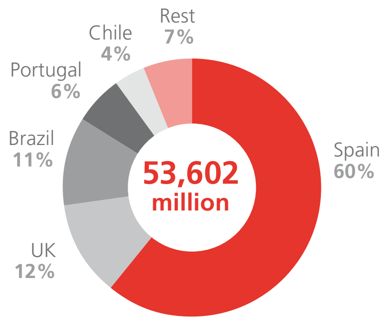
EX-ANTE FORBEARANCE




EX-POST FORBEARANCE




TOTAL




Spain accounted for 60% (EUR 32,271 million) of the Group's forbearance portfolio, which was reduced by EUR 596 million in 2013. The structure of the portfolio was as follows:

- Some 27% corresponded to companies with real estate purpose, with specific coverage of 46%. This portfolio is subject to the process of real estate deleveraging in Spain (more detail in section 6.3.2.4. Run-off real estate activity in Spain).

- Companies without a real estate purpose accounted for 45% of the total. Despite the fall in consumer markets and domestic demand, 57% of the portfolio remained non-doubtful.

- Some 28% is related to forbearance with individual clients, mainly mortgages with a high percentage of real guarantee.

In the rest of the countries where the Group operates, the portfolio of forbearance does not represent in any of them more than 1% of the Group's total credit risk.

**Management metrics**[6]

Credit risk management uses other metrics to those already commented on, particularly management of non-performing loans variation plus net write-offs (known in Spanish as VMG) and expected loss. Both enable risk managers to form a complete idea of the evolution and future prospects of the portfolio.

5. The figures of the non-doubtful portfolio include the portfolio in normal and substandard classification of Bank of Spain Circular 4/04. For more detail, see Note 54 of the Auditor's Report and Annual Financial Statements.

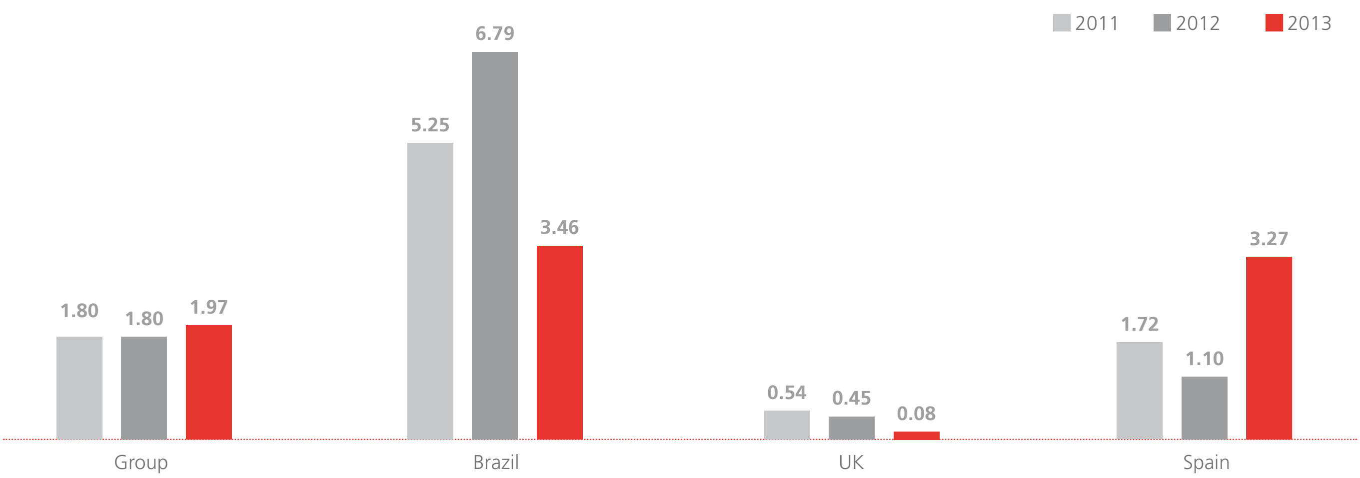
6. For more detail on these metrics see 6.5.5. Measurement and control, in this section.

Unlike non-performing loans, the **VMG** refers to the total portfolio deteriorated over a period of time, regardless of the situation in which it finds itself (doubtful loans and write-offs). This makes the metric a main driver when it comes to establishing measures to manage the portfolio.

The VMG is frequently considered in relation to the average loan that generated them, giving rise to what is known as the risk premium, whose evolution can be seen below.

## NON-PERFORMING LOANS VARIATION PLUS NET WRITE-OFFS

Change in doubtful loans plus net write-offs (% of average balances)




The Group's risk premium was a little higher than in 2012, in a context of lower lending in most mature markets.

**The expected loss** is the estimate of the economic loss during the following year of the portfolio existing at a given moment. Its forward-looking component complements the view provided by the VMG when analysing the portfolio and its evolution.

The expected loss reflects the portfolio's features as regards the exposure at default (EaD), the probability of default (PD) and the severity or recovery once the default occurs (loss given default, LGD).

The table below sets out the distribution by segments in terms of EaD, PD and LGD. For example, it can be seen how the consideration of the LGD in the metrics makes the portfolios with mortgage guarantee generally produce a lower expected loss, the result of the recovery that occurs in the event of a default via the mortgaged property.

The expected loss with clients of the portfolio in normal situation is 1.20% (1.27% in 2012) and 0.98% for the whole of the Group's credit exposure (0.99% in 2012), which underscores the medium-low risk profile assumed.

## SEGMENTATION OF THE CREDIT RISK EXPOSURE

| Segment | EaD[1] | % | Average PD | Average LGD | Expected loss |
|---|---|---|---|---|---|
| Sovereign debt | 131,951 | 13.8% | 0.07% | 12.92% | 0.01% |
| Banks and other fin. instit. | 59,238 | 6.2% | 0.37% | 48.64% | 0.18% |
| Public sector | 17,697 | 1.9% | 2.49% | 8.08% | 0.20% |
| Corporate | 126,881 | 13.3% | 0.73% | 33.33% | 0.24% |
| SMEs | 144,494 | 15.1% | 4.51% | 37.95% | 1.71% |
| Individual mortgages | 310,371 | 32.5% | 2.75% | 7.65% | 0.21% |
| Consumer credit (individuals) | 114,060 | 11.9% | 7.00% | 56.03% | 3.92% |
| Credit cards (individuals) | 35,340 | 3.7% | 4.48% | 67.31% | 3.02% |
| Other assets | 15,469 | 1.6% | 2.84% | 43.20% | 1.23% |
| Memorandum item[2] | 748,842 | 78.4% | 3.47% | 34.69% | 1.20% |
| **Total** | **955,501** | **100.0%** | **2.80%** | **34.86%** | **0.98%** |

Data at December 2013.
1. Excludes doubtful loans. Million euros.
2. Excludes sovereign debt, banks and other financial institutions and other assets.

## 6.3. Geographic areas with the largest concentration of risk

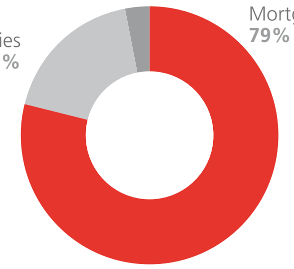
The portfolios with the largest concentration of risk are set out below, based on the figures in 6.2.2. Performance of magnitudes in 2013.

### 6.3.1. United Kingdom

#### 6.3.1.1. General view of the portfolio

Santander UK's loans amounted to EUR 235,627 million at the end of 2013 (31.9% of the Group's total), with the following distribution by segments:

## CREDIT RISK: SEGMENTATION OF THE PORTFOLIO




#### 6.3.1.2. Mortgage portfolio

Because of its importance not just for Santander UK but for all of the Group's lending, it is worth highlighting the mortgage portfolio, EUR 177,617 million at the end of 2013.

This portfolio consists of mortgages for buying or reforming homes, granted to new as well as existing clients. There are no operations that entail second or successive charges on mortgaged properties.

The mortgaged property must always be located within UK territory, regardless of the destiny of the financing except in the case of some one-off operations in the Isle of Man. Mortgages can be granted for properties outside the UK, but the collateral for such mortgages must consists of a property in the UK.

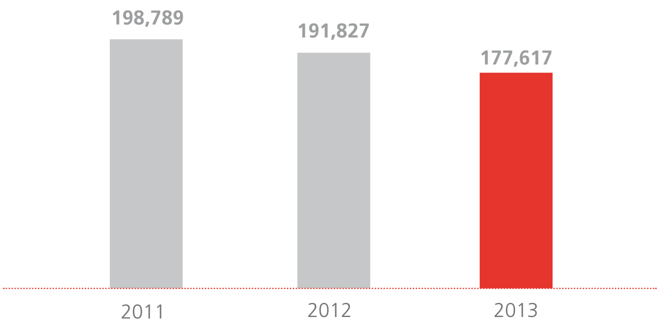
Most of credit exposure is in the south-east of the UK, where housing prices are more stable even during the periods of economic slowdown.

All the properties are valued independently before each new operation is approved, in accordance with the principles established by the Group for risk management.

Mortgages that have already been granted are subject to a quarterly updating of the value of property in guarantee, by an independent agency, using an automatic valuation system in accordance with the market's usual practices and in compliance with prevailing legislation.

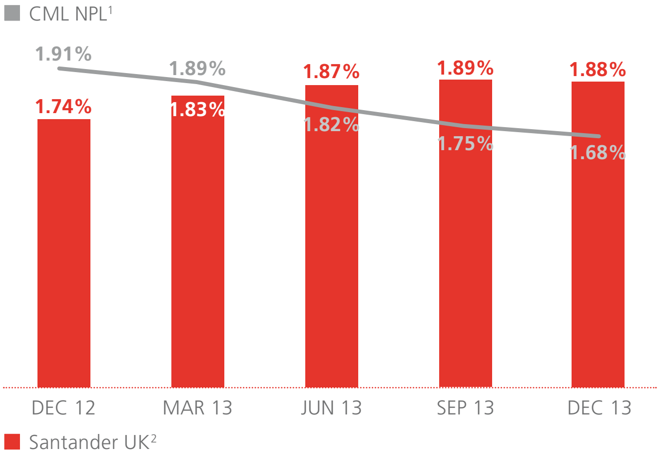
The evolution of the portfolio over the last three years was as follows:

**EVOLUTION OF THE MORTGAGE PORTFOLIO**
Million euros




In 2013, as can be seen in the chart below, the NPL ratio of this portfolio rose from 1.74% in 2012 to 1.88%, slightly above that of the UK banking industry as a whole, according to the Council of Mortgage Lenders (CML).

**EVOLUTION OF THE NPL RATIO OF THE MORTGAGE PORTFOLIO**




1. CML figures in accordance with the volume of cases.
2. Figures of Santander UK in accordance with the amount of the cases.

This growth was mainly due to the fall in lending as a result of stricter credit and pricing policies implemented in previous years. The result of these measures was a lower exposure in some subsegments with a worse performance, such as interest-only mortgages, in a greater proportion than the new lending generated with the consequent reduction in the total stock.

Non-performing loans improved significantly thanks to a more favourable macroeconomic environment and the increased NPL exits due to the improvements in the efficiency of the recovery teams. The amount of NPLs rose 1.1% to EUR 3,453 million, including foreclosed properties (+8.5% in 2012).

It is also necessary to point out the more conservative focus adopted in Santander UK's NPL definition, in line with the criteria set by the Bank of Spain and Grupo Santander, with regard to the standard applied in the UK market. This focus includes the classification as doubtful in the following operations:

- Clients with payment delays of between 30 and 90 days and who have been declared insolvent publicly (via the bankruptcy process) in the previous two years.
- Operations in which once the maturity date is reached there is still capital of the loan pending payment with a maturity of more than 90 days, although the client remains current with the monthly payments.
- Forbearance operations which, in accordance with the corporate policy, are considered as "payment agreements" and thus classified as doubtful.

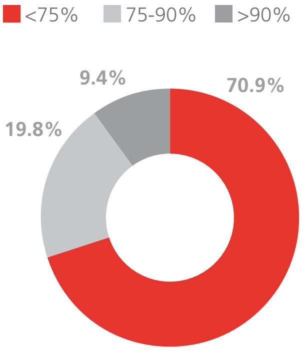
Excluding these concepts, which are not included for calculating the NPL ratio in the UK market, and under which EUR 495 million of NPLs were classified at the end of 2013, the ratio of the mortgage portfolio was 1.60%, well below the aforementioned 1.88% and that published by the Council of Mortgage Lenders (1.68%).

The strict credit policies limit the maximum loan-to-value (LTV) to 90% for those loans that amortise interest payments and capital, and to 50% for those that amortise interest regularly and the capital at maturity. Applying these policies enabled the simple arithmetic average LTV of the portfolio to be 50.75% and the average weighted LTV 46.7%. The proportion of the portfolio with a LTV of more than 100% was reduced to 4.4% from 4.9% in 2012.

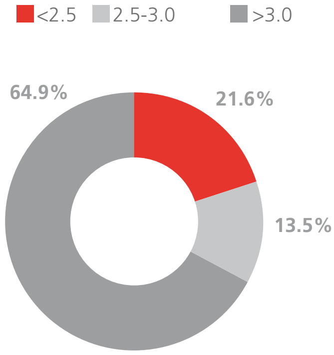
7. Percentage calculated for just interest-only loans. Including loans with some interest-only component, the percentage of the portfolio rises to 43.8%.

The following charts show the LTV structure for the stock of residential mortgages and the distribution in terms of the income multiple of new loans in 2013:

LOAN-TO-VALUE (AVERAGE 50.7%)[1]




INCOME MULTIPLE (AVERAGE 3.1)[2]




1. Loan-to-value: relation between the amount of the loan and the appraised value of the property.
2. Income multiple: relation between the total original amount of the mortgage and the customer's annual gross income declared in the loan request.

The credit risk policies explicitly forbid loans regarded as high risk (subprime mortgages) and establish demanding requirements for credit quality, both for operations and for clients. For example, as of 2009 mortgages with a loan-to-value of more than 100% were not allowed. As of then and until 2012 less than 0.1% of new loans had a loan-to-value of more than 90%.

There are various types of products with different risk profiles, all of them subject to the limits inherent in the policies of a prime lender such as Santander UK. The features of some of them (in brackets the percentage of the portfolio of UK mortgages they represent) are as follows:

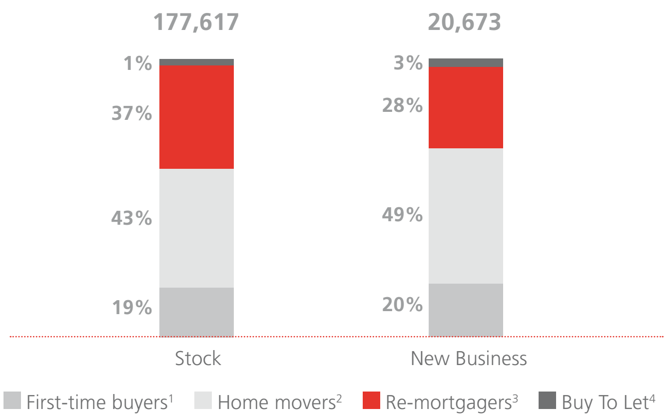
- Interest-only loans (33.3%)[7]: The customer amortises every month the interest and capital at maturity. An appropriate repayment vehicle such as a pension plan, mutual funds, etc., is needed. This is a regular product in the UK market for which Santander UK applies restrictive policies in order to mitigate the risks inherent in it. For example, maximum LTV of 50%, higher cut-off in the admission score or the evaluation of the payment capacity simulating the amortisation of capital and interest payments instead of just interest. New loans of this type were reduced by 11% in 2013.

- Flexible loans (10.9%): This type of loan contractually enables the customer to modify the monthly payments or make additional provision of funds up to a pre-established limit, as well as having disbursements from previously paid amounts above that limit.

- Buy-to-Let (1.48%): Buy-to-let mortgages (purchase of a property to then rent it out) account for a small percentage of the total portfolio. Admission was halted between 2009 and 2012. In 2013, after the improvement in market conditions, only EUR 36 million a month was approved (around 2.5% of the total monthly admission) and under strict risk policies.

The following chart shows the distribution by type of loan:

SANTANDER UK: DISTRIBUTION BY TYPE OF LOAN
Million euros




1. First Time Buyer: Customers who buy a home for the first time.
2. Home Mover: customers who change home with or without changing the bank that granted the mortage.
3. Remortgage: customers who transfer their mortage from another bank.
4. Buy To Let: Housing bought with the intention of renting it out.

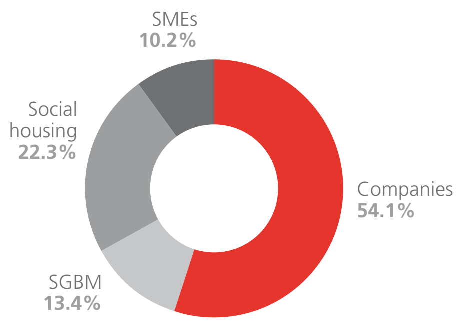
An additional indicator of the portfolio's good performance is the small volume of foreclosed homes (EUR 109 million at the end of 2013, less than 0.1% of the total mortgage exposure). Efficient management of these cases and the existence of a dynamic market for this type of property, which enables sales to take place in a short period, contributed to the good results.

**6.3.1.3. SMEs and companies**

As shown in the chart on the segmentation of the portfolio at the beginning of this section, lending to SMEs and companies (EUR 41,787 million) represented 18.6% of the total at Santander UK.

The following subsegments are included in these portfolios:

PORTFOLIO, SME AND COMPANY SEGMENTS




**SMEs:** This segment includes those small firms which, from the risk management standpoint, are in the standardised model. Specifically, those belonging to the business lines of small business banking and regional business centres. Total lending at the end of 2013 amounted to EUR 4,256 million, with a NPL ratio of 5.99% (7.2% at the start of the year).

**Companies:** This includes companies under individualised risk management (i.e. they have a risk analyst assigned). Also included are portfolios considered as not strategic (legacy and non-core). Lending at the end of 2013 amounted to EUR 22,600 million, with a NPL ratio of 3.6% (5.9% at the start of the year).

**SGBM:** This includes companies under the risk management model of Global Wholesale Banking. Lending was EUR 5,600 million at the end of 2013 (NPL ratio of 0.4%).

**Social housing:** This includes lending to companies that build, sell and rent social housing, This segment is supported by local governments and the central government and has no NPLs. Lending stood at EUR 9,330 million at the end of 2013.

In line with the objective of becoming the reference bank for SMEs and companies, the concession of loans in the most representative portfolios of this segment grew by around 13% in 2013 (+EUR 4,900 million).

## 6.3.2. Spain

### 6.3.2.1. General view of the portfolio

The total credit risk (including guarantees and documentary credits) in Spain (excluding the run-off real estate unit) amounted to EUR 189,783 million at the end of 2013 (26% of the Group's total), with an adequate level of diversification by both product and customer segment.

Lending continued to fall in 2013 because of the lower demand and the economic situation, and additionally in the fourth quarter the amortisation of the administration's financing plan for suppliers (around EUR 4,000 million).

*Million euros*

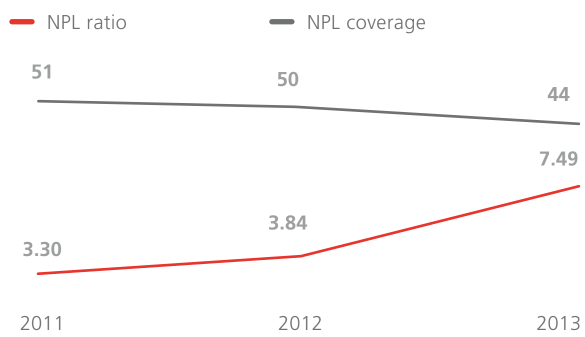
| | 2013 | 2012** | 2011** | Var 13/12 | Var 12/11 |
|---|---|---|---|---|---|
| **Total credit risk*** | **189,783** | **210,536** | **223,456** | **-10%** | **-6%** |
| Home mortgages | 52,016 | 52,834 | 56,434 | -2% | -6% |
| Rest of loans to individuals | 17,728 | 20,042 | 19,543 | -12% | 3% |
| Companies | 106,042 | 119,808 | 134,396 | -11% | -11% |
| Public administrations | 13,996 | 17,852 | 13,083 | -22% | 36% |

* Including guarantees and documentary credits.
** In order to facilitate like-for-like comparisons with prior years the figures for 2011 and 2012 have been restated.

The NPL ratio for the total portfolio was 7.49% and was affected by a lower level of lending (which increased the ratio by 74 b.p.), the impact of the reclassification of sub standard loans in June 2013 (+95 b.p.) and higher levels of arrears in the segment of companies.

The reclassification of loans also affected the NPL coverage ratio (+5 p.p.), as there was a slight rise in the second half of the year to 44% at the end of 2013.

NPL RATIO AND COVERAGE
%




Below are the main portfolios.

### 6.3.2.2. Home mortgages

Lending to households to acquire a home in Spain amounted to EUR 52,878 million at the end of 2013 (28% of total credit), of which 99% has a mortgage guarantee.

## LENDING TO HOUSEHOLDS TO ACQUIRE HOMES*

Million euros

| | 2013 | 2012** | 2011** |
|---|---|---|---|
| **Gross amount** | **52,879** | **53,408** | **57,352** |
| Without mortgage guarantee | 863 | 574 | 918 |
| With mortgage guarantee | 52,016 | 52,834 | 56,434 |
| **Of which doubtful** | **3,956** | **1,371** | **1,512** |
| Without mortgage guarantee | 461 | 8 | 28 |
| With mortgage guarantee | 3,495 | 1,363 | 1,484 |

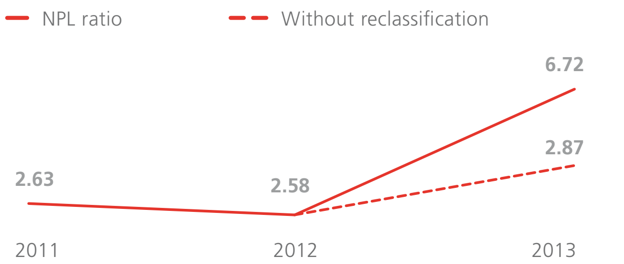
* Excluding the mortgage portfolio of Santander Consumer Spain (EUR 2,279 million in 2013), with doubtful loans of EUR 85 million.

** In order for a like-for-like comparison to be made, the figures for 2011 and 2012 have been restated and the perimeters made the same.

The NPL ratio of mortgages to households to acquire a home was 6.72%. The increase over 2012 was mainly due to marking as doubtful for subjective reasons EUR 2,000 million of loans in June 2013.

## SPAIN: NPL RATIO OF HOME MORTGAGE LOANS

%




The portfolio of mortgages for homes in Spain kept its medium-low profile and with limited expectations of a further deterioration:

- All mortgages pay principle right from the start.
- Early amortisation is usual and so the average life of the operation is well below that in the contract.
- The borrower responds with all his assets and not just the home.
- High quality of collateral concentrated almost exclusively in financing the first home.
- Some 88% of the portfolio has a loan-to-value of less than 80% (total risk/latest available valuation of the home).
- Average affordability rate of close to 29%.

## RANGES OF TOTAL LTV*

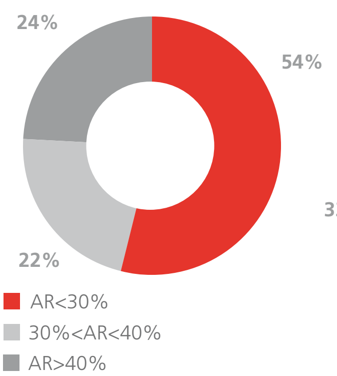
Million euros

| | 2013 | 2012 |
|---|---|---|
| **Gross amount with mortgage guarantee** | **52,016** | **52,834** |
| LTV < 40% | 12,389 | 12,103 |
| LTV between 40% and 60% | 16,105 | 15,766 |
| LTV between 60% and 80% | 17,364 | 18,745 |
| LTV between 80% and 100% | 5,392 | 5,649 |
| LTV > 100% | 815 | 571 |
| **of which doubtful** | **3,496** | **1,364** |
| LTV < 40% | 273 | 145 |
| LTV between 40% and 60% | 634 | 190 |
| LTV between 60% and 80% | 1,335 | 326 |
| LTV between 80% and 100% | 931 | 545 |
| LTV > 100% | 323 | 158 |

* Excluding Santander Consumer Spain.

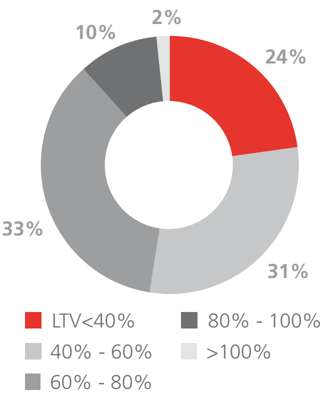
## AFFORDABILITY RATE

Average: 29.0%




## LOAN-TO-VALUE

%



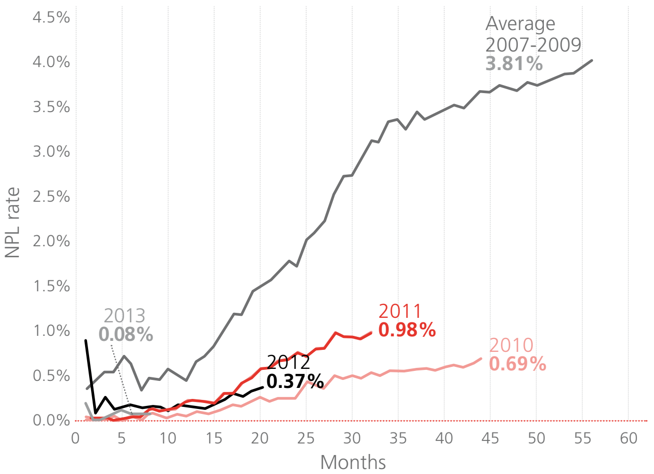

Loan-to-value: Percentage total risk/amount of the latest value appraisal. With management criteria, the average LTV of the portfolio of residential mortgages is 54.8%.

Affordability rate: relation between the annual quotas and the customer's net income.

Despite the economic situation and the gradual deterioration over the last few years, the loan admission measures produced a good evolution of vintages. The following chart shows the performance of vintages before the change in admission policies (2009 and before) and after that change (as of 2010):

8. For more detail on the real estate portfolio, see Note 54 of the auditors' report and annual financial statements.

## MATURITY OF MORTGAGE VINTAGES. SANTANDER BRANCH NETWORK, SPAIN




Note: mortgage vintages originated in the Santander Branch Network in Spain.

The Santander Branch Network in Spain offered, as of 1 August 2011, a three-year moratorium on capital to alleviate the situation of clients, including the self-employed, for those presenting objective causes of economic problems, such as being unemployed or having suffered a fall in income of more than 25%, and thus facing temporary difficulties in paying the mortgage on their usual home. Customers who take advantage of this measure have the possibility of extending the maturity of their loan in order to compensate for the grace period, but without changing the loan's financial conditions either during the grace period or at the end of it.

This measure served to mitigate the social impact of the economic crisis, while preserving the good culture of payment, one of the elements that distinguishes the Spanish mortgage market. At the end of 2013, more than 22,800 clients had taken advantage of this measure.

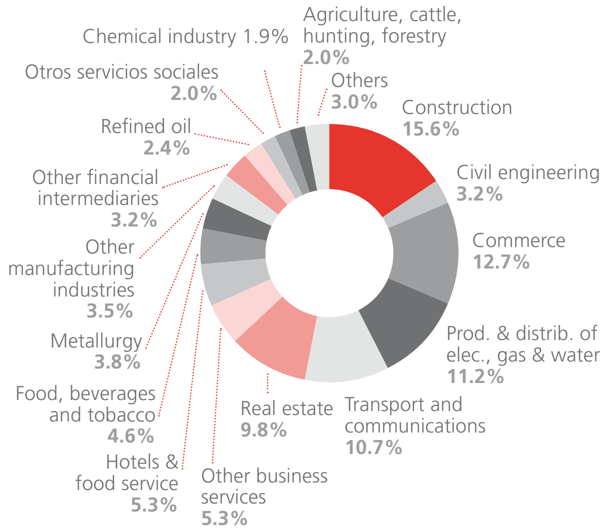
### 6.3.2.3. Portfolio of companies distribution without real estate purpose

Lending to SMEs and companies (EUR 106,042 million) is the main segment in lending in Spain (56% of total credit).

Most of the portfolio corresponds to individualised clients who, because of the risk assumed, are assigned a risk analyst who continuously monitors the client during all the phases of the risk cycle.

The portfolio is well diversified, with more than 200,000 active clients and no significant concentrations by sector.

## DISTRIBUTION OF THE COMPANIES' PORTFOLIO WITHOUT REAL ESTATE PURPOSE




The NPL ratio of this portfolio was 8.72% at the end of 2013, affected by the continued complex economic environment and the fall in lending.

### 6.3.2.4. Run-off real estate activity in Spain

The Group began to manage a separate unit for run-off real estate activity in Spain[8], which includes loans to clients mainly for real estate promotion, and has a specialised management model, stakes in real estate companies (Metrovacesa and Sareb) and foreclosed assets.

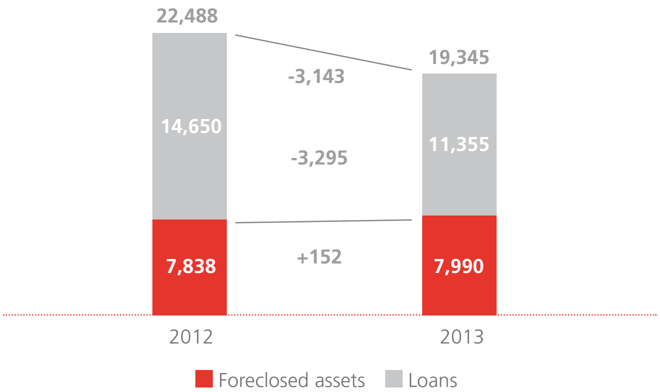
The Group's strategy in the last few years has been to reduce the volume of these loans which at the end of 2013 stood at EUR 10,821 million in net terms (around 3% of loans in Spain and less than 1% of the Group's loans). The portfolio's composition is as follows:

- Net loans were EUR 5,735 million, EUR 1,563 million less than in 2012 and with coverage of 49%.
- Net foreclosed assets ended 2013 at EUR 3,600 million, with coverage of 55%.
- The value of the stakes in Metrovacesa and Sareb was EUR 1,486 million.

The following table shows the evolution and classification of the lending and foreclosed portfolio:

| | 2013 | | | 2012 | | |
|---|---|---|---|---|---|---|
| | Gross balance | % Cover. | Net balance | Gross balance | % Cover. | Net balance |
| 1. Credit | 11,355 | 49% | 5,735 | 14,650 | 50% | 7,298 |
| a. Normal | 424 | 0% | 424 | 4,362 | 57% | 1,894 |
| b. Substandard | 2,815 | 36% | 1,797 | 2,286 | 39% | 1,394 |
| c. Doubtful | 8,116 | 57% | 3,514 | 8,002 | 50% | 4,010 |
| 2. Foreclosed | 7,990 | 55% | 3,600 | 7,838 | 53% | 3,674 |
| **TOTAL 1+2** | **19,345** | **52%** | **9,335** | **22,488** | **51%** | **10,972** |

Under the new management parameter (real estate activity unit), gross exposure was reduced by 13.9% in 2013.




This reduction continued the path begun in previous years (-44.2% between 2008 and 2012).

By type of real estate that guarantees the loans (independent of their classification by credit quality into doubtful, substandard or normal) or foreclosed assets, the coverage levels are as follows:

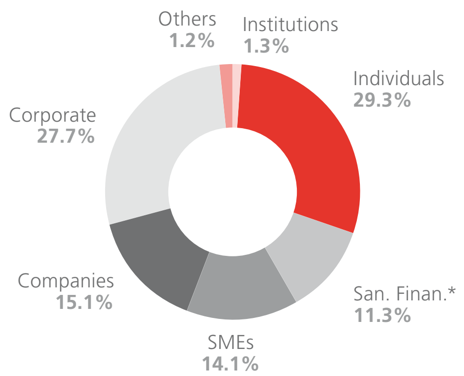
| | Real estate loans | | Foreclosed assets | | Total | |
|---|---|---|---|---|---|---|
| | Expos. | Cover. | Expos. | Cover. | Expos. | Cover. |
| Finished buildings | 4,673 | 31% | 2,343 | 40% | 7,016 | 34% |
| Promotions under construction | 614 | 47% | 733 | 47% | 1,347 | 47% |
| Land | 4,240 | 65% | 4,841 | 63% | 9,081 | 64% |
| Other guarantees | 1,828 | 62% | 73 | 63% | 1,901 | 62% |
| **Total DISA*** | **11,355** | **49%** | **7,990** | **55%** | **19,345** | **52%** |

* Real estate division for the cleaning up of assets.

### 6.3.3. Brazil

Brazil's lending amounted to EUR 79,216 million (11% of the Group's total) and is adequately diversified and with a mainly retail profile (55% to individuals, consumer finance and SMEs).

PORTFOLIO MIX
%




* Santander Financiamentos: unit specialised in consumer finance (mainly auto finance).

Loans grew 7.1% (at constant exchange rate) compared to 11% in 2012. This growth was aligned with the nominal rise in the Brazilian economy and the average of private sector banks in Brazil.

Below are the levels of lending and growth of the main segments.

## LENDING: SEGMENTATION

Million euros, constant exchange rates, 2013

| 1,2 | 2013 | 2012 | 2011 | 2010 | 13 / 12 | 12 / 11 | 11 / 10 |
|---|---|---|---|---|---|---|---|
| **Individuals** | **23,230** | **21,734** | **19,515** | **15,677** | **7%** | **11%** | **24%** |
| Mortgages | **5,060** | 3,860 | 3,116 | 2,078 | 31% | 24% | 50% |
| Consumer | **11,676** | 11,947 | 11,075 | 9,247 | -2% | 8% | 20% |
| Cards | **5,286** | 4,965 | 4,342 | 3,303 | 6% | 14% | 31% |
| Others | **1,207** | 962 | 983 | 1,049 | 25% | -2% | -6% |
| **Santander Financiamentos** | **8,976** | **9,302** | **9,560** | **8,330** | **-4%** | **-3%** | **15%** |
| **SMEs and large companies** | **45,057** | **41,164** | **36,536** | **32,213** | **9%** | **13%** | **13%** |
| SMEs | **11,137** | 11,477 | 9,535 | 7,523 | -3% | 20% | 27% |
| Companies | **11,940** | 10,496 | 10,055 | 8,210 | 14% | 4% | 22% |
| Corporate | **21,981** | 19,190 | 16,946 | 16,480 | 15% | 13% | 3% |

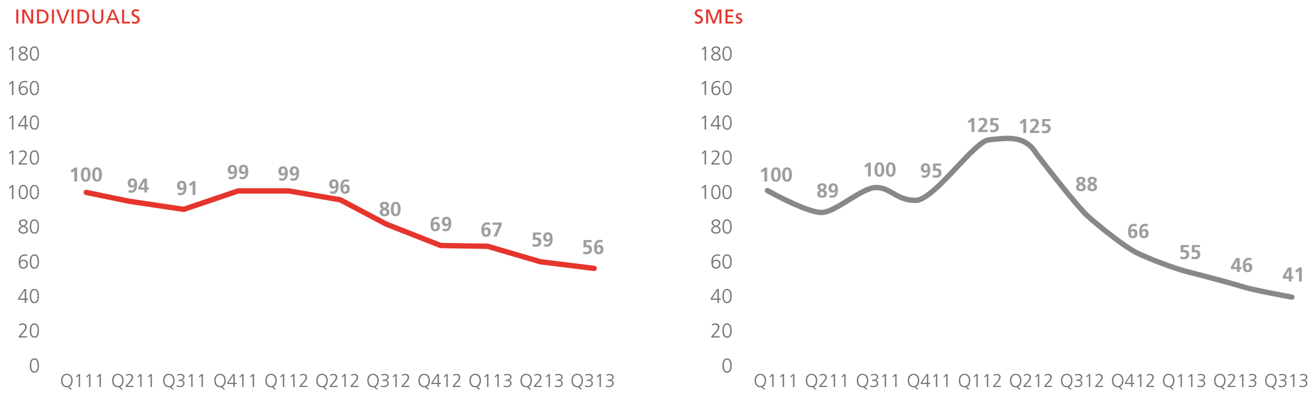
Growth was stronger in the segments with a more conservative risk profile, in line with the Bank's policy of giving greater weight in the portfolio's composition to segments with a better credit profile.

Of note in the segment of individuals were growth in mortgages (22% of the total lending as against 13% three years ago), and the stronger rise to companies and corporations.

The Bank also continued during 2013 the measures started in 2012 regarding the quality of loan admission, which has led to a sustained improvement in the leading indicators on the credit profile of new loans (vintages). The following charts show these indicators for the portfolios of loans to individuals and SMEs, which accounted for 66% of NPLs and 75% of provisions.

## VINTAGES. EVOLUTION OF THE OVER30* RATIO AT THREE MONTHS OF THE ADMISSION OF EACH VINTAGE

Q1/2011=100

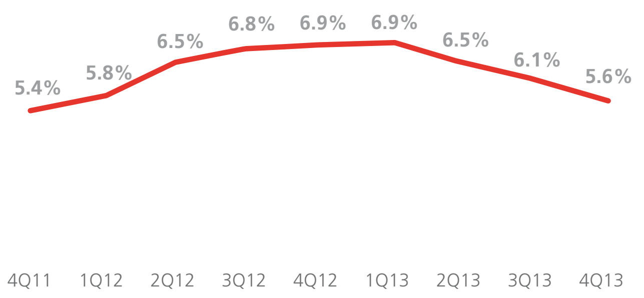



* Over30: more than 30 days in payment arrears.

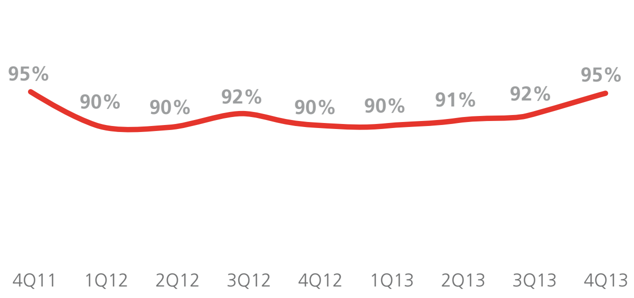
As a result of these policies to improve admission and change the mix, the NPL ratio fell by 122 b.p. in 2013 to 5.64%, versus 6.86% in 2012.

The NPL coverage ratio also improved to 95% at the end of 2013, a rise of 5 p.p. and largely due to the fall in non-performing loans.

NPL RATIO




COVERAGE RATIO




## 6.4. Other credit risk optics

### 6.4.1. Credit risk by activity in the 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 measured with MtM methodology (replacement value of derivatives or available in committed credit lines) plus a potential future exposure (add on). In addition, 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).

After markets close, exposures are re-calculated by adjusting all operations to their new time frame, adjusting the potential future exposure and applying mitigation measures (netting, collateral, etc), so that exposure can be controlled directly against the limits approved by senior management. Risk control is done through an integrated system and in real time, enabling the exposure limit available with any counterparty, product and maturity and in any Group unit to be known at each moment.

**Exposure in derivatives**

The total exposure in terms of positive market value (management criteria) after applying netting and collateral agreements by derivative activities was EUR 10,997 million (EUR 48,451 million in net exposure terms) and was concentrated in high quality counterparties (75.1% of the risk with counterparties has a rating equal to or more than A-).

Around 93% of the exposure with notional derivatives was with financial institutions and central counterparty institutions (CCP in English) with whom we operate almost entirely under netting and collateral agreements. The rest of operations with customers who are not financial institutions are, in general, operations whose purpose is hedging. Occasionally, operations are conducted for purposes other than hedging, always with specialised clients.

DISTRIBUTION OF RISK IN OTC DERIVATIVES BY TYPE OF COUNTERPARTY

In nominal terms*

| RATING | % |
|---|---|
| AAA | 1.36 |
| AA | 0.81 |
| A | 72.88 |
| BBB | 20.90 |
| BB | 4.01 |
| B | 0.02 |
| REST | 0.01 |

*Ratings based on equivalences between internal ratings and ratings of agencies.

## OTC DERIVATIVES: DISTRIBUTION BY NOMINAL RISK AND MARKET VALUE*

Million euros

| | 2013 | | | 2012 | | | 2011 | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Market value | | | Market value | | | Market value | |
| | Nominal | Positive | Negative | Nominal | Positive | Negative | Nominal | Positive | Negative |
| CDS protection acquired** | 45,968 | 86 | 887 | 52,332 | 476 | 680 | 61,981 | 2,082 | 385 |
| CDS protection sold | 38,675 | 763 | 89 | 42,697 | 453 | 333 | 51,129 | 232 | 2,035 |
| **Total credit derivatives** | **84,642** | **849** | **976** | **95,030** | **930** | **1,013** | **113,109** | **2,315** | **2,420** |
| Equity forwards | 2,125 | 76 | 20 | 4,630 | 338 | 132 | 4,601 | 149 | 158 |
| Equity options | 58,964 | 1,686 | 2,420 | 60,689 | 1,376 | 1,438 | 62,525 | 1,476 | 1,796 |
| Equity spot | 10,041 | 1,103 | - | 6,616 | 999 | 0 | 6,583 | 564 | 0 |
| Equity swaps | 685 | - | 265 | 88 | - | 266 | 512 | 0 | 229 |
| **Total equity derivatives** | **71,814** | **2,865** | **2,705** | **72,022** | **2,713** | **1,835** | **74,221** | **2,188** | **2,183** |
| Fixed-income forwards | 3,089 | 1 | 0 | 4,855 | 5 | 4 | 1,979 | 0 | 0 |
| Fixed-income options | - | 0 | - | - | - | 0 | 0 | 0 | 0 |
| Fixed-income spot | 1,906 | - | - | 1,693 | - | 0 | 2,165 | 0 | 0 |
| **Total fixed income derivatives** | **4,995** | **1** | **0** | **6,548** | **5** | **4** | **4,144** | **0** | **0** |
| Forward and spot rates | 101,216 | 2,594 | 1,504 | 105,089 | 1,380 | 1,342 | 125,032 | 2,129 | 1,788 |
| Exchange-rate options | 46,290 | 604 | 345 | 70,298 | 232 | 496 | 82,698 | 511 | 724 |
| Other exchange rate derivatives | 125 | 2 | 1 | 41 | 1 | 0 | 37 | 0 | 2 |
| Exchange-rate swaps | 411,603 | 9,738 | 8,530 | 418,930 | 9,617 | 9,550 | 371,305 | 10,882 | 9,982 |
| **Total exchange rate derivatives** | **559,233** | **12,940** | **10,380** | **594,358** | **11,231** | **11,388** | **579,072** | **13,523** | **12,496** |
| Asset swaps | 22,594 | 901 | 1,634 | 22,322 | 870 | 1,623 | 20,586 | 867 | 1,440 |
| Call money swaps | 235,981 | 698 | 608 | 215,404 | 673 | 1,011 | 237,096 | 584 | 763 |
| Interest-rate structures | 37,398 | 1,997 | 2,553 | 6,640 | 2,180 | 2,339 | 8,087 | 1,981 | 2,260 |
| Forward interest rates- FRAs | 117,011 | 16 | 18 | 304,041 | 41 | 49 | 184,242 | 77 | 114 |
| IRS | 2,711,552 | 58,164 | 54,774 | 2,038,235 | 81,091 | 77,005 | 2,153,153 | 72,024 | 68,345 |
| Other interest-rate derivatives | 230,735 | 3,870 | 3,456 | 251,526 | 4,255 | 3,726 | 259,809 | 3,507 | 12,269 |
| **Total interest-rate derivatives** | **3,355,272** | **65,648** | **63,043** | **2,838,168** | **89,109** | **85,752** | **2,862,973** | **79,040** | **85,190** |
| Commodities | 1,363 | 265 | 78 | 1,871 | 308 | 104 | 3,479 | 410 | 192 |
| **Total commodity derivatives** | **1,363** | **265** | **78** | **1,871** | **308** | **104** | **3,479** | **410** | **192** |
| **Total gross derivatives** | **4,077,320** | **82,568** | **77,183** | **3,607,996** | **104,295** | **100,097** | **3,636,999** | **97,476** | **102,480** |

* Figures on the basis of management criteria. Excluding organised markets.

** Credit derivatives acquired including hedging of loans.

## OTC DERIVATIVES: EXPOSURE IN TERMS OF MARKET VALUE AND EQUIVALENT CREDIT RISK INCLUDING MITIGATION EFFECT[1]

Million euros

| | 2013 | 2012 | 2011 |
|---|---|---|---|
| Market value netting effect[2] | 18,919 | 22,643 | 21,549 |
| Collateral received[3] | 7,922 | 10,555 | 11,508 |
| Netting and collateral market value effect[4] | 10,997 | 12,088 | 10,041 |
| Net ECR[5] | 48,451 | 52,184 | 53,358 |

1. Figures with management criteria. Excluding organised markets.
2. Market value used for including the effects of mitigant agreements in order to calculate the exposure by counterparty risk.
3. Collateral received corresponding to derivatives operations.
4. Taking into account the mitigation of the netting agreements and after discounting the collateral received.
5. ECR (equivalent credit risk: net value of replacement plus the maximum potential value. Including mitigants).

## NOTIONAL OTC DERIVATIVE PRODUCTS BY MATURITY*

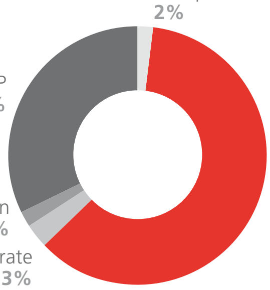
Million euros

| | 1 year** | 1-5 years | 5-10 years | Over 10 years | TOTAL |
|---|---|---|---|---|---|
| CDS protection acquired*** | 45,655 | 109 | 6 | 198 | 45,968 |
| CDS protection sold | 38,645 | 0 | 0 | 0 | 38,645 |
| **Total credit derivatives** | **84,299** | **109** | **6** | **198** | **84,612** |
| Equity forwards | 2,125 | 0 | 0 | 0 | 2,125 |
| Equity options | 52,175 | 22 | 6,646 | 120 | 58,964 |
| Equity spot | 9,878 | 10 | 152 | 0 | 10,041 |
| Equity swaps | 685 | 0 | 0 | 0 | 685 |
| **Total equity derivatives** | **64,863** | **33** | **6,798** | **120** | **71,814** |
| Fixed-income forwards | 2,438 | 0 | 622 | 29 | 3,089 |
| Fixed-income options | 0 | 0 | 0 | 0 | 0 |
| Fixed-income spot | 1,906 | 0 | 0 | 0 | 1,906 |
| **Total fixed income derivatives** | **4,344** | **0** | **622** | **29** | **4,995** |
| Forward and spot rates | 98,633 | 83 | 2,499 | 1 | 101,216 |
| Exchange-rate options | 44,879 | 0 | 1,411 | 0 | 46,290 |
| Other exchange rate derivatives | 108 | 0 | 17 | 0 | 125 |
| Exchange-rate swaps | 377,666 | 8,412 | 21,378 | 4,147 | 411,603 |
| **Total exchange rate derivatives** | **521,285** | **8,495** | **25,305** | **4,149** | **559,233** |
| Asset swaps | 21,202 | 633 | 193 | 566 | 22,594 |
| Call money swaps | 233,495 | 108 | 2,250 | 129 | 235,981 |
| Interest-rate structures | 34,077 | 874 | 566 | 1,882 | 37,398 |
| Forward interest rates - FRAs | 117,011 | 0 | 0 | 0 | 117,011 |
| IRS | 2,542,301 | 33,360 | 88,225 | 47,666 | 2,711,552 |
| Other interest-rate derivatives | 210,872 | 6,340 | 11,371 | 2,152 | 230,735 |
| **Total interest-rate derivatives** | **3,158,958** | **41,314** | **102,605** | **52,395** | **3,355,272** |
| Commodities | 1,259 | 0 | 105 | 0 | 1,363 |
| **Total commodity derivatives** | **1,259** | **0** | **105** | **0** | **1,363** |
| **Total gross derivatives** | **3,835,008** | **49,950** | **135,441** | **56,891** | **4,077,290** |

* Figures on the basis of management criteria. Excluding organised markets.
** In operations under collateral agreement the period of the collateral replacement is considered as maturity.
*** Credit derivatives acquired including hedging of loans.

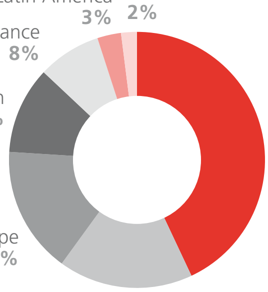
The distribution of risk in notional derivatives by type of counterparty was 61% with banks and 32% with clearing houses.

## DISTRIBUTION OF RISK IN OTC DERIVATIVES BY TYPE OF COUNTERPARTY




As regards the geographic distribution, 43% of notional derivatives is with UK counterparties (whose weight within the total is due to the increasing use of clearing houses), 17% with US counterparties, 11% with Spanish counterparties, 8% with French ones and among the rest of note is 16% with other European countries and 3% with Latin America.

## GEOGRAPHIC DISTRIBUTION OF RISK IN DERIVATIVES




### OTC derivatives, organised markets and clearing houses

The Group's policies seek to anticipate wherever possible the implementation of measures resulting from new regulations regarding operations of OTC derivatives, both if settled by clearing house or if remaining bilateral. Since 2011, there has been a gradual standardisation of OTC operations in order to conduct clearing and settlement via houses of all new trading operations required by the new rules, as well as foster internal use of the electronic execution systems.

As regards the operations of organised markets, until 2013 credit risk was not considered as incurred for this type of operation. This risk is eliminated by the organised markets acting as counterparty in the operations, given that they have mechanisms that enable them to protect their financial position via systems of deposits and improved guarantees and processes that ensure the liquidity and transparency of transactions. As of 2014, with the entry into force of the new CRD IV (Capital Requirements Directive) and the CRR (Capital Requirements Regulations), which transpose the Basel III principles, credit risk is considered for this type of operation.

The following tables show the relative share in total derivatives of new operations settled by clearing house at the end of 2013 and the significant evolution of operations settled by clearing house since 2011.

## RISK DISTRIBUTION WITH OTC DERIVATIVES ON THE BASIS OF THE CHANNEL OF CLEARING AND TYPE OF DERIVATIVE*

Nominal in million euros

| | Bilateral | | CCP** | | |
|---|---|---|---|---|---|
| | Nominal | % | Nominal | % | Total |
| Credit derivatives | 83,664 | 99% | 949 | 1.1% | **84,612** |
| Equity derivatives | 71,703 | 100% | 111 | 0.2% | **71,814** |
| Fixed-income derivatives | 4,994 | 100.0% | 1 | 0.0% | **4,995** |
| Exchange-rate derivatives | 558,617 | 99.9% | 616 | 0.1% | **559,233** |
| Interest-rate derivatives | 2,064,776 | 61.5% | 1,290,496 | 38.5% | **3,355,272** |
| Commodities derivatives | 1,363 | 100.0% | - | 0.0% | **1,363** |
| **Total** | **2,785,117** | **68.3%** | **1,292,173** | **31.7%** | **4,077,290** |

* Figures based on management criteria. Excluding organised markets.
** Central counterparty institutions (CCPs).

## RISK DISTRIBUTION ON THE BASIS OF SETTLEMENT IN CCPS AND BY TYPE OF DERIVATIVE AND EVOLUTION*

Gross exposure. Million euros

| | 2013 | 2012 | 2011 |
|---|---|---|---|
| Credit derivatives | 949 | - | - |
| Equity derivatives | 111 | 138 | 211 |
| Fixed-income derivatives | 1 | 33 | 5 |
| Exchange-rate derivatives | 616 | 988 | 425 |
| Interest-rate derivatives | 1,290,496 | 669,750 | 420,501 |
| Commodities derivatives | - | - | - |
| **Total** | **1,292,173** | **670,908** | **421,143** |

* Data on the basis of management criteria. Excluding organised markets.

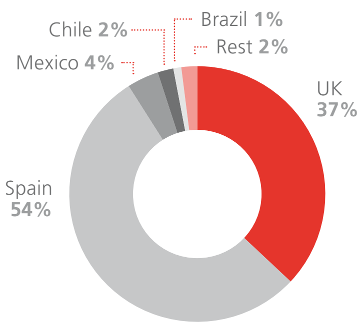
The Group actively manages operations not settled by clearing house and seeks to optimise their volume, given the requirements of spreads and capital that the new regulations impose on them.

In general, the operations with financial institutions are done under netting and collateral agreements, and a continued effort is being made to ensure that the rest of operations are covered under this type of agreement. Generally, the collateral agreements that the Group signs are bilateral ones with some exceptions mainly with multilateral institutions and securitisation funds.

The collateral received under the different types of collateral (CSA, OSLA, ISMA, GMRA, etc.) signed by the Group amounted to EUR 9,451 million (of which EUR 7,922 million corresponded to collateral received by derivatives), mostly effective (96.9%), and the rest of the collateral types are subject to strict policies of quality as regards the type of issuer and their rating, debt seniority and haircuts applied.

The chart below shows the geographic distribution:

## GEOGRAPHIC DISTRIBUTION OF COLLATERAL RECEIVED




### Off-balance sheet credit risk

The off-balance sheet risk corresponding to funding and guarantee commitments with wholesale clients amounted to EUR 68,459 million and with the following distribution by products:

## OFF-BALANCE SHEET EXPOSURE

Million euros

| | Maturity | | | | |
|---|---|---|---|---|---|
| Product | Less than 1 | 1-3 years | 3-5 years | Over 5 years | Total |
| Funding* | 8,539 | 15,089 | 18,265 | 1,985 | **43,878** |
| Technical guarantees | 4,407 | 5,930 | 1,574 | 4,357 | **16,268** |
| Financial and commercial guarantees | 2,419 | 3,193 | 824 | 843 | **7,279** |
| Foreign trade** | 440 | 435 | 60 | 99 | **1,035** |
| **Total** | **15,804** | **24,646** | **20,724** | **7,285** | **68,459** |

* Mainly including credit lines committed bilaterally and syndicated.
** Mainly including stand-by letters of credit.

### Activity in credit derivatives

Grupo Santander uses credit derivatives to cover loans, customer business in financial markets and 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 41,770 million of acquired protection[9] and EUR 38,645 million of sold protection.

At 31 December 2013, for the Group's trading activity, the sensitivity of lending to increases in spreads of one basis point was minus EUR 0.5 million, higher than 2012, and the average VaR was EUR 2.1 million, lower than in 2012 and 2011 (average VaR of EUR 2.9 million and EUR 10.6 million, respectively).

### 6.4.2 Risk of concentration

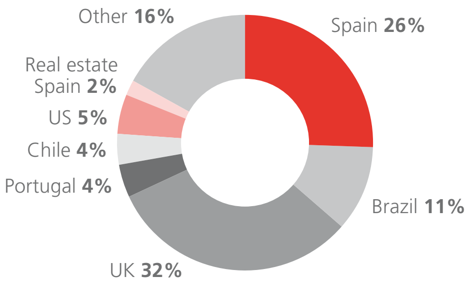
Control of risk concentration is a vital part of management. The Group continuously tracks the degree of concentration of its credit risk portfolios using various criteria: geographic areas and countries, economic sectors, products and groups of clients.

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[10].

In **geographic terms**, credit risk with customers is diversified in the main markets in which the Group operates, as shown in the chart below:

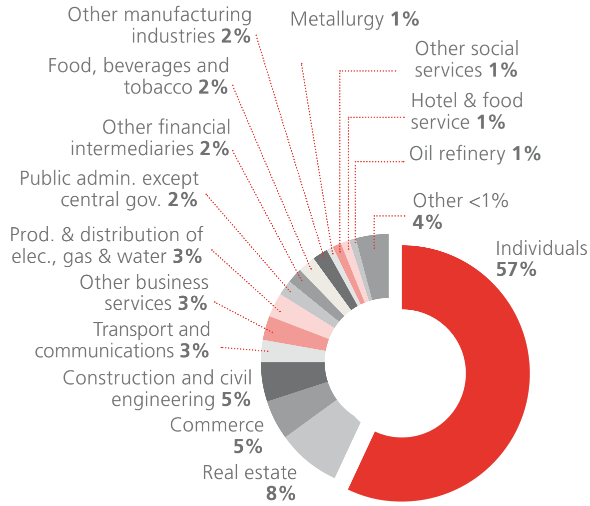
CREDIT RISK WITH CUSTOMERS

% of operating areas. December 2013




Some 57% of the Group's credit risk corresponds to individual customers, who, due to their inherent nature, are highly diversified. In addition, the portfolio is also well distributed **by sectors**, with no significant concentrations in specific sectors. The following chart shows the distribution at the end of the year:

RISK DIVERSIFICATION BY ECONOMIC SECTOR




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 31 December 2013 (the last period reported to the Bank of Spain), there were several declared economic groups that initially exceeded 10% of equity: seven financial institutions, a general government and an EU central counterparty unit. After applying risk mitigation techniques and the rules applicable for large risks, all were below 4% of eligible equity.

At 31 December 2013, the 20 largest economic and financial groups, excluding AAA governments and sovereign securities denominated in local currency, represented 4.7% of the outstanding credit risk of the Group's clients (lending plus guarantees), slightly lower than in 2012.

The Group has an exposure to a central counterparty entity which exceeds 5% of equity. The Top 10 of International Financial Institutions (IFIs) account for EUR 14,769 million.

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.

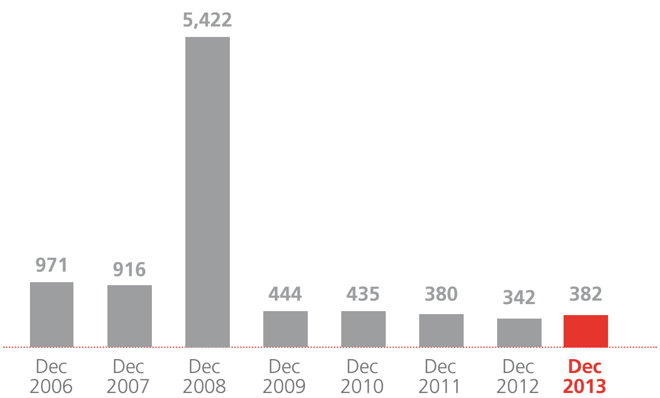
9. This figure excludes around EUR 3,200 million nominal of CDS which cover loans that for accounting purposes are recorded as financial guarantees instead of credit derivatives as their change in value has no impact on resilts or reserves in order to avoid accounting asymmetry.
10. For more detail, see "Supplementary quantitative metrics of risk appetite of concentration" in section 2. "Corporate management principles, control and risk appetite."

### 6.4.3. 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 that could affect international financial activity (wars, natural disasters, balance of payments crisis, etc).

The exposure susceptible to country-risk provisions at the end of 2013 was EUR 382 million. At the end of 2012, the total country risk in need of provisions was EUR 342 million. Total provisions in 2013 stood at EUR 47 million compared with EUR 45 million in 2012. Of note in 2013 was Puerto Rico which changed its classification, in accordance with Bank of Spain criteria, from Group 1 to Group 2[11].

EVOLUTION OF COUNTRY-RISK SUBJECT TO PROVISIONS
Million euros




The exposure subject to provisions is moderate and has been on a downward path in recent years. The only exception was in 2008 when there was a significant increase due to the incorporation of transactions with Brazilian clients resulting from the purchase of ABN/Banco Real. This increase was reduced in 2009, with the reclassification of Brazil to Group 2, in accordance with the criteria of Bank of Spain circulars.

The total exposure to country risk, regardless of whether it requires provisions or not, is also moderate. Except for Group 1 countries (considered by the Bank of Spain as those of less risk[12]), the individual exposure by country does not exceed in any cases 1% of Grupo Santander's total assets.

The principles of country risk management continued to follow criteria of maximum prudence; country risk is assumed very selectively in operations that are clearly profitable for the Bank, and which enhance the global relation with customers.

### 6.4.4. Sovereign risk and vis-á-vis the rest of public administrations

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 similar entity (portfolio of public debt) and that arising from operations with public institutions with the following features: their funds only come from the state's budgeted income and the activities are of a non-commercial nature.

This criterion, historically used by Grupo Santander, has some differences with that of the European Banking Authority (EBA) used for its regular stress exercises. The main ones are that the EBA's criterion does not include risk with central banks, the exposures with insurance companies, indirect exposures via guarantees and other instruments. On the other hand, it includes public administrations in general and not only the central government.

Exposure to sovereign risk (according to the criterion applied in the Group) mainly emanates from the obligations to which our subsidiary banks are subject regarding the establishment of certain deposits in central banks as well as fixed-income portfolios maintained as part of the risk management strategy for structural interest. Most of these exposures are in local currencies and are financed with deposits captured locally, also in local currencies. The exposures in the local sovereign but in currencies different to the official one of the country of issuance is not very significant (EUR 5,743 million, 3.5% of the total sovereign risk), and less so the exposure in non-local sovereign issuers, which means cross-border risk[13] (EUR 1,497 million, 0.9% of the total sovereign risk).

In general, the total exposure to sovereign risk has remained relatively stable in the last few years, which seems reasonable if we bear in mind the strategic reasons behind it, as commented on.

The investment strategy for sovereign risk also takes into account the credit quality of each country when setting the maximum exposure limits. The following table shows the percentage of exposure by rating levels[14].

EXPOSURE BY LEVEL OF RATING
%

| | 31 Dec 2013 | 31 Dec 2012 | 31 Dec 2011 | 31 Dec 2010 |
|---|---|---|---|---|
| **AAA** | 36% | 34% | 29% | 61% |
| **AA** | 6% | 3% | 26% | 0% |
| **A** | 27% | 29% | 6% | 3% |
| **BBB** | 26% | 31% | 38% | 34% |
| **Menos de BBB** | 5% | 4% | 1% | 2% |

11. The typology of countries for each risk group is defined in Bank of Spain Circular 4/2004 (page 221).
12. This group includes operations with final debtor resident in the European Union, Norway, Switzerland, Iceland, the US, Canada, Japan, Australia and New Zealand.
13. Countries classified as low risk by the Bank of Spain (Group 1, according to its terminology) are not considered.
14. Internal ratings used.

The distribution of sovereign exposure by level of rating was affected by many rating revisions of sovereign issuers in the last few years, mainly Spain, Portugal, the US and Chile.

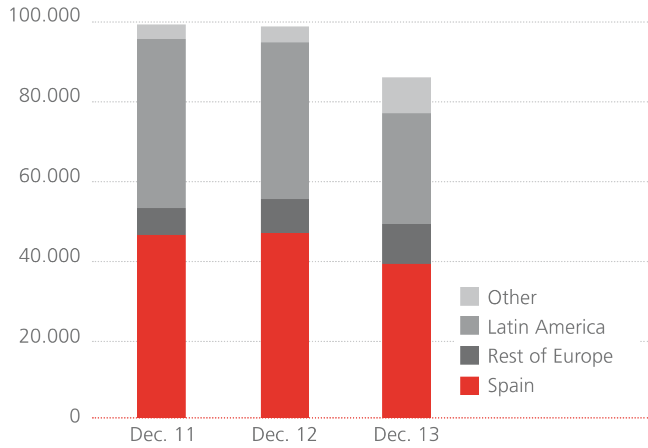
On the basis of the EBA criteria already mentioned, the exposure to public administrations at the end of the last three years is shown in the tables below[15].

In 2013, exposure was reduced by 13%, mainly due to Spain. Sovereign risk exposure in Spain (country where the Group has its headquarters) is not high, compared with our peers, in terms of total assets or equity (3.4% at December 2013).

This exposure increased in the first half of 2013, within structural interest rate risk management of the balance sheet, mainly to accommodate the rise in interest rate risk (sensitivity of the financial margin) derived from the growth in commercial deposits. In the second half, on the other hand, the sovereign risk to Spain was reduced as a result of the cancellation of the loan of the fund to pay suppliers and, in the context of interest rate risk management of the balance sheet, anticipating a fall in the average cost of deposits.

The sovereign exposure in Latin America is almost all in local currency, recorded in local books, and with a concentration in short maturities of less interest rate risk and greater liquidity.

SOVEREIGN RISK AND COMPARED TO OTHER PUBLIC ADMINISTRATIONS: DIRECT NET EXPOSURE (EBA CRITERIA)
Million euros




### 6.4.5. 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 assess

EXPOSURE TO SOVEREIGN RISK (EBA CRITERIA)
Million euros

| 31 DEC 2013 | Portfolio | | | |
|---|---|---|---|---|
| | Trading & FV th. P&L | Portfolio Available for sale | Loans & receivables | Net total direct exposure |
| Spain | 4,359 | 21,144 | 12,864 | **38,367** |
| Portugal | 149 | 2,076 | 583 | **2,807** |
| Italy | 1,310 | 77 | 0 | **1,386** |
| Greece | 0 | 0 | 0 | **0** |
| Ireland | 0 | 0 | 0 | **0** |
| Rest of euro zone | (1,229) | 67 | 0 | **(1,161)** |
| UK | (1,375) | 3,777 | 0 | **2,402** |
| Poland | 216 | 4,770 | 43 | **5,030** |
| Rest of Europe | 5 | 117 | 0 | **122** |
| US | 519 | 2,089 | 63 | **2,671** |
| Brazil | 8,618 | 8,901 | 223 | **17,743** |
| Mexico | 3,188 | 2,362 | 2,145 | **7,695** |
| Chile | (485) | 1,037 | 534 | **1,086** |
| Rest of Latam | 268 | 619 | 663 | **1,550** |
| Rest of world | 5,219 | 596 | 148 | **5,964** |
| **Total** | **20,762** | **47,632** | **17,268** | **85,661** |

| 31 DEC 2012 | Portfolio | | | |
|---|---|---|---|---|
| | Trading & FV th. P&L | Portfolio Available for sale | Loans & receivables | Net total direct exposure |
| Spain | 4,403 | 24,654 | 16,528 | **45,586** |
| Portugal | 0 | 1,684 | 616 | **2,299** |
| Italy | (71) | 76 | 0 | **4** |
| Greece | 0 | 0 | 0 | **0** |
| Ireland | 0 | 0 | 0 | **0** |
| Rest of euro zone | 943 | 789 | 0 | **1,731** |
| UK | (2,628) | 4,419 | 0 | **1,792** |
| Poland | 669 | 2,898 | 26 | **3,592** |
| Rest of Europe | 10 | 0 | 0 | **10** |
| US | (101) | 1,783 | 30 | **1,712** |
| Brazil | 14,067 | 11,745 | 351 | **26,163** |
| Mexico | 4,510 | 2,444 | 2,381 | **9,335** |
| Chile | (293) | 1,667 | 521 | **1,895** |
| Rest of Latam | 214 | 916 | 771 | **1,900** |
| Rest of world | 1,757 | 645 | 234 | **2,636** |
| **Total** | **23,480** | **53,718** | **21,457** | **98,655** |

15. In addition, at December 31, 2013, the Group had direct net exposure in derivatives whose reasonable value amounted to EUR 206 million, as well as an indirect net exposure in derivatives with a reasonable value of EUR 6 million. Aditionally, Santander has not any exposure in hold to maturity porfolios.

the operation, taking into account the social and environmental risks, and to finance only those projects that can accredit adequate management of the social and environmental impacts. The methodology used is set out below:

- 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, from 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 and non-high income OECD), a more detailed questionnaire has to be filled out, adapted according to the sector of activity.

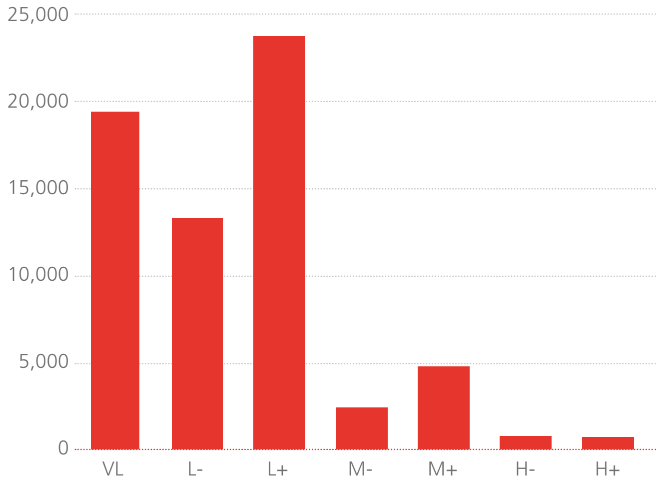
- According to the category and location of the projects a social and environmental audit is carried out by independent external auditors. Specific questionnaires have been developed for those sectors where the Bank is most active. The Bank also gives training courses in social and environmental matters to risk teams as well as to those responsible for business.

In 2013, 28 projects were analysed under the Equator principles for a total amount of EUR 8,128 million.

In April 2013, and in force as of 2014, it was agreed to increase the reach of the Equator principles to corporate financings with known destiny (bridge loans with forbearance, envisaged via project finance and corporate financings for construction or increasing a specific project), provided that the total amount of the operation is equal to or more than $100 million and the individual tranche of each bank is equal to or more than $50 million.

- 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 2013, 44,048 clients were assessed by this tool in Spain (total risk of EUR 64,375 million).

**ENVIRONMENTAL RISK CLASSIFICATION**
Million euros




VL: very low; L: low; M: medium and H: high.
VIDA assessment in the retail banking network in Spain.

Low or very low environmental risk accounts for 87% of total risk, in line with the levels in 2012.

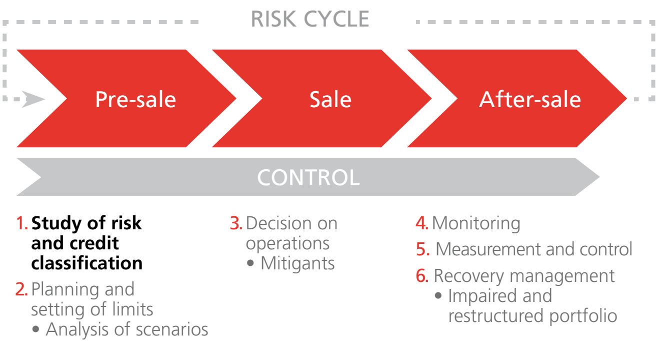
| 31 DEC 2011 | Portfolio | | | |
|---|---|---|---|---|
| | Trading & FV th. P&L | Portfolio Available for sale | Loans & receivables | Net total direct exposure |
| Spain | 4,815 | 27,459 | 13,421 | **45,695** |
| Portugal | 1 | 1,782 | 862 | **2,645** |
| Italy | (7) | 69 | 0 | **63** |
| Greece | 0 | 84 | 0 | **84** |
| Ireland | 0 | 0 | 0 | **0** |
| Rest of euro zone | 105 | 39 | 0 | **144** |
| UK | 715 | 0 | 0 | **715** |
| Poland | 1,135 | 2,488 | 58 | **3,682** |
| Rest of Europe | 0 | 0 | 0 | **0** |
| US | 8 | 1,853 | 1 | **1,862** |
| Brazil | 13,557 | 12,674 | 380 | **26,611** |
| Mexico | 6,515 | 2,989 | 1,981 | **11,485** |
| Chile | (228) | 1,943 | 380 | **2,095** |
| Rest of Latam | 156 | 1,341 | 490 | **1,986** |
| Rest of world | 2,073 | 516 | 242 | **2,831** |
| **Total** | **28,845** | **53,238** | **17,815** | **99,898** |

## 6.5 Credit risk cycle

The process of credit risk management consists of identifying, analysing, controlling and deciding on the risks incurred by the Group's operations. The business areas, senior management and the risk areas are all involved.

The board and the executive committee participate in the process, as well as the risk committee, which sets the risk policies and procedures, the limits and delegation of powers, and approves and supervises the framework of the risk function.

The risk cycle has three phases: pre-sale, sale and after-sale. The process is constantly revised, incorporating the results and conclusions of the after-sale phase to the study of risk and pre-sale planning.




### 6.5.1. Study of risk and credit rating process

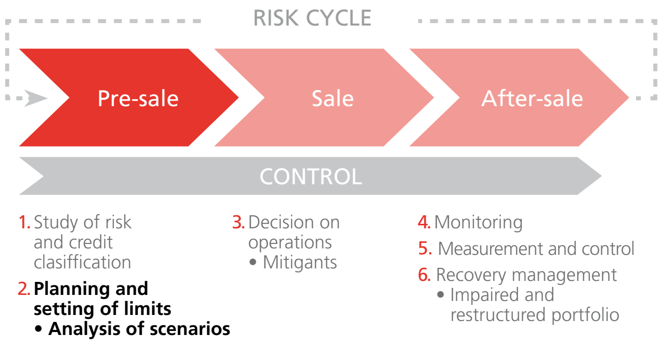
Risk study consists of analysing a customer's capacity to meet his contractual commitments with the Bank. This entails analysing the customer's credit quality, risk operations, solvency and profitability to be obtained on the basis of the risk assumed.

With this objective, the Group has used since 1993 models for assigning solvency ratings. These mechanisms are used in all individualised management segments, both wholesale (sovereign, financial institutions and corporate banking), as well as the rest of companies and institutions in this category.

The rating is the result of a quantitative model based on balance sheet ratios or macroeconomic variables, which is supplemented by the expert advice of the analyst.

The ratings given to customers are regularly reviewed, incorporating the latest available financial information and experience in the development of banking relations. The regularity of the reviews increases in the case of customers who reach certain levels in the automatic warning systems and in those classified as special watch. The rating tools are also revised in order to adjust the accuracy of the rating granted.

While ratings are used for companies under individualised management, scoring techniques are used for the standardised segment, which automatically assign a score to operations, as set out in the section "decisions on operations."




### 6.5.2. Planning and setting limits

The purpose of this phase is to limit efficiently and comprehensively the risk levels assumed by the Group.

The credit risk planning process serves to set the budgets and limits at portfolio or customer level on the basis of the segment.

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.

The most basic level in the individualised management sphere is the customer and when certain features are present, 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. The result of pre-classification is the maximum risk level that a client or group can assume in terms of amount of maturity. A more streamlined version is used for those companies which meet certain requirements (high knowledge, rating, etc.).

**Analysis of scenarios**

An important part of planning is to consider the volatility of macroeconomic variables that affect the evolution of portfolios.

16. More detail on the risk appetite in chapter 2 of this report.

The Group conducts simulations of its portfolio using various adverse scenarios and stress tests 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:

- Defines reference scenarios (at the global level as well as for each of the Group's units).

- Determines the sensitivity of risk factors (PD, LGD) to certain significant macroeconomic variables for each portfolio, and their levels in proposed 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 used by the Group use the data of a complete economic cycle to measure the performance of risk factors in the face of changes in macroeconomic variables. These models are subject to backtesting and regular fine-tuning in order to guarantee they correctly reflect the relation between the macroeconomic variables and the risk parameters.

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.

**Definition of suppositions and scenarios (baseline/acid)**
The projections of the risk and loss parameters, usually with a time frame of three years, are executed under different economic scenarios which include the main macroeconomic variables (GDP, jobless rate, house prices, inflation, etc).

The scenarios defined are supported in different levels of stress, from the central (baseline) one or the most likely to the most acid scenarios which, although unlikely, are possible.

These scenarios are set by the Group's research department in coordination with the research service of each unit and use as their reference the figures published by the main international institutions.

A global acid (stress) scenario is always defined which describes a global crisis situation and the way in which it would affect each of the countries where Grupo Santander operates. A local stress scenario is also defined which would only affect some of the Group's main units and with a greater degree of stress than the global stress one.

In the capital coordination committee, senior management studies the situation, proposes the changes and formally approves the set of definitive scenarios to be used in the Group's stress test.

**Uses of analysis of scenarios**
The techniques of analysis of scenarios are used throughout the whole credit risk cycle. The various uses can be grouped as follows:

- **Regulatory uses:** those where an external agent or regulator requests the result of the year after executing the Group's corporate methodology. Sometimes the scenarios or hypotheses of execution are imposed by whoever requests the information. In other cases, the exercise is conducted by the person requesting on the basis of the information provided by the Group.

  This group of uses includes, for example, the stress tests requested by the European Banking Authority (EBA), the ICAAP, and all the exercises requested by the various regulators of the countries in which the Group operates. Of particular importance in 2014 will be the stress test carried out within the comprehensive assessment that the European Central Bank, the EBA and local regulatory authorities are coordinating.

- **Planning and management uses:** this category covers the exercises to facilitate decisions made on the Group's portfolios, through knowing their sensitivity to the evolution of the macroeconomic variables that affect them. The following aspects, among others, are analysed and presented to senior management:

  - Impact on the income statement and on capital.

  - Evolution envisaged for the next three years of the cost of credit with the strategy of business planned.

  - Sufficiency of funds and provisions.

  - Measures the level of sensitivity of each portfolio to the economic environment.

  - Diversification of the portfolio in acid scenarios.

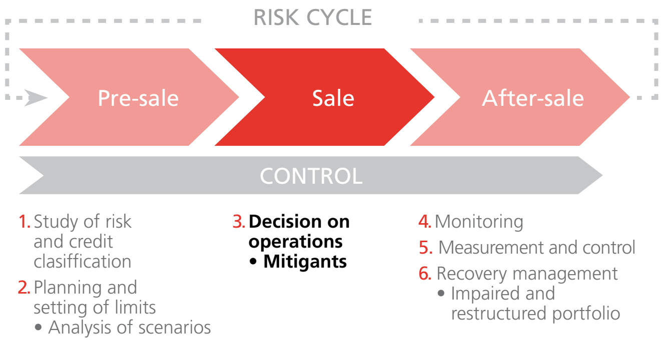
  - Contrast with other estimates made locally.

  Of note in this type of application is its use in annual budgetary exercises and their constant monitoring. Its use is also very important for establishing and monitoring the Group's risk appetite.

**Results obtained**
The various stress test exercises, from both an internal and external standpoint, have underlined the strength and validity of Grupo Santander's business model, due to its resistance to acid scenarios for both the whole Group as well as for each of the main units.

Each updating of the risk appetite[16], which is presented to the board, validates that Grupo Santander maintains positive results and its solvency even in the most adverse stress scenarios.

One of the most important conclusions observed via the analysis of scenarios is the benefit that the Group's diversification provides in terms of countries, sectors and non-concentration in large clients, which enables it to face with solvency adverse macroeconomic scenarios.




## 6.5.3. Decisions on operations

The sales phase consists of the decision-taking process which analyses and resolves operations. Approval by the risks area is a prior requirement before contracting any risk operation. This process must take into account the policies defined for approving operations and take into consideration both the risk appetite as well as those elements of the operation that are relevant in the search for the right balance between risk and profitability.

In the sphere of clients under **standardised management,** the administration of large volumes of credit operations with the use of automatic decision models is facilitated, which classifies the client/operation binomial. Investment is classified into homogeneous risk groups, on the basis of the information on the features of the operation and of its owner. These models are used in banking with individuals, businesses and standardised SMEs.

As already indicated, the prior phase of setting limits can follow two different paths, giving rise to different types of decision in the sphere of clients under **individualised management:**

- Automatic and verifying if there is capacity for the proposed operation (in amount, product, maturity and other conditions) within the limits authorised under the framework of pre-classification. This process is generally applied to corporate pre-classifications.

- Always requiring the authorisation of the analyst although the operation meets the amount, maturity and other conditions set in the pre-classified limit. This process applies to the pre-classification of companies under individualised management of retail banking.

**Credit risk mitigation techniques**

Grupo Santander applies various forms of credit risk reduction on the basis, among other factors, of the type of client and product. As we will later see, some are inherent in specific operations (for example, real estate guarantees) while others apply to a series of operations (for example, netting and collateral).

The various mitigation techniques can be grouped into the following categories:

**Determination of a net balance by counterparty**

The concept of netting is the possibility of determining a net balance among operations of the same type, under the umbrella of a framework agreement such as ISDA or similar.

It consists of aggregating the positive and negative market values of derivative transactions that we have with a certain counterparty, so that in the event of its default it owes us (or we owe it, if the net is negative) a single net figure and not a series of positive or negative values corresponding to each operation we have closed with the counterparty.

An important aspect of the contracts framework is that they represent a single legal obligation that covers all operations. This is fundamental when it comes to being able to net the risks of all operations covered by said contract with a same counterparty.

**Real guarantees**

These are those goods that are subject to compliance with the guaranteed obligation and which can be provided not only by the client but also by a third party. The real goods or rights that are the object of the guarantee can be:

- Financial: Cash, deposit of securities, gold, etc.

- Non-financial: real estate (both properties as well as commercial premises, etc..), other property goods.

From the standpoint of risk admission, the highest level of real guarantees is required. From the position of the regulatory capital calculation, not all can be considered as reduction factors, only those which meet the minimum qualitative requirements set out in the Basel agreements.

A very important example of a real financial guarantee is **collateral** agreements. The collateral is a series of instruments with a certain economic value and high liquidity that are deposited/transferred by a counterparty in favour of another in order to guarantee/reduce the credit risk of the counterparty that could result from portfolios of transactions of derivatives with risk existing between them.

The nature of these agreements is diverse, but whatever the specific form of collateralisation, the final purpose, as in the netting technique, is to reduce the counterparty risk.

The operations subject to the collateral agreement are regularly valued (normally day to day) and, on the net balance resulting from this valuation, the parameters defined in the contract are applied so that a collateral amount is obtained (normally cash or securities), which is to be paid to or received from the counterparty.

As regards **real estate guarantees,** there are regular re-appraisal processes, based on the real market values which for the different types of property are provided by valuation agencies, which meet all the requirements set by the regulator.

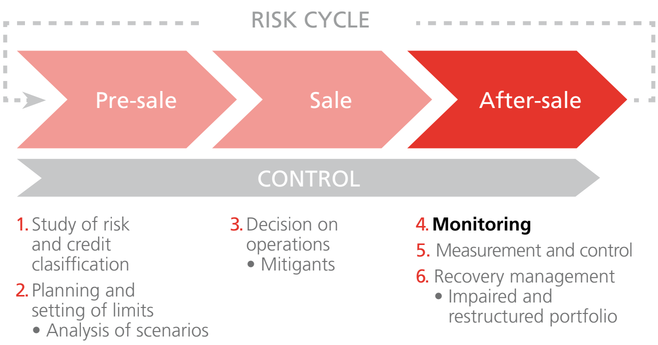
Implementation of the mitigation techniques follows the minimum requirements established in the manual of credit risk management policies, and which consists of ensuring:

- Legal certainty. The possibility of legally requiring the settlement of guarantees must be examined and ensured at all times.
- The non-existence of substantial positive correlation between the counterparty and the value of the collateral.
- The correct documentation of all guarantees.
- The availability of documentation of the methodologies used for each mitigation technique.
- Adequate monitoring and regular control.

**Personal guarantees and credit derivatives**
This type of guarantees corresponds to those that place a third party in a position of having to respond to obligations acquired by another to the Group. It includes, for example, sureties, guarantees, stand-by letters of credit, etc. The only ones that can be recognised, for the purposes of calculating capital, are those provided by third parties that meet the minimum requirements set by the supervisor.

Credit derivatives are financial instruments whose main objective is to cover the credit risk by acquiring protection from a third party, through which the bank transfers the issuer risk of the underlying asset. Credit derivatives are over the counter (OTC) instruments that are traded in non-organised markets. The coverage with credit derivatives, mainly through credit default swaps, is contracted with front line banks.

The information on mitigation techniques is in "Credit risk reduction techniques of the Prudential Relevance Report (Pillar III)". There is also more information on credit derivatives in the section "Activity in credit derivatives" in item "6.4.1. Credit risk by activities in financial markets" of this report.




## 6.5.4. Monitoring

Monitoring is a continuous process of constant observation, which allows changes that could affect the credit quality of clients to be detected early on, in order to take measures to correct the deviations that impact negatively.

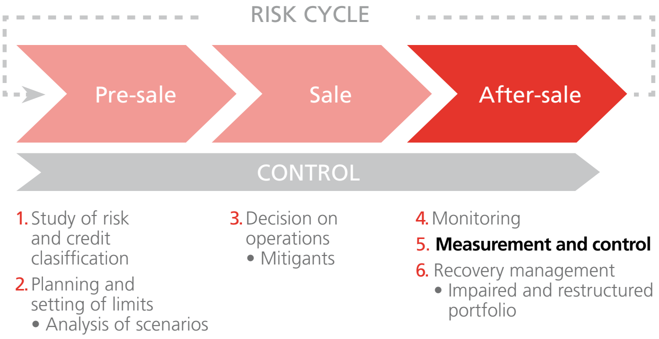
Monitoring is based on segmentation of customers, and is carried out by local and global risk dedicated teams, supplemented by internal auditing.

The function consists, among other things, of identifying and tracking clients under special watch, reviewing ratings and continuous monitoring of indicators of standardised clients.

The system called **companies in special watch** (FEVE) 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 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.




### 6.5.5. Measurement and control

As well as monitoring of clients' credit quality, Grupo Santander establishes the control procedures needed to analyse the current credit risk profile and its evolution, through different credit risk phases.

The function is developed by assessing the risks from various perspectives that complement one another, establishing as the main elements control by countries, business areas, management models, products, etc., facilitating early detection of points of specific attention, as well as drawing up action plans to correct any deteriorations.

Each element of control admits two types of analysis:

**1. Quantitative and qualitative analysis of the portfolio.**
Analysis of the portfolio controls, permanently and systematically, the evolution of risk with respect to budgets, limits and standards of reference, assessing the impacts of future situations, exogenous as well as resulting from strategic decisions, in order to establish measures that situate the profile and volume of the risks portfolio within the parameters set by the Group.

The credit risk control phase uses, among others and in addition to traditional metrics, the following metrics:

- **Management of non-performing loans variation plus net write-offs (VMG)**

The VMG measures how NPLs change during a period, discounting write-offs and taking loan loss recoveries into account.

It is an aggregate measure at portfolio level that allows a response to deteriorations observed in the evolution of NPLs.

It is the result of the final balance less the initial balance of non-performing loans of the period under consideration, plus the write-offs of this period less loan loss recoveries of this same period.

The VMG and its components play a key role as variables of monitoring.

- **Expected loss (EL) and regulatory capital**

The expected loss is the estimate of the economic loss that would occur during the next year of the portfolio existing at a given moment.

It is one more cost of activity, which must have a repercussion on the price of operations. Its calculation is mainly based on three parameters:

- Exposure at default (EaD): maximum amount that could be lost as a result of a default.

- Probability of default (PD): the probability of a client's default during the year.

- Loss Given Default (LGD): this reflects the percentage of exposure that could not be recovered in the event of a default. It is calculated by discounting at the time of the default the amounts recovered during the whole recovery process and this figure is compared in percentage terms with the amount owed by the client at that moment.

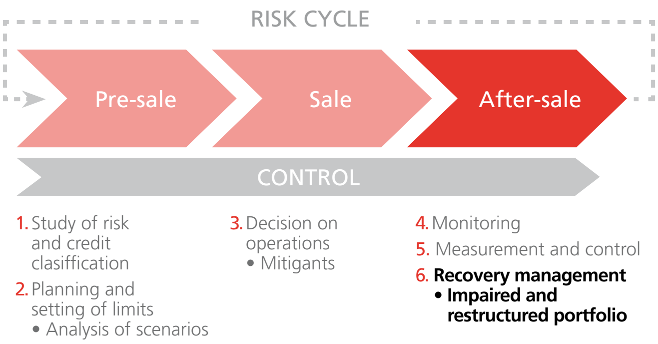
Other relevant aspects regarding the risk of operations are covered, such as quantification of off-balance sheet exposures or the expected percentage of recoveries, related to the guarantees associated with the operation, as well as other issues such as the type of product, maturity, etc.

The risk parameters also enable economic and regulatory capital to be calculated. The integration in management of the metrics of capital is vital for rationalising its use. More detail is available in chapter 11 (Capital) of this report.

**2. Evaluation of the control processes**
Evaluation of the control processes includes systematic and regular revision of the procedures and methodology, developed throughout the credit risk cycle, in order to guarantees their effectiveness and validity.

In 2006, within the corporate framework established in the Group for compliance with the Sarbanes Oxley law, a corporate tool was established in the Group's intranet to document and certificate all the sub processes, operational risks and controls that mitigate them. The risks division assesses every year the efficiency of internal control of its activities.

The directorate general of integral control and internal validation of risks, within its mission of supervising the quality of the Group's risk management guarantees that the management and control systems of the different risks inherent in its activity fulfil the most demanding requirements and the best practices observed in industry and/or required by regulators. In addition, internal auditing is responsible for ensuring that the policies, methods and procedures are adequate, effectively implemented and regularly reviewed.




### 6.5.6. Recovery management

Recovery activity is a significant element in the Bank's risk management.

In order to conduct recovery management adequately, it is done in four phases: irregularity or early non-payment, recovery of non-performing loans, recovery of write-offs and management of foreclosed assets. Indeed, the recovery function begins before the first non-payment when the client shows signs of deterioration and ends when the debt has been paid or regularised. The function aims to anticipate non-compliance and is focused on preventative management.

The current macroeconomic environment directly impacts the non-payment index and customers' bad loans. The quality of portfolios is thus fundamental for the development and growth of our businesses in different countries where great importance is attached to debt recovery in order to ensure that this quality always remains within the expected levels.

The Group has a corporate management model that sets the guidelines and general pattern of actions applied to the various countries, always taking into account the local features that recovery activity requires, be it the economic environment, the business model or a mixture of both. This model is constantly reviewed and the processes and management methodology that sustains it improved. Recovery management for Santander directly involves all the management areas (commercial staff, technology, operations, human resources and risks), helping to incorporate solutions that improve the model's effectiveness and efficiency.

The diverse features of our customers make segmentation necessary in order to manage recoveries adequately. Massive management for large collectives of clients with similar profiles and products is done through processes with a high technological component, while personalised management focuses on customers that because of their profile require individualised management and analysis.

Recovery activity has been aligned with the socio-economic reality of various countries and different risk management mechanisms, with adequate criteria of prudence, have been used on the basis of their age, guarantees and conditions, always ensuring, as a minimum, the required classification and provisions.

Particular emphasis in the recovery function is placed on management of the aforementioned mechanisms for early management, in line with corporate policies, taking account of the various local realities and closely tracking vintages, stocks and performance. These policies are renewed and regularly adopted in order to reflect both the better management practices as well as the regulatory changes that are applied.

As well as measures focused on adapting operations to the client's payment capacity, recovery management is also noteworthy in seeking solutions other than judicial ones for the advance payment of debts.

One of the ways to recover debt from clients who have suffered a severe deterioration in their repayment capacity is repossession (judicial or in lieu of payment) of the real estate assets that serve as guarantees of the loans. In countries with a high exposure to real estate risk, such as Spain, there are very efficient instruments of sales management which enable the capital to be returned to the bank and reduce the stock in the balance sheet at a much faster speed than the rest of banks.

# 7. MARKET RISK

## 7.0 Organisation of this chapter

We will first describe the activities subject to market risk, setting out the different risk types and factors (pages 212-213).

Then we will look at the evolution of market risks and results in 2013, distinguishing trading activity from structural risks (pages 214-227).

The methodologies and various metrics used in Santander are analysed, again making a distinction between trading activity and structural risks (pages 227-230).

The market risk management framework is described, setting out the organisational and governance structure and the system of controlling limits (pages 230-233).

Lastly, the current perimeter of trading activity is examined whose regulatory capital is calculated by advanced internal models (page 233).

## 7.1 Activities subject to market risk and types of market risk

The market risk area has a **perimeter** for measuring, controlling that covers those operations where equity risk is assumed as a result of changes in market factors. This risk comes from the change in **risk factors** - interest rates, inflation rates, exchange rates, share prices, the spread on loans, raw material prices and the volatility of each of these elements - as well as the liquidity risk of the various products and markets in which the Group operates.

- **Interest rate risk** is the possibility that changes in interest rates could adversely affect the value of a financial instrument, a portfolio or the Group as a whole. It affects, among others, loans, deposits, debt securities, most assets and liabilities of trading portfolios as well as derivatives.

- The **inflation rate risk** is the possibility that changes in inflation rates could adversely affect the value of a financial instrument, a portfolio or the Group as a whole. It affects, among others, loans, debt securities and derivatives, whose yield is linked to inflation or to a real rate of variation.

- The **exchange rate risk** is the sensitivity of the value of a position in a currency different to the base currency to a potential change in exchange rates. A long position or one bought in a foreign currency would produce a loss in the event that the currency depreciated against the base currency. Among the positions affected by this risk are non-euro investments in subsidiaries, as well as loans, securities and derivatives denominated in foreign currencies.

- The **equity risk** is the sensitivity of the value of positions opened in equities to adverse movements in the market prices or in expectations of future dividends. Among other instruments, this affects positions in shares, stock market indices, convertible bonds and derivatives using shares as the underlying asset (put, call, and equity swaps).

- The **credit spread risk** is the risk or sensitivity of the value of positions opened in fixed income securities or in credit derivatives to movements in credit spread curves or in recovery rates associated with issuers and specific types of debt. The spread is a differential between financial instruments that trade with a spread over other reference instruments, mainly the yield on government securities and interbank rates.

- The **commodities price risk** is the risk derived from the effect of potential change in prices. The Group's exposure to this risk is not significant and is concentrated in derivative operations on commodities with clients.

- **Volatility risk** is the risk or sensitivity of the value of a portfolio to changes in the volatility of risk factors: volatility of interest rates, exchange rates, shares, credit spreads and commodities. This risk is incurred by financial instruments which have volatility as a variable in their valuation model. The most significant case is portfolios of financial options.

All these market risks can be partly or fully mitigated by using options, futures, forwards and swaps.

There are **other types of market risk,** whose coverage is more complex. They are the following:

- **Correlation risk** is the sensitivity of the value of a portfolio to changes in the relation between risk factors, be they of the same type (for example, between two exchange rates) or of a different nature (for example, between an interest rate and the price of a commodity).

- **Market liquidity risk** is that of a Group entity or the Group as whole finding itself unable to get out of or close a position in time without impacting on the market price or on the cost of the transaction. This risk can be caused by a fall in the number of market makers or institutional investors, the execution of large volumes of operations, market instability and increases with the concentration existing in certain products and currencies.

- **Risk of prepayment or cancellation.** When in certain operations the contract allows, explicitly or implicitly, cancellation before the maturity without negotiation there is a risk that the cash flows have to be reinvested at a potentially lower interest rate. This mainly affects loans or mortgage securities.

- **Underwriting risk.** This occurs as a result of an entity's participation in underwriting a placement of securities or another type of debt, assuming the risk of partially owning the issue or the loan due to non-placement of all of it among potential buyers.

On the basis of the finality of the risk, activities are segmented in the following way:

a) **Trading.** This includes financial services to customers and purchase-sale and positioning mainly in fixed-income, equity and currency products.

b) **Structural risks.** Constituted by market risks inherent in the balance sheet excluding the trading portfolio. They are:

  - **Structural interest-rate risk.** This arises from mismatches in the maturities and repricing of all assets and liabilities.

  - **Structural exchange rate risk/hedging of results**. Exchange rate risk occurs when the currency in which the investment is made is different from the euro in companies that consolidate and those that do not (structural exchange rate). In addition, exchange rate hedging of future results generated in currencies other than the euro (hedging of results) are included.

  - **Structural equity risk.** This involves investments via stakes in financial or non-financial companies that are not consolidated, as well as portfolios available for sale formed by equity positions

The Global Banking and Markets division is mainly responsible for managing the taking of trading activity positions, in order to develop the activity of clients in financial markets and, to a much lesser extent, take its own positions.

The financial management area is responsible for implementing the management strategy for structural risks, applying standardised methodologies adapted to each market where the Group operates, either directly in the case of the parent bank or in coordination with the rest of units. The management decisions for these risks are taken by each country's ALCO committee in coordination with the Group's markets' committee. The aim is to inject stability and recurrence into the net interest margin of commercial activity and the Group's economic value, while maintaining adequate levels of liquidity and solvency.

Each of these activities is measured and analysed with different metrics in order to show their risk profile in the most precise way.

## 7.2. Market risks in 2013

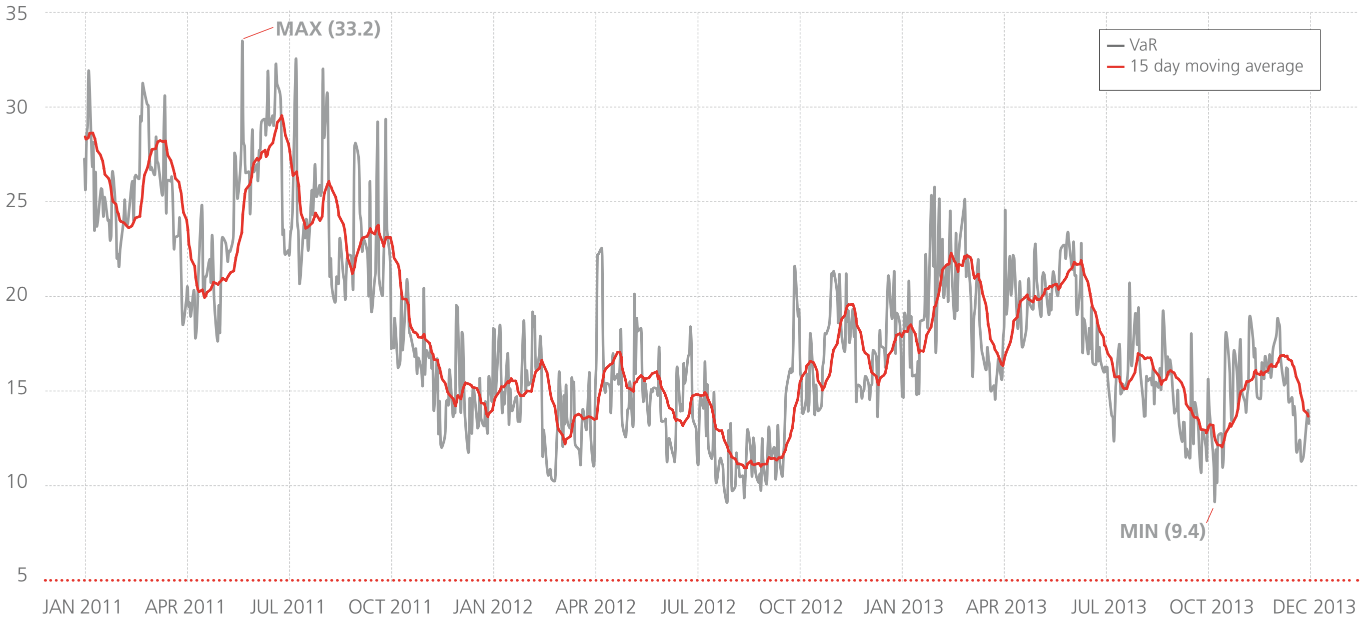
### 7.2.1. Trading activity

#### 7.2.1.1. VaR analysis[17]

Grupo Santander maintained its strategy of concentrating its trading activity in customer business, minimising where possible exposures of directional risk opened in net terms. This was reflected in the VaR[18] evolution, which was around the average of the last three years.

**EVOLUTION OF VAR 2011- 2013**

Million euros. VaR at 99%, with a time frame of one day



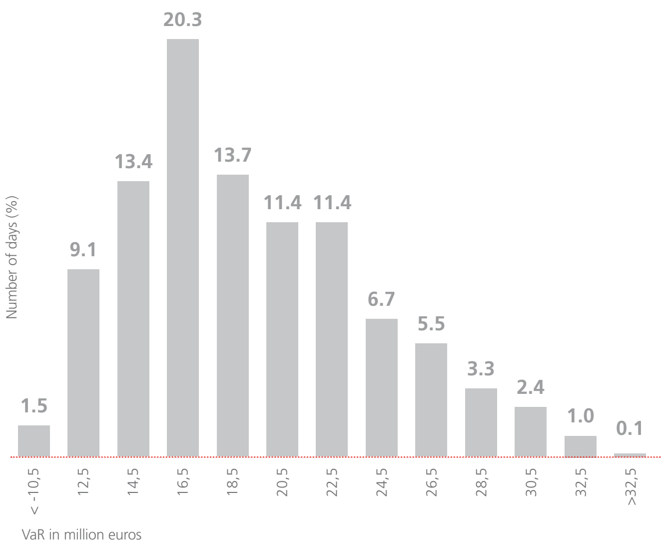

VaR during 2013 fluctuated between EUR 9.4 million and EUR 25.6 million. The main increases were linked to the Brazilian Treasury's changes in exposure to exchange rates and Spain's to interest rates and credit spreads.

The average VaR in 2013 was EUR 17.4 million, similar to the two previous years (EUR 22.4 million in 2011 and EUR 14.9 million in 2012) for the reason already mentioned of the concentration of activity in customers. In relation to other comparable financial groups, the Group can be said to have a low risk trading profile.

The histogram below shows the distribution of average risk in terms of VaR between 2011 and 2013 where the accumulation of days with levels between EUR 10.5 million and EUR 26.5 million can be seen (91.5%). The higher values of EUR 26.5 million (6.9%) were concentrated in periods mainly caused by one-off rises of volatility in the Brazilian currency and by the euro zone's sovereign debt crisis.

**VAR RISK HISTOGRAM**

Var at 99% with a time frame of one day
Number of days (%) in each range




17. Trading activity in financial markets.
18. The definition and methodology for calculating VaR is in section 7.3.1.1.

### Risk by factor

The average and year-end values in VaR terms at 99% for the last three years as well as their minimum and maximum values and the expected shortfall (ES) at 97.5%[19] in 2013 were as follows:

## VAR STATISTICS BY RISK FACTOR[20, 21]

Million euros. VaR at 99% with a time frame of one day

| | | 2013 | | | | | 2012 | | 2011 | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | VaR (99%) | | | | ES (97.5%) | VaR | | VaR | |
| | | Minimun | Average | Maximum | Year-end | Year-end | Average | Year-end | Average | Year-end |
| Total trading | **Total VaR** | **9.4** | **17.4** | **25.6** | **13.1** | **13.4** | **14.9** | **18.5** | **22.4** | **15.9** |
| | Diversification effect | (9.6) | (16.2) | (34.7) | (12.3) | (12.3) | (15.2) | (13.5) | (21.8) | (16.7) |
| | Interest rate VaR | 8.1 | 12.7 | 21.3 | 8.5 | 8.4 | 11.8 | 12.0 | 14.8 | 14.6 |
| | Equity VaR | 2.1 | 5.6 | 11.7 | 4.7 | 4.5 | 7.0 | 7.1 | 4.8 | 3.7 |
| | FX VaR | 1.6 | 5.4 | 14.5 | 4.7 | 4.8 | 5.0 | 3.5 | 9.0 | 4.2 |
| | Credit spread VaR | 6.1 | 9.6 | 16.4 | 7.2 | 7.5 | 6.1 | 9.1 | 15.0 | 9.6 |
| | Commodities VaR | 0.1 | 0.3 | 0.7 | 0.3 | 0.4 | 0.4 | 0.3 | 0.6 | 0.4 |
| Europe | **Total VaR** | **8.2** | **13.9** | **21.6** | **9.9** | **9.7** | **11.0** | **16.4** | **15.5** | **10.1** |
| | Diversification effect | (7.6) | (14.1) | (26.8) | (9.0) | (9.6) | (12.9) | (9.9) | (15.1) | (13.0) |
| | Interest rate VaR | 6.1 | 9.3 | 18.5 | 6.6 | 6.4 | 7.9 | 6.8 | 11.5 | 11.9 |
| | Equity VaR | 1.6 | 4.3 | 9.2 | 2.6 | 2.5 | 6.2 | 6.3 | 3.9 | 3.6 |
| | FX VaR | 1.4 | 5.2 | 14.2 | 3.7 | 4.0 | 4.1 | 4.0 | 8.5 | 3.9 |
| | *Credit spread VaR* | 4.2 | 9.0 | 15.1 | 5.8 | 6.0 | 5.4 | 8.9 | 6.0 | 3.3 |
| | Commodities VaR | 0.1 | 0.3 | 0.7 | 0.3 | 0.4 | 0.4 | 0.3 | 0.6 | 0.4 |
| Latin America | **Total VaR** | **3.9** | **11.1** | **24.1** | **6.9** | **7.4** | **10.1** | **8.9** | **11.7** | **10.7** |
| | Diversification effect | (1.2) | (5.3) | (16.1) | (6.7) | (7.4) | (6.4) | (3.8) | (6.4) | (8.7) |
| | Interest rate VaR | 3.6 | 9.6 | 22.1 | 5.9 | 7.4 | 8.8 | 8.8 | 11.2 | 10.5 |
| | Equity VaR | 0.8 | 3.2 | 8.1 | 2.9 | 2.8 | 3.1 | 1.6 | 3.5 | 2.2 |
| | FX VaR | 0.7 | 3.5 | 11.7 | 4.7 | 4.6 | 3.1 | 1.3 | 3.7 | 1.2 |
| US & Asia | **Total VaR** | **0.4** | **0.8** | **1.7** | **0.5** | **0.5** | **0.9** | **0.8** | **1.2** | **0.9** |
| | Diversification effect | 0.0 | (0.4) | (1.1) | (0.2) | (0.2) | (0.5) | (0.3) | (0.5) | (0.4) |
| | Interest rateVaR | 0.3 | 0.7 | 1.5 | 0.5 | 0.5 | 0.7 | 0.6 | 0.9 | 0.9 |
| | Equity VaR | 0.0 | 0.1 | 1.8 | 0.0 | 0.0 | 0.2 | 0.1 | 0.1 | 0.1 |
| | FX VaR | 0.1 | 0.4 | 1.2 | 0.2 | 0.2 | 0.6 | 0.4 | 0.6 | 0.4 |
| Global activities | **Total VaR** | **0.9** | **1.5** | **2.3** | **2.0** | **2.0** | **2.7** | **1.2** | **10.5** | **9.7** |
| | Diversification effect | (0.1) | (0.3) | (0.8) | (0.5) | (0.4) | (0.6) | (0.3) | (1.1) | (0.9) |
| | Interest rate VaR | 0.2 | 0.3 | 0.6 | 0.4 | 0.4 | 0.3 | 0.2 | 0.4 | 0.5 |
| | Credit spread VaR | 0.9 | 1.5 | 2.3 | 2.1 | 2.0 | 2.6 | 1.3 | 10.3 | 8.4 |
| | FX VaR | 0.0 | 0.1 | 0.1 | 0.0 | 0.0 | 0.4 | 0.1 | 0.9 | 1.8 |

19. Item 7.3.1.5 sets out the definition of this metric. Following the recommendation of the Basel Committee in its *Fundamental review of the trading book: A revised market risk framework* (October 2013), the confidence level of 97.5% means approximately a risk level similar to that which the VaR captures with a 99% confidence level.
20. The VaR of global activities includes operations that are not assigned to any particular country
21. In Latin America, the US and Asia, the VaR levels of the credit spread and commodity factors are not shown separately because of their scant or zero materiality.

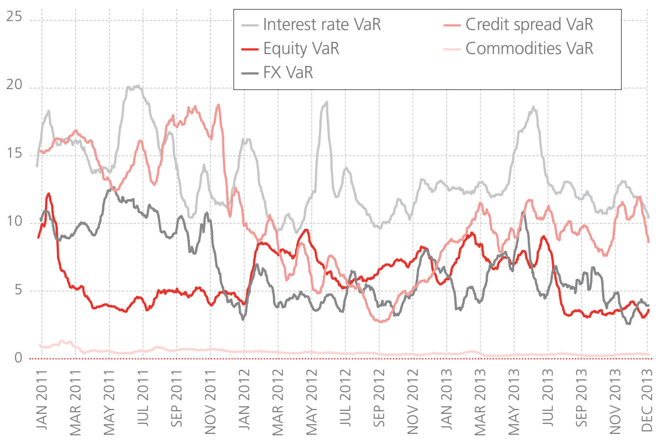
For the first time another risk metric is shown, the expected shortfall. Its proximity to VaR shows that the risk of high losses of tail risk is not high, at least bearing in mind the historic window of the last two years.

The average VaR increased a little in 2013 by EUR 2.5 million, although if compared with the year-end figures VaR declined by EUR 5.4 million. By risk factor, the average VaR increased in interest rates, credit spreads and exchange rates, and declined in equities and commodities. By geographic zone, it rose in Europe and Latin America and dropped in the United States and Asia and global activities.

The VaR evolution by risk factor in general also declined, with peaks and troughs sharper in the case of the VaR by credit spread, partly due to the exclusion of the risk spread of securitisations and credit correlation which by BIS 2.5 is considered as banking book for the purposes of regulatory capital as of November 15 2011. The temporary changes in the VaR of various factors was due more to the temporary rises in the volatility of market prices than to significant changes in positions.

**VAR BY RISK FACTOR**

Million euros. VaR at 99% with a time frame of one day (15 day moving average)




Lastly, the table below compares the VaR figures[22] with stressed VaR figures[19] for trading activity in Spain and Brazil, whose treasuries were those that experienced the Group's largest average VaR in 2013. In Spain, unlike Brazil, the fact that the stressed VaR (with window of historic crisis) does not significantly exceed the VaR (with window of the two last years) indicates that the portfolio was not very exposed to events not covered in the most recent past.

**STRESSED VAR STATISTICS VERSUS VAR IN 2013: TREASURIES IN SPAIN AND BRAZIL**

Million euros. Stressed VaR and VaR at 99% with time frame of one day

| | | 2013 | | | |
|---|---|---|---|---|---|
| | | Minimum | Average | Maximum | Year-end |
| Spain | VaR (99%) | 5.4 | 10.7 | 19.3 | 6.0 |
| | Stressed VaR (99%) | 7.4 | 12.2 | 22.2 | 14.8 |
| Brazil | VaR (99%) | 5.0 | 9.1 | 22.6 | 5.3 |
| | Stressed VaR (99%) | 5.1 | 17.2 | 48.3 | 12.1 |

### 7.2.1.2. Distribution of risks and management results[23]

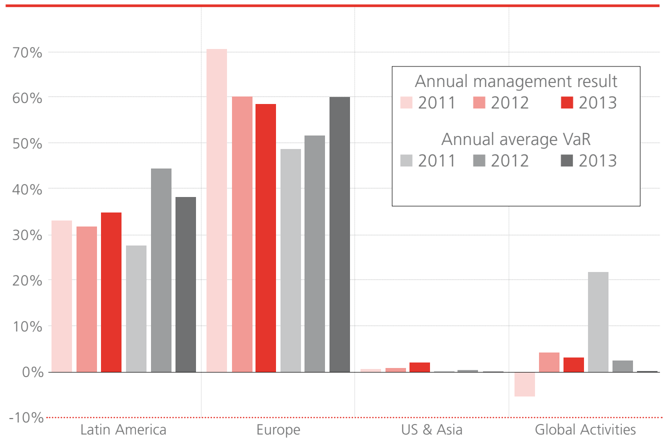
#### 7.2.1.2.1. Geographic distribution

In trading activity, the average contribution of Latin America to the Group's total VaR in 2013 was 38.5% compared with a contribution of 35.6% in economic results. Europe, with 60.7% of global risk, contributed 58.1% of results. In relation to prior years, there was a gradual homogenisation in the profile of activity in the Group's different units, focused generally on providing service to professional and institutional clients.

Below is the geographic contribution (by percentage), both in risks, measured in VaR terms, as well as in results (economic terms).

**VAR BINOMIAL-MANAGEMENT RESULTS: GEOGRAPHIC DISTRIBUTION**

Average VaR (at 99% with a time frame of one day) and annual accumulated management result (million euros)



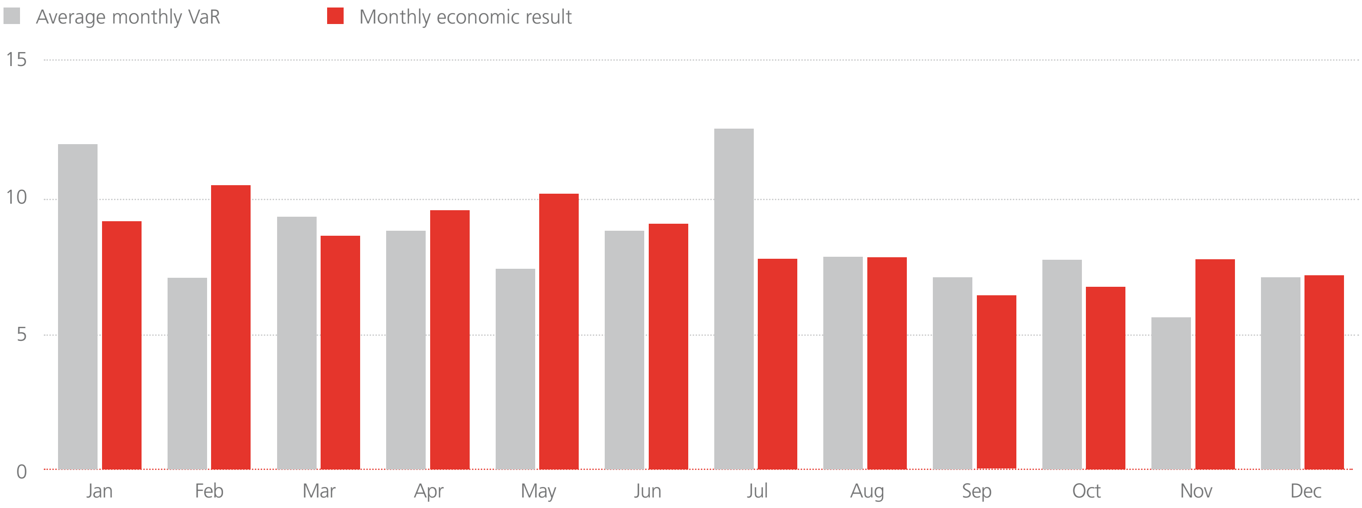

#### 7.2.1.2.2. Monthly distribution of risks and results

The next chart shows the risk assumption profile, in terms of VaR, compared to results in 2013. The average VaR remained relatively stable, although on a downward path to some extent, while results evolved in a more irregular way during the year. January and July were positive months and November negative, with results below the annual average.

22. Description in 7.3.1.5.
23. Results in terms that can be likened to the gross margin (excluding operating expenses; the only cost is financial).

## DISTRIBUTION OF RISK BY TIME AND RESULTS IN 2013: PERCENTAGES OF ANNUAL TOTALS

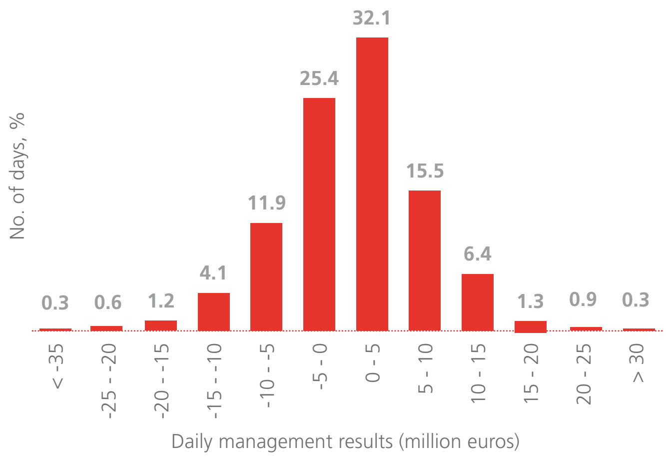
VaR (at 99% with a time frame of one day) and annual accumulated management result (million euros)




The following histogram of frequencies shows the distribution of daily economic results on the basis of their size between 2011 and 2013. The daily yield[24] was between -EUR 15 and +EUR 15 million on more than 95% of days when the market was open.

## HISTOGRAM OF THE FREQUENCY OF DAILY RESULTS (MTM)

Daily results of management "clean" of commissions and intraday operations (million euros). Number of days (%) in each range




**7.2.1.3. Risk management of financial derivatives market**

Financial derivatives activity is mainly focused on designing investment products and hedging risks for clients. Management is focused on ensuring that the net risk opened is the lowest possible.

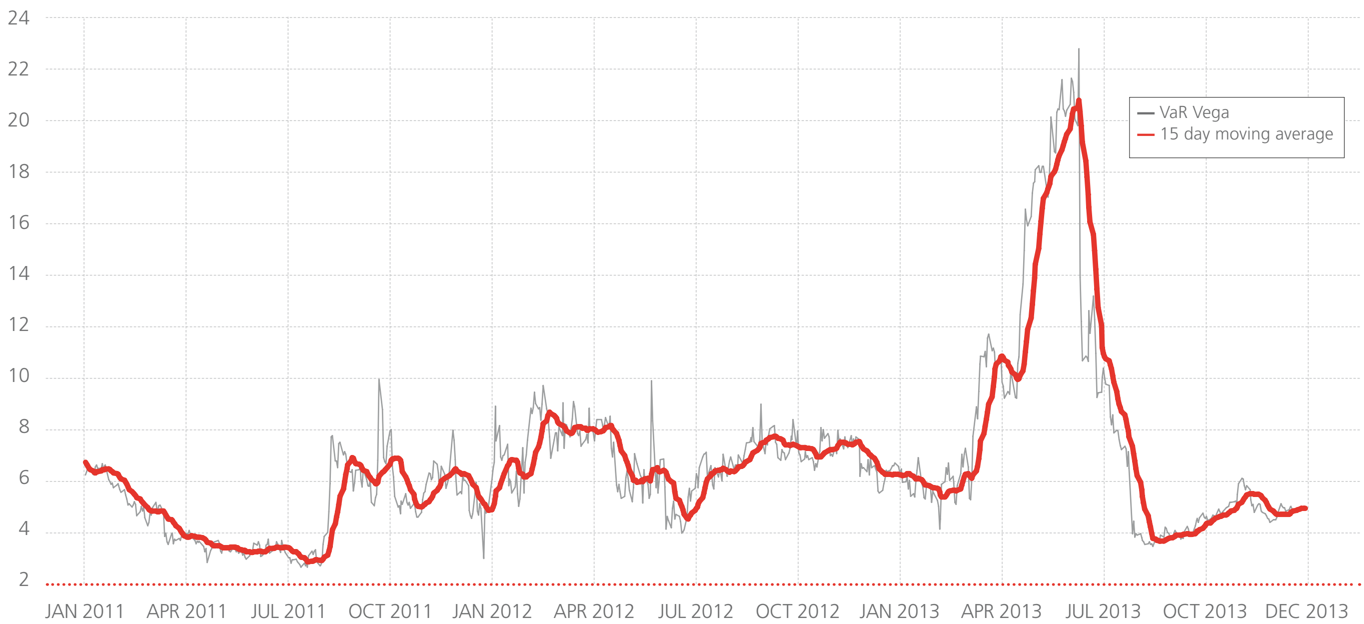
These transactions include options on equities, fixed-income and exchange rates. The units where this activity mainly takes place are: Madrid, Banesto, Santander UK, and, to a lesser extent, Brazil and Mexico.

The chart below shows the VaR Vega[25] performance of structured derivatives business over the last three years. It fluctuated at around an average of EUR 6.5 million. The periods with higher VaR levels related to episodes of significant rises in volatility in the markets. The evolution of VaR Vega in the second quarter of 2013 is the result of the increased volatility of euro and US dollar interest rate curves, coinciding with a strategy of hedging client operations of significant amounts.

24. Yields "clean" of commissions and results of intraday derivative operations.
25. Vega, a Greek term, means here the sensitivity of the value of a portfolio to changes in the price of market volatility.

## EVOLUTION OF RISK (VAR) OF THE BUSINESS OF FINANCIAL DERIVATIVES

Million euros. VaR at 99% with a time frame of one day.




As regards the VaR by risk factor, on average, the exposure was concentrated, in this order: interest rates, equities, exchange rates and commodities. This is shown in the table below:

## FINANCIAL DERIVATIVES. RISK (VAR) BY RISK FACTOR

Million euros. VaR at 99% with a time frame of one day.

| | 2013 | | | | 2012 | | 2011 | |
|---|---|---|---|---|---|---|---|---|
| | Minimum | Average | Maximum | Year-end | Average | Year-end | Average | Year-end |
| **Total VaR Vega** | **3.4** | **8.0** | **22.7** | **4.5** | **6.8** | **6.5** | **4.7** | **4.9** |
| Diversification impact | 2.8 | (3.8) | (7.0) | (2.7) | (3.0) | (3.4) | (2.9) | (3.7) |
| Interest rate VaR | 1.4 | 6.6 | 22.7 | 4.1 | 2.3 | 2.8 | 2.0 | 2.0 |
| Equity VaR | 1.5 | 3.4 | 7.2 | 1.8 | 6.5 | 5.5 | 4.1 | 5.2 |
| FX VaR | 0.2 | 1.7 | 5.0 | 1.3 | 0.7 | 1.3 | 1.2 | 1.0 |
| Commodities VaR | 0.0 | 0.1 | 0.2 | 0.1 | 0.3 | 0.2 | 0.3 | 0.4 |

As regards the distribution by business unit, the exposure is concentrated, in this order: Spain, Santander UK, Brazil and Mexico.

## FINANCIAL DERIVATIVES. RISK (VAR) BY UNIT

Million euros. VaR at 99% with a time frame of one day.

| | 2013 | | | | 2012 | | 2011 | |
|---|---|---|---|---|---|---|---|---|
| | Minimum | Average | Maximum | Year-end | Average | Year-end | Average | Year-end |
| **Total VaR Vega** | **3.4** | **8.0** | **22.7** | **4.5** | **6.8** | **6.5** | **4.7** | **4.9** |
| Spain | 2.0 | 7.0 | 22.3 | 3.8 | 5.9 | 5.4 | 4.0 | 3.7 |
| Santander UK | 1.5 | 2.2 | 3.6 | 1.6 | 2.8 | 2.0 | 1.4 | 2.7 |
| Brazil | 0.8 | 1.2 | 2.8 | 0.9 | 1.0 | 2.8 | 0.8 | 0.3 |
| Mexico | 0.8 | 1.2 | 1.5 | 1.2 | 0.7 | 0.6 | 1.2 | 1.1 |

The average risk in 2013 (EUR 8 million) was more than the combined average of the last three years, for the previously explained reasons.

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 2013, the Group had:

- CDOs and CLOs: the position continues to be not very significant (EUR 194 million), An important part of it is the result of integrating the portfolio of Alliance & Leicester in 2008.

- Hedge funds: the total exposure is not significant (EUR 317 million at the end of 2013) and most of it is via the financing of these funds (EUR 136 million), with the rest direct participation in portfolio or via counterparty by derivatives to hedge funds. This exposure has low loan-to-value levels of around 25% (collateral of EUR 1,260 million at the end of 2013). The risk with this type of counterparty is analysed case by case, establishing percentages of collateralisation on the basis of the features and assets of each fund.

- Conduits: no exposure.

- Monolines: Santander's exposure to bond insurance companies (monolines) was EUR 141 million[26] at the end of 2013, mainly indirect exposure (EUR 138 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. 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 7% lower than in 2012.

In short, the exposure to this type of instrument, the result of the Group's usual operations, continued to decline in 2013. This was mainly due to the integration of positions of institutions acquired by the Group, 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 observable data (inputs) needed 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.

**7.2.1.4. Issuer risk in trading portfolios**

Trading activity in credit risk is mainly conducted in Treasury in Spain. It is done by taking positions in bonds and credit default swaps (CDS) at different maturities on corporate and financial references, as well as indexes (Itraxx, CDX).

The table below shows the largest positions at the end of the year, distinguishing between long positions (bond purchase or protection sale via CDS and short positions (bond sale or purchase protection via CDS):

*Million euros*

| | Largest "long" positions (protection sale) | | Largest "short" positions (purchase protection) | |
|---|---|---|---|---|
| | **Exposure at default (EaD)** | **% of total EaD** | **Exposure at default (EaD)** | **% of total EaD** |
| 1st reference | 118 | 3.8% | -65 | 6.7% |
| 2nd reference | 112 | 3.6% | -45 | 4.7% |
| 3rd reference | 94 | 3.0% | -44 | 4.6% |
| 4th reference | 92 | 3.0% | -29 | 3.0% |
| 5th reference | 84 | 2.7% | -29 | 3.0% |
| **Top 5 subtotal** | 500 | 16.1% | -212 | 22.0% |
| **Total** | **3,103** | **100.0%** | **-965** | **100.0%** |

Note: zero recoveries are supposed (LCR=0) in the EaD calculation

26. Guarantees provided by monolines for bonds issued by US states (municipal bonds) are not considered as exposure. They amounted to EUR 566 million at the end of 2013.

**7.2.1.5. Gauging and contrasting measures**

In 2013, the Group continued to regularly conduct analysis and contrasting tests on the effectiveness of the Value at Risk (VaR) calculation model, obtaining the same conclusions that enable us to verify the model's reliability. The objective of these tests is to determine whether it is possible to accept or reject the model used to estimate the maximum loss of a portfolio for a certain level of confidence and a specific time frame.

The most important test is backtesting, analysed at the local and global levels by the market risk control units. The methodology of backtesting is implemented in the same way for all the Group's portfolios and sub-portfolios.

Backtesting consists of comparing the forecast VaR measurements, with a certain level of confidence and time frame, with the real results of losses obtained in a same time frame.

Santander calculates and evaluates three types of backtesting:

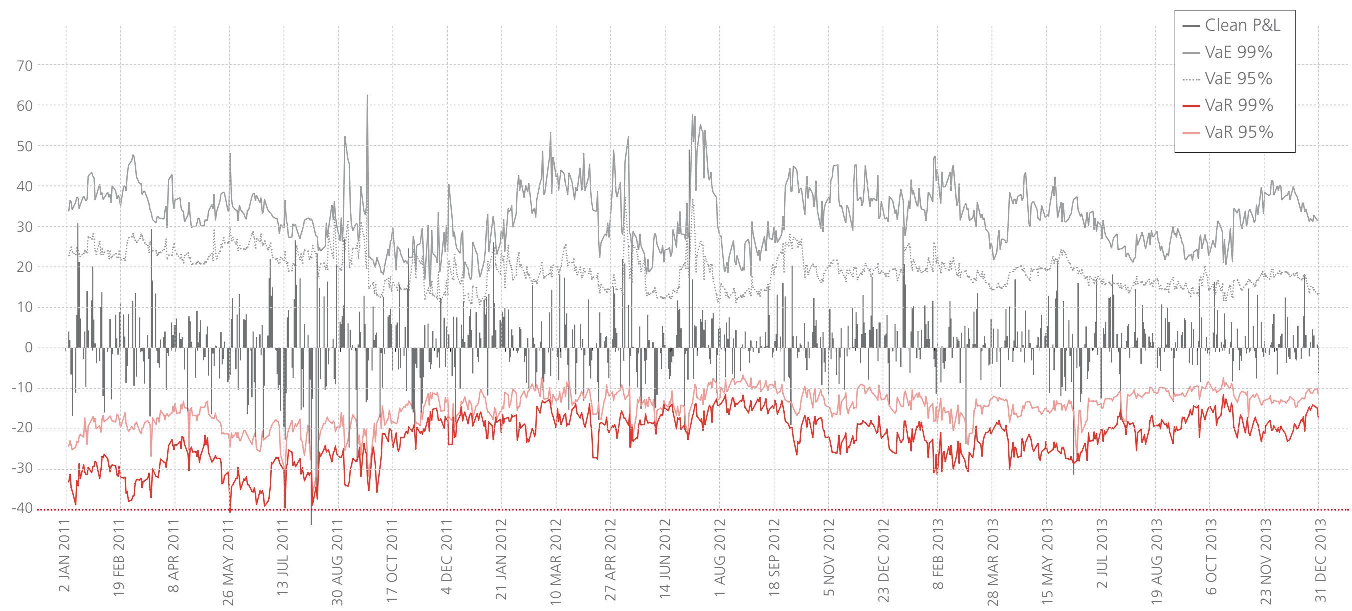
- "Clean" backtesting: the daily VaR is compared with the results obtained without taking into account the intraday results or the changes in the portfolio's positions. This method contrasts the effectiveness of the individual models used to assess and measure the risks of the different positions.
- Backtesting on complete results: the daily VaR is compared with the day's net results, including the results of the intraday operations and those generated by commissions.
- Backtesting on complete results: without mark-ups or commissions: the daily VaR is compared with the day's net results from intraday operations but excluding those generated by mark- ups and commissions. This method aims to give an idea of the intraday risk assumed by the Group's treasuries.

For the first case and the total portfolio, there were two exceptions in 2013 of VaR at 99% (days when the daily loss was higher than the VaR): May 31 - concentrated in Brazil due to a more than usually high rise in the Brazilian currency curves, both nominal as well as inflation-indexed (IPCA) - and July 11 - concentrated in Spain due movements in curves and their greater than usual volatility, and Brazil, because of the currency's significant appreciation against the dollar.

The number of exceptions responded to the expected performance of the VaR calculation model, which works with a confidence level of 99% and an analysis period of one year (over a longer period of time, an average of two or three exceptions a year is expected).

The backtesting exercises are regularly conducted for each relevant portfolio or strategy of the Group, and its main objective (as in the rest of contrasting tests) is to detect anomalies in the VaR model of each portfolio (for example, shortcomings in the parameterisation of the valuation models of certain instruments, not very adequate proxies, etc). This is a dynamic process contextualized in the framework of the procedure for reviewing and validating the model.

BACKTESTING OF BUSINESS PORTFOLIOS: DAILY RESULTS VERSUS PREVIOUS DAY'S VALUE AT RISK
Million euros



#### 7.2.1.6. Analysis of scenarios

Various stress scenarios were calculated and analysed regularly in 2013 (at least every month) at the local and global levels for all the trading portfolios and using the same suppositions by risk factor.

**Maximum volatility scenario (worst case)**

This scenario is given particular attention as it combines historic movements of risk factors with an ad-hoc analysis in order to reject very unlikely combinations of variations (for example, sharp falls in stock markets together with a decline in volatility). As regards the variations, an historic volatility equivalent to six typical deviations is applied. The scenario is defined by taking for each risk factor the movement which represents the greatest potential loss in the portfolio, rejecting the most unlikely combinations in economic-financial terms. For year-end, that scenario implied, for the global portfolio, interest rate rises, falls in stock markets, depreciation of all currencies against the euro, rise in credit spreads and mixed volatility movements. The following table shows the results of this scenario at the end of 2013.

MAXIMUM VOLATILITY STRESS SCENARIO (WORST CASE)
Million euros, 31 Dec 2013

| | Interest rates | Equities | Exchange rates | Credit Spread | Commodities | Total |
|---|---|---|---|---|---|---|
| **Total trading** | **(51.3)** | **(21.5)** | **(27.3)** | **(30.3)** | **(0.2)** | **(130.6)** |
| Europe | (17.2) | (7.7) | (14.5) | (24.5) | (0.2) | (64.1) |
| Latin America | (30.4) | (13.8) | (12.7) | 0.0 | 0.0 | (56.9) |
| US | (2.5) | 0.0 | (0.1) | 0.0 | 0.0 | (2.6) |
| Global activities | (1.2) | 0.0 | 0.0 | (5.8) | 0.0 | (7.0) |

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 130.6 million, a loss that would be concentrated in Europe (in this order, credit spreads, interest rates and exchange rates) and Latin America (interest rates, equities and exchange rates).

#### Other global stress test scenarios

Various global scenarios (similar for all the Group's units) are established:

Abrupt crisis: ad hoc scenario with very sudden movements in markets. Rise in interest rate curves, sharp falls in stock markets, large appreciation of the dollar against the rest of currencies, rise in volatility and in credit spreads.

Crisis 11S: historic scenario of the 11 September 2001 attacks with a significant impact on the US and global markets. It is sub-divided into two scenarios: 1) maximum accumulated loss until the worst moment of the crisis and 2) maximum loss in a day. In both cases, there are drops in stock markets and in interest rates in core markets and rises in emerging markets, and the dollar appreciates against the rest of currencies.

Subprime crisis: Historic scenario of the US mortgage crisis. The objective of the analysis is to capture the impact on results of the reduction in liquidity in the markets. The scenarios have two time frames (one day and 10 days): in both cases there are drops in stock markets and in interest rates in core markets and rises in emerging markets, and the dollar appreciates against the rest of currencies.

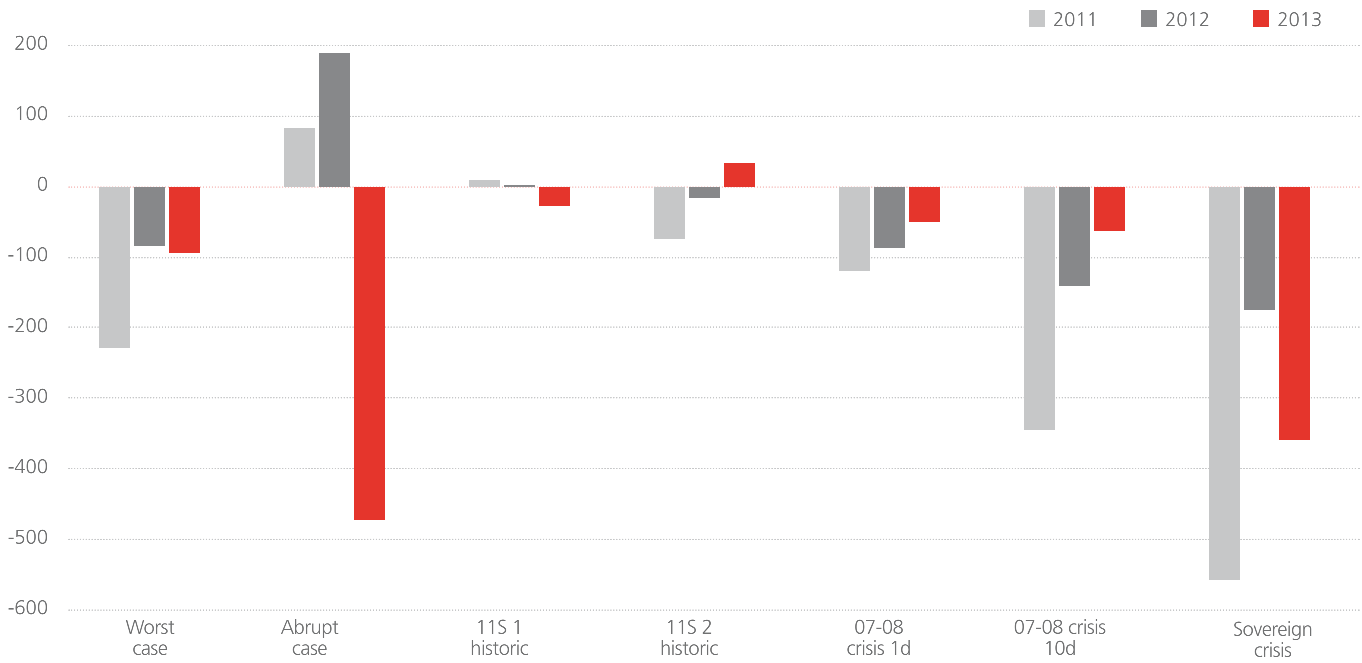
Sovereign crisis: the severest historic scenario by the Committee of European Banking Supervisors (CEBS) to measure the market's shock capacity between 15 April and 1 September 2010. Given the Group's international sphere, four geographic zones are distinguished (US, Europe, Latin America and Asia), interest rate rises, falls in stock markets and volatilities are established, rises in credit spreads and depreciation of the euro and Latin American currencies and appreciation of Asian currencies against the dollar.

Every month a consolidated stress test report is drawn up with explanations of the main changes in results for the various scenarios and units supervised by the global committee of market risks. An early warning mechanism has also been established so than when the loss of a scenario is high in historic terms and/or the capital consumed by the portfolio in question, the relevant business executive is informed.

Here we show the results of the global scenarios for the last three years.

STRESS TEST RESULTS: COMPARISON OF THE 2011-2013 SCENARIOS (ANNUAL AVERAGES)

Million euros




**7.2.1.7. Linkage with balance sheet items. Other alternative risk measures**

Below are balance sheet items of the Group's consolidated position that are subject to market risk, showing the positions whose main risk metric is the VaR and where monitoring is also carried out with other metrics.

RELATION OF RISK METRICS WITH BALANCES OF THE GROUP'S CONSOLIDATED POSITION

Million euros, 31 Dec 2013

| | | Main market risk metrics | | |
|---|---|---|---|---|
| | **Balance** | **VaR** | **Others** | **Main risk factor for balance in "·others"** |
| **Assets subject to market risk** | **244,305** | **145,163** | **99,141** | |
| Trading portfolios | 115,305 | 114,361 | 944 | Interest rate, credit spread |
| Other financial assets at reasonable value | 31,381 | 30,802 | 578 | Interest rate, credit spread |
| Financial assets available for sale | 83,799 | - | 83,799 | Interest rate, equities |
| Equities | 5,536 | - | 5,536 | Equities |
| Hedging derivatives | 8,283 | - | 8,283 | Interest rate, exchange rate |
| **Liabilities subject to market risk** | **142,266** | **142,005** | **261** | |
| Trading portfolio | 94,696 | 94,479 | 216 | Interest rate, credit spread |
| Other financial assets at reasonable value | 42,311 | 42,266 | 45 | Interest rate, credit spread |
| Hedging derivatives | 5,260 | 5,260 | - | |

For activity managed with metrics different to the VaR, alternative measures are used, mainly: sensitivity to different risk factors (interest rates, credit spread, etc.).

In the case of the trading portfolio, the securitisations and "level III" exposures (those in which not observable market data constitutes significant inputs in their corresponding internal models of valuation) are excluded from VaR measurement.

Securitisations are mainly treated as if they were credit risk portfolio (in terms of default, rate of recovery, etc). For "level III" exposures, which are not very significant in Grupo Santander (basically derivatives linked to the home price index (HPI) in the activity of markets in Santander UK, and the not very significant portfolio of illiquid CDOs in the activity of markets of the parent bank), as well as in general for inputs that cannot be observed in the market (correlation, dividends, etc), a very conservative policy is followed, reflected in valuation adjustments as well as sensitivity.

## 7.2.2. Structural market risks[27]

### 7.2.2.1. Structural interest rate

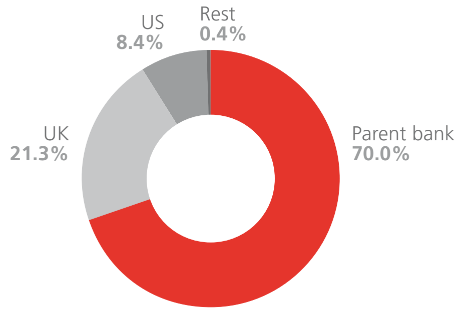
#### 7.2.2.1.1. Europe and the United States

Generally, in these mature markets and in a context of low interest rates, the general positioning has been to maintain balance sheets with positive sensitivity to short-term interest rate rises for the net interest margin (NIM). In the case of economic value (MVE), the sense of risk is determined by expectations of long-term interest rates in each market, on the basis of their economic indicators.

In any case, the exposure level in all countries is very low in relation to the annual budget and the amount of equity. Moreover, in 2013 the most general trend was to maintain or reduce the exposure.

At the end of 2013, the sensitivity of the NIM at one year to parallel rises of 100 basis points was concentrated in the euro interest rate curve, the US dollar and sterling, with the parent bank, the US subsidiary and Santander UK the units that contributed the most (EUR 111 million, $54 million and £39 million, respectively). The sensitivity of the margin to the rest of convertible currencies is not significant.

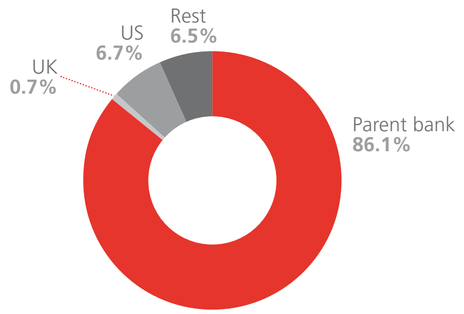
**NIM SENSITIVITY TO 100 B.P.**
% of the total




Other: Portugal, SCF, SC USA, Poland and BPL.

At the same date, the main sensitivity of economic value to parallel rises in the yield curve of 100 basis points was in the euro interest rate curve in the parent bank (EUR 1,478 million). As regards the dollar and sterling curves, the amounts were $285 million and £16 million, respectively).

**MVE SENSITIVITY TO 100 B.P.**
% of the total




Other: Portugal, SCF, SC USA, Poland and BPL.

27. Includes the entire balance sheet except for the trading portfolios.

The tables below give the structure by maturity of interest rates at the parent bank and Santander UK at the end of 2013.

## PARENT BANK: INTEREST RATES REPRICING GAP[28] (31 DECEMBER 2013)

Million euros

| | Total | 3 months | 1 year | 3 years | 5 years | > 5 years | Non sensitive |
|---|---|---|---|---|---|---|---|
| Assets | 408,298 | 163,941 | 78,854 | 23,913 | 12,690 | 21,056 | 107,844 |
| Liabilities | 408,298 | 139,231 | 73,936 | 72,089 | 24,836 | 33,441 | 64,766 |
| Off-balance sheet | 0 | (15,974) | (2,378) | 13,411 | 3,509 | 1,433 | 0 |
| Net gap | 0 | 8,736 | 2,540 | (34,766) | (8,637) | (10,952) | 43,078 |

## SANTANDER UK: INTEREST RATES REPRICING GAP[29] (31 DECEMBER 2013)

Million euros

| | Total | 3 months | 1 year | 3 years | 5 years | > 5 years | Non sensitive |
|---|---|---|---|---|---|---|---|
| Assets | 287,814 | 190,079 | 21,650 | 48,057 | 12,761 | 301 | 14,966 |
| Liabilities | 287,814 | 182,894 | 38,628 | 23,061 | 14,815 | 638 | 27,778 |
| Off-balance sheet | 0 | 407 | 8,555 | (4,970) | (3,790) | (187) | (15) |
| Net gap | 0 | 7,591 | (8,423) | 20,026 | (5,843) | (524) | (12,828) |

In general, the gaps by maturities remained at very low levels in relation to the size of the balance sheet, in order to minimise interest rate risk.

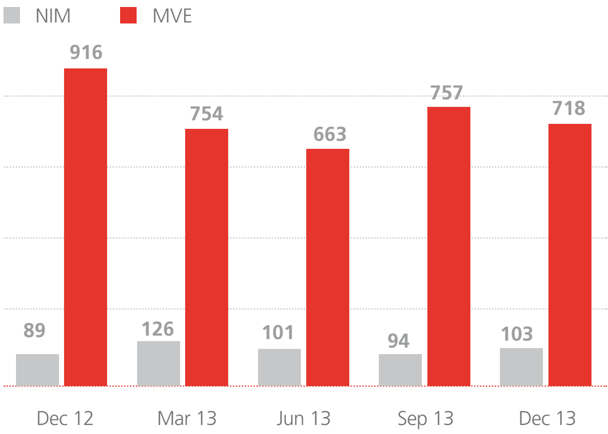
### 7.2.2.1.2. Latin America

Due to differences in the macroeconomic context and the degree of maturity of these markets, the positioning with regard to the NIM was not homogeneous.
There are countries with balance sheets positioned to interest rate rises and others to interest rate falls.
With regard to MVE, the general positioning of the balance sheets was such that the average duration of the asset was higher than that of the liability (negative sensitivity to interest rate rises).

The risk in the main countries was reduced or maintained in 2013. In any case, the exposure level in all countries is very low in relation to the annual budget and the amount of equity.

## EVOLUTION OF THE LATIN AMERICAN STRUCTURAL INTEREST RISK PROFILE

Sensitivity of NIM and MVE to 100 b.p. Million euros.

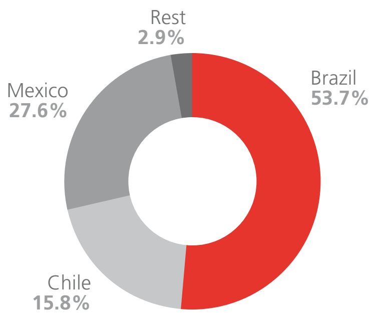



For Latin America as a whole, the consumption of risk at December 2013, measured to 100 b.p. of the financial margin[30], stood at EUR 103 million (EUR 89 million at December 2012). It can be seen from the chart below that over 95% of the risk was concentrated in three countries: Brazil, Chile and Mexico.

28. Aggregate gap of all currencies in the balance sheet of Santander parent bank, expressed in euros.
29. Aggregate gap of all currencies in the balance sheet of Santander UK, expressed in euros.
30. Betas are used to aggregate the sensitivities of different curves.

## NIM SENSITIVITY TO 100 B.P.

% of the total

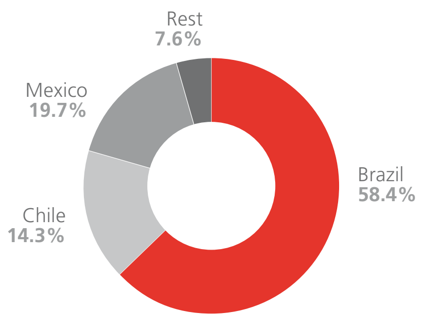



Other: Argentina, Colombia, Panama, Peru, Puerto Rico, Santander Overseas and Uruguay.

At the end of 2013, the risk consumption for the region, measured to 100 b.p. of asset value[31], was EUR 718 million (EUR 916 million in 2012). 90% of the asset value risk was concentrated in three countries: Brazil, Chile and Mexico.

## MVE SENSITIVITY TO 100 B.P.

% of the total




Other countries: Argentina, Colombia, Panama, Peru, Puerto Rico, Santander Overseas and Uruguay.

The gap tables show the interest-rate risk maturity structure in Brazil at the end of 2013.

## BRAZIL: INTEREST RATES REPRICING GAP[32] (31 DECEMBER 2013)

Million euros

| | Total | 3 months | 1 year | 3 years | 5 years | > 5 years | Not sensitive |
|---|---|---|---|---|---|---|---|
| Assets | 158,399 | 71,197 | 22,683 | 19,896 | 9,169 | 7,428 | 28,027 |
| Liabilities | 158,399 | 88,456 | 17,659 | 10,495 | 3,473 | 3,371 | 34,945 |
| Off-balance sheet | 0 | 5,293 | 1,101 | (6,854) | 302 | 159 | 0 |
| ***Gap*** | 0 | (11,967) | 6,126 | 2,547 | 5,997 | 4,216 | (6,918) |

31. Betas are used to aggregate the sensitivities of different curves.
32. Aggregate gap of all currencies in the balance sheet of Brazil, expressed in euros.

#### 7.2.1.1.3. Balance sheet structural interest rate risk (VaR)

As well as sensitivity to interest rate movements (those of +/- 25, +/- 50, +/-75 and +/-100 b.p.), Santander uses other methods to monitor the structural interest rate risk of the balance sheet including analysis of scenarios and calculation of the VaR, using methodology similar to that used for the trading portfolios.

The table below shows the average, minimum, maximum and year-end values of the VaR of structural interest rate risk.

**BALANCE SHEET STRUCTURAL INTEREST RATE RISK (VAR)**

VaR at 99% with a time frame of one day. Million euros

| | 2013 | | | |
|---|---|---|---|---|
| | **Minimum** | **Average** | **Maximum** | **Year-end** |
| **Structural interest rate risk (VaR)*** | **580.6** | **782.5** | **931.0** | **681.0** |
| Diversification impact | (142.3) | (164.7) | (182.0) | (150.3) |
| Europe and US | 607.7 | 792.5 | 922.0 | 670.0 |
| Latin America | 115.2 | 154.6 | 191.0 | 161.3 |

| | 2012 | | | |
|---|---|---|---|---|
| | **Minimum** | **Average** | **Maximum** | **Year-end** |
| **Structural interest rate risk (VaR)*** | **361.7** | **446.4** | **525.7** | **517.5** |
| Diversification impact | (78.1) | (124.4) | (168.1) | (144.9) |
| Europe and US | 334.4 | 451.4 | 560.8 | 552.0 |
| Latin America | 105.5 | 119.5 | 133.0 | 110.3 |

| | 2011 | | | |
|---|---|---|---|---|
| | **Minimum** | **Average** | **Maximum** | **Year-end** |
| **Structural interest rate risk (VaR)*** | **256.0** | **273.1** | **328.1** | **238.1** |
| Diversification impact | (97.9) | (116.8) | (109.6) | (99.3) |
| Europe and US | 231.8 | 258.2 | 295.3 | 295.3 |
| Latin America | 122.1 | 131.7 | 142.4 | 132.1 |

* Includes VaR by credit spread in the ALCO portfolios.

The structural interest rate risk, measured in VaR terms at one day and at 99%, was an average of EUR 782 million in 2013. The contribution to it of the balances of Europe and the US was significantly greater than that of Latin America. Of note was the high diversification between both areas and the increased volatility in emerging countries at the end of 2013.

#### 7.2.2.2. 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 hedging 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 2013, the largest exposures of a permanent nature (with potential impact on equity value) were concentrated, in this order, in sterling, Brazilian reais, US dollars, Mexican pesos, Chilean pesos and Polish zlotys. 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.

#### 7.2.2.3. Structural equity risk

Santander maintains equity positions in its banking book in addition to those of the trading portfolio. These positions are maintained as portfolios available for sale (capital instruments) or as equity stakes, depending on their envisaged time in the portfolio.

These positions are exposed to market risk. VaR calculations are made for these positions, using market price series for listed shares and proxies for those that do not. At the end of 2013, the VaR at 99% with a one day time frame was EUR 253.3 million (EUR 281.4 million and EUR 305.7 million at the end of 2012 and 2011, respectively).

#### 7.2.2.4. Balance sheet market risk

With a homogeneous metric such as the VaR, the total market risk in the banking book can be monitored, distinguishing between fixed income (both interest rate as well the credit spread for the ALCO portfolios), exchange rate and equities.

The total VaR is not high in terms of the Group's volume of assets or equity. It has declined over the last few years due to the reduction in exchange rate risk and structural equity risk.

**VaR OF THE BALANCE SHEET EXCLUDING TRADING ACTIVITY**
VaR at 99% with a time frame of one day. Million euros

| | 2013 | | | | 2012 | | 2011 | |
|---|---|---|---|---|---|---|---|---|
| | Minimum | Average | Maximum | Year-end | Average | Year-end | Average | Year-end |
| **Non-trading VaR** | **670.9** | **857.6** | **1.051.3** | **733.9** | **593.1** | **659.0** | **460.4** | **534.4** |
| Diversification effect | (333.3) | (448.3) | (499.7) | (380.2) | (390.7) | (347.1) | (419.4) | (446.2) |
| Interest rate VaR* | 580.6 | 782.5 | 931.0 | 681.0 | 446.4 | 517.5 | 273.1 | 328.1 |
| Exchange rate VaR | 197.8 | 254.5 | 320.5 | 197.8 | 237.0 | 207.3 | 372.7 | 346.8 |
| Equity VaR | 225.8 | 269.0 | 299.6 | 235.3 | 300.4 | 281.4 | 234.0 | 305.7 |

* Includes VaR by credit spread in the ALCO portfolios.

## 7.3 Methodologies

### 7.3.1. Trading activity

**7.3.1.1. VaR**

The standard methodology that Grupo Santander applied to trading activities during 2013 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. 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 by historic simulation has many advantages as a risk metric (it sums up in a single number the market risk of a portfolio, is based on market movements that really occurred without the need to make suppositions of formal functions nor of correlations between market factors, etc.), but also has limitations. The most important ones are the high sensitivity to the historic window used, the incapacity to capture large impact possible events if they do not occur in the window used, the existence of valuation parameters which do not have market input (such as correlations, dividends and recovery rate) and the slow adjustment to new volatilities and correlations, if the most recent data receives the same weight as the oldest data.

Part of these limitations are corrected by using the stressed VaR (see later) and calculating the VaR with exponential decay and applying conservative valuation adjustments.

**7.3.1.2. Analysis of scenarios**

The VaR is not the only measurement. It is used because of its calculation facility and for being a good benchmark of the Group's risk level, but other measures are also used which allow for greater control of risks in all the markets where the Group operates.

Among these measures is analysis of scenarios, which consists of defining alternatives for the performance of different financial variables and obtaining the impact on results by applying them to activities. These scenarios can replicate events that happened in the past (crisis) or determine possible alternatives that do not correspond to past events.

The potential impact on results of applying different stress scenarios to all the trading portfolios and considering the same suppositions by risk factor is calculated and analysed at least monthly. Three types of scenario are defined: possible, severe and extreme, obtaining along with the VaR a fuller spectrum of the risk profile.

In addition, levels of warning (triggers) are set for global scenarios, on the basis of the historic results of these scenarios and of the capital associated with the portfolio in question. In the event of surpassing these levels those responsible for management of the portfolio are informed so they can take the necessary measures. At the same time, the results of the stress exercises at the global level, as well as the possible breaching of the levels set, are regularly reviewed by the global committee of market risks so that if required senior management is informed.

**7.3.1.3. Analysis of positions, sensitivities and results**

The market risk area, in line with the principle of independence of the business units, monitors the positions daily, both those of each unit as well as globally, and conducts an exhaustive control of the changes in the portfolios in order to detect possible incidents so that they can be corrected immediately.

The positions are traditionally used to quantify the net volume of the market values of the transactions in portfolio, grouped by main risk factor, and considering the delta value of the futures and options that could exist. All the risk positions can be expressed in the base currency of the unit and in the currency of homogenising information.

The market risk sensitivity measures are those that gauge the change (sensitivity) of the market value of an instrument or portfolio to changes in each of the risk factors. The sensitivity of the value of an instrument to changes in market factors can be obtained through analytical approximations by partial derivatives or through a full revaluation of the portfolio.

The daily drawing up of the income statement is also an excellent indicator of risks, as it enables the impact that changes in financial variables have on portfolios to be identified.

**7.3.1.4. Credit management activity**

Control of derivative activities and credit management should also be mentioned. This control, because of its atypical nature, is conducted daily according to specific measures. In the case of derivative activities, sensitivity to the price movements of the underlying asset (delta and gamma), volatility (vega) and time (theta) is controlled. In the case of credit management, 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 is 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 credit 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.

**7.3.1.5. Other measures: stressed VaR (sVaR) and expected shortfall (ES)**

As well as the usual VaR, Santander began to calculate every day a stressed VaR, as of October 2011, for the main portfolios. The methodology for calculation is the same as that used for the VaR, with the following two exceptions:

- Historic period of observation of factors: the stressed VaR uses a window of 250 figures, instead of one of 520 for the VaR.

- In order to obtain the stressed VaR, unlike when calculating the VaR the maximum between the percentile uniformly weighted and the one exponentially weighted is not applied. Instead, the percentile uniformly weighted is used directly.

All the other aspects regarding the methodology and the inputs for calculating the stressed VaR are the same as those for the VaR. As regards determining the period of observation, for each relevant portfolio, the methodology area has analysed the history of a subseries of market risk factors that were chosen on the basis of expert criteria taking into account the most relevant positions of the books.

Moreover, the expected shortfall (ES) has begun to be calculated in order to estimate the expected value of the potential loss when this is higher than the level set by the VaR. The ES, unlike the VaR, has the advantage of capturing better the tail risk and of being a subadditive metric[33]. With regard to the near future, the Basel Committee recommends replacing VaR with the expected shortfall as the reference metric for calculating the regulatory capital of the trading portfolios[34].The committee believes that the confidence level of 97.5% is a risk level similar to that which VaR captures with a confidence level of 99%.

**7.3.1.6. CVA and DVA**

Grupo Santander incorporates credit valuation adjustment (CVA) and debt valuation adjustment (DVA) in the calculation of the results of trading portfolios. The credit valuation adjustment (CVA) is a valuation adjustment of over-the-counter (OTC) derivatives, as a result of the risk associated with the credit exposure assumed by each counterparty.

The CVA is calculated by taking into account the potential exposure with each counterparty in each future maturity. The CVA for a certain counterparty would be equal to the sum of the CVA for all maturities. It is calculated on the basis of the following inputs:

- Expected exposure: including, for each operation the current market value (MtM) as well as the potential future risk (add-on) to each maturity. Mitigants such as collateral and netting contracts are taken into account, as well as a factor of temporary decay for those derivatives with intermediate payments.

- Severity: the percentage of final loss assumed in case of credit/non-payment of the counterparty.

- Probability of default: for cases where there is no market information (spread curve traded via CDS, etc) probabilities are employed on the basis of ratings (preferably internal ones).

- Discount factors curve.

33. The sub-additive metric is one of the desirable properties which, according to French literature, should present a coherent risk metric. This property establishes that f (a+b) be lower or equal to f(a)+f(b). Intuitively, it supposes that the more instruments or risk factors there are, the less risky a portfolio due to the benefits of diversification. VaR does not meet this property for certain distributions, while the ES always does.

34. *Fundamental review of the trading book: a revised market risk framework* (consultative documents of the Basel Committee on banking supervision, October 2013).

The debt valuation adjustment (DVA) is a valuation adjustment similar to the CVA, but in this case as a result of Grupo Santander's risk that counterparties assume in the OTC derivatives.

## 7.3.2. Structural market risks

### 7.3.2.1. Structural interest rate risk

The Group analyses the sensitivity of net interest margin and of equity value 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 equity value to changes in interest rate levels and the Value at Risk (VaR), for the purposes of calculating economic capital.

#### 7.3.2.1.1. 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 the Bank's equity value.

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.

#### 7.3.2.1.2. 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.

#### 7.3.2.1.3. Market value of equity sensitivity (MVE)

The sensitivity of equity value 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.

#### 7.3.2.1.4. Treatment of liabilities without defined maturity

In the corporate model, the total volume of the balances of accounts without maturity is divided between stable and unstable balances.

The separation between the stable and unstable balances is obtained from a model that is based on the relation between balances and their own moving averages.

From this simplified model the monthly cash flows are obtained and used to calculate the NIM and MVE sensitivities.

The model requires a variety of inputs:

- Parameters inherent in the product.
- Performance parameters of the customer (in this case analysis of historic data is combined with the expert business view).
- Market data.
- Historic data of the portfolio.

#### 7.3.2.1.5. Pre-payment treatment for certain assets

The pre-payment issue mainly affects fixed-rate mortgages in units where the relevant interest rate curves for the balance sheet (specifically for the portfolio of investment in fixed rate mortgages) are at low levels. In these units the risk is modelised and some changes can also be made to assets without defined maturity (credit card businesses and similar).

The usual techniques used to value options cannot be applied directly because of the complexity of the factors that determine the pre-payment of borrowers. As a result, the models for assessing options must be combined with empirical statistical models which seek to capture the pre-payment performance. Some of the factors are:

- Interest rate: the differential between the fixed rate of the mortgage and the market rate at which it could be refinanced, net of cancellation and opening costs;
- Seasoning: pre-payment trend downward at the start of the instrument's life cycle (signing of the contract) and upward and stabilising as time passes;

- Seasonality: the amortisations or early cancellations tend to take place at specific dates;

- Burnout: decreasing trend in the speed of pre-payment as the instrument's maturity approaches, which includes:

**a)** Age: defines low rates of pre-payment.

**b)** Cash pooling: defines as more stable those loans that have already overcome various waves of interest rate falls. In other words, when a portfolio of loans has passed one or more cycles of downward rates and thus high levels of pre-payment, the "surviving" loans have a significantly lower pre-payment probability.

**c)** Others: geographic mobility, demographic, social, available income factors, etc.

The series of econometric relations that seek to capture the impact of all these factors is the probability of pre-payment of a loan or pool of loans and is denominated the pre-payment model.

#### 7.3.2.1.6. 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.

### 7.3.2.2. Structural exchange rate risk/hedging of results

These activities are monitored via position measurements, VaR and results, on a daily basis.

### 7.3.2.3. Structural equity risk

These activities are monitored via position measurements, VaR and results, on a monthly basis.

## 7.4 Management framework

### 7.4.1.Organisational and governance structure

The market and structural risks area is integrated into one of the Group's two general risk directorates. The missions of the market risk function are:

- Define and supervise the market risk management model, which includes corporate policies, defining the risks map and segmentation criteria.

- Control and manage the consolidation, reporting and centralised admission process of market risks.

These missions rest on five basic pillars, vital for correct management of market risks:

- Measurement, analysis and control of market and liquidity risks.

- Calculation, analysis, explanation and conciliation of results.

- Defining, capturing, validating and distributing market data.

- Admission of limits, products and underlying assets.

- Consolidation of information.

In turn, market risks management is guided by the following basic principles:

- Involvement of senior management.

- Independence of the risk function from business.

- Clear definition of powers.

- Risk measurement.

- Limiting risks.

- Analysis and control of risk positions.

- Establishing risk policies and procedures.

- Assessing risk methodologies.

In the same way that the market risks function is structured at the corporate or global level, each local market risk unit has and arranges its functions, with the adjustments that arise in accordance with their specific business, operational and legal requirement features, etc.

For the correct functioning of global policies and local execution, the global area of market risks and local units carry out different functions:

- Global market risk:
  - Establish, propose and document risk policies and criteria, the global limits and the decision-making and control processes.
  - Generate management frameworks, systems and tools.
  - Promote and support their implementation and ensure they function effectively in all units.
  - Know, assimilate and adapt the best practices inside and outside the Group.
  - Promote activity for obtaining results.
  - Consolidate, analyse and control the market risk incurred by all units of the perimeter.
- Local market risk units:
  - Manage risks.
  - Transfer, adapt and assume internally the corporate policies and procedures through local approval.
  - Define and document policies and lead local sphere projects.
  - Apply policies and decision-making systems to each market.
  - Adapt the organisation and management frameworks and corporate rules.
  - Contribute critical and best practices, as well as local knowledge and proximity to customers/markets.
  - Assume greater responsibilities in decisions, control and management of risks.
  - Measure, analyse and control market risk within its sphere of responsibility.

The committees, by hierarchical order, which have powers in decision-making, control and monitoring of market risks are set out below:

| Sphere | Hierarchical level | Name |
|---|---|---|
| CENTRALISED SPHERE | Executive | Executive Committee<br>- Markets Committee |
| | | Risks Committee |
| | Risks division | Risks Management Committee |
| | | Global Committee of the Directorate General of Risks |
| | | Permanent Committee of Risks |
| | | Corporate Committee of Risks Brazil |
| | Areas and departments dependent on the Risk Division | Global Market Risks Committee |
| | | Underwriting and Structured Products Committee |
| | | Models Committee |
| DECENTRALISED SPHERE | Units | Risks Committee in the Banks of the Group/Countries |
| | | Risks Committee of Branches Abroad |
| | | Risks Committee in Business Units |
| | | Local ALCOs |
| | | Other committees |

The collegiate organ of the market risks area is the global committee of market risks (GMRC). This committee is responsible for the functioning of market risk in Grupo Santander, both at the centralised level (global areas) and local level (local units). Its powers emanate directly from the risk committee, the maximum organ responsible for the risks function in Grupo Santander.

## 7.4.2. System for controlling limits

Setting market risk and liquidity limits is designed as a dynamic process which responds to the Group's risk appetite level (described in section 2.3 of this report). This process is part of the annual limits plan, which is drawn up by the Group's senior management and administered by the general directorate of risks in a way that involves all the Group's institutions.

### 7.4.2.1. Definition of limits

The market risk limits used in Grupo Santander are established on different metrics and try to cover all activity subject to market risk from many perspectives, applying a conservative criterion. The main ones are:

- Trading limits:
  - VaR limits.
  - Limits of equivalent positions and/or nominal.
  - Sensitivity limits to interest rates.
  - Vega limits.
  - Risk limits of delivery by short positions in securities (fixed income and equities).
  - Limits aimed at reducing the volume of effective losses or protecting results generated during the period:
    - Loss trigger.
    - Stop loss.
  - Credit limits:
    - Limit on the total exposure.
    - Limit to the jump to default by issuer.
    - Others.
  - Limits for origination operations
- Structural interest rate risk of the balance sheet:
  - Sensitivity limit of net interest margin at 1 year.
  - Sensitivity limit of equity value.
- Structural exchange rate risk:
  - Net position in each currency (for positions of hedging results).

These general limits are complemented by sub-limits. In this way, the market risk area has a structure of limits sufficiently granular to conduct an effective control of the various types of market risk factors on which an exposure is maintained. Positions are tracked daily, both of each unit as well as globally. An exhaustive control is made of the changes in the portfolios, in order to detect possible incidents for their immediate correction. Meanwhile, the daily drawing up of the income statement by the market risks area is an excellent indicator of risks, as it allows the impact that changes in financial variables have had on portfolios to be identified.

### 7.4.2.2 Structure of limits

The table below shows the levels of applying limits, the categories and the sphere of control in which they are classified and their levels of approval.

| Levels | Category/Control | Approval |
|---|---|---|
| Activity / Unit | Globales/control global | Risk Committee |
| | Global/Local control | Global Market Risk Committee |
| | Local/Local control | Local market risks |

- Global limits of global control: the Risks Committee approves the limits at the activity/unit level in the annual process of setting limits. Changes that are subsequently made can be approved by the Global Market Risks Committee, in accordance with the powers delegated in it.

  These limits are requested by the relevant business executive in each country/entity on the basis of the nature of the business and the budget established, seeking consistency between limits and the return/risk ratio.

- Global limits of local control: on the basis of the local features of products and of the internal organisation of business, sub-limits are set for the aforementioned activities in order to exercise greater control of the positions maintained in each business. Sub-limits are set by risk factor, currency positions, equity positions, sensitivity by currencies and maturities, vega by maturities, etc.

### 7.4.2.3. Compliance and control of limits

Business units must comply with the approved limits. The possible excesses trigger a series of actions by the local and global market risk areas, risk management committees or the Risk Committee in order to reduce the risk levels and control them more strictly or executive actions, which can make the risk takers reduce the risks levels assumed.

The local executives for market risk notify the excesses to the business executives. These have to explain the reasons for the excess and, where appropriate, provide the plan of action to correct the situation. The business executive must respond, in writing and on the day, to the requirement made. The alternatives are to reduce the position to the prevailing limits or set out the strategy that justifies an increase in the limits.

If the excess situation continues without a response by the business unit for three days, the market risks area contacts the relevant global business executives and informs them of this, and requests adjustment measures be taken. If this situation persists 10 days after the first excess, the market risks area will contact senior risk management so that a decision can be taken.

## 7.5. Internal model

Grupo Santander had, at the end of 2013, 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, Mexico and Portugal. The Group's objective is to gradually increase approval to the rest of units.

The regulatory capital consolidated by the internal model of market risks for Grupo Santander is obtained by adding the regulatory capital of each of the units for which there is the corresponding Bank of Spain approval. A conservative criterion is used for consolidating the Group's capital, as it does not take into account the savings in capital derived from the diversification impact among various countries.

As a result of this approval, the regulatory capital of trading activity for the commented perimeter is calculated via advanced methods, using VaR as the fundamental metric, the stressed VaR and the incremental risk charge (IRC), in line with the new capital requirements demanded by the Basel agreements and, specifically in the European directive CRD-IV (transposition of the Basel III agreements).

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.

# 8. LIQUIDITY RISK AND FUNDING

## 8.0 Organisation of this chapter

Following an introduction to the liquidity risk concept and funding in Grupo Santander, we present the liquidity management framework set by the Group, including monitoring and control of liquidity risk (pages 235-239).

We then look at the funding strategy for the Group and its subsidiaries over the last five years (pages 239-242), with particular attention to the liquidity evolution in 2013. The evolution of the liquidity management ratios in 2013 and business and market trends that gave rise to it are shown on pages 242-246.

The section ends with a qualitative description of the prospects for funding in 2014 for the Group and its main countries (page 246).

## 8.1 Introduction to the treatment of liquidity risk and funding

- Santander developed a funding model based on autonomous subsidiaries responsible for covering their own liquidity needs.
- This structure makes it possible for Santander to take advantage of its retail banking business model in order to maintain comfortable liquidity positions at Group level and in its main units, even during stress in the markets.
- In the last few years, as a result of the tensions arising from the global economic and financial crisis, it has been necessary to adapt the funding strategies to the new commercial business trends and the markets' conditions.
- In 2013, the Group exploited the capacity to generate and attract liquidity by some of the businesses and units in order to keep on strengthening its liquidity position and that of its subsidiaries. All of this enables the Group to tackle 2014 from a good starting point, without growth restrictions.

Liquidity management and funding have always been basic elements in Banco Santander's business strategy and a fundamental pillar, together with capital, in supporting its balance sheet strength.

Liquidity has recovered its importance in the last few years because of tensions in financial markets against the backdrop of a global economic crisis. This scenario has enhanced the importance for banks of having appropriate funding structures and strategies to ensure its intermediation activity.

During this period of stress, Santander has enjoyed an appropriate liquidity position, higher than that of its peers, which has given it a competitive advantage to develop and expand its activity in a demanding environment.

This better position for the whole Group has been supported by a decentralised funding model consisting of autonomous subsidiaries and self-sufficient in liquidity. Each subsidiary is responsible for covering the liquidity needs of its current and future activity, either through deposits captured from its customers in its area of influence or through recourse to the wholesale markets in which it operates, within a framework of management and supervision coordinated at the Group level.

The funding structure is one that shows its greatest effectiveness in situations of high levels of market stress as it prevents the difficulties of one area from affecting the funding capacity of other areas and thus of the Group as a whole, as could happen in the case of a centralized funding model.

Moreover, at Grupo Santander this funding structure benefits from the advantages of a retail banking model with a significant presence (market shares of around 10% or more) in 10 high potential markets and focused on retail clients and high efficiency. All of this gives our subsidiaries a big capacity to attract stable deposits, as well as a strong issuance capacity in the wholesale markets of these countries, generally in their own currency, and backed by the strength of their franchise and belonging to a leading group.

Santander's management of funding and liquidity risk, both theoretical as well as practical, is set out in the following sections:

- Liquidity management framework – monitoring and control of liquidity risk.
- Funding strategy and evolution of liquidity in 2013.
- Funding outlook for 2014.

## 8.2 Liquidity management framework - monitoring and control of liquidity risk

Management of structural liquidity aims to fund the Group's recurring activity in optimum conditions of maturity and cost, avoiding the assumption of undesired liquidity risks.

Santander's liquidity management is based on the following principles:

- **Decentralized liquidity model.**
- **Needs derived from medium and long term activity must be financed by medium and long term instruments.**
- **High contribution from customer deposits,** derived from the retail nature of the balance sheet.
- **Diversification of wholesale funding sources** by instruments/investors, markets/currencies and terms.
- **Limited recourse to short-term funding.**
- **Availability of sufficient liquidity reserve,** which includes the discount capacity in central banks to be used in adverse situations.

The effective application of these principles by all the institutions that comprise the Group required development of a unique **management framework** built around three essential pillars:

- A solid organizational and governance model that ensures the involvement of the senior management of subsidiaries in decision-taking and its integration into the Group's global strategy.
- Deep balance sheet analysis and measurement of liquidity risk, which supports decision-taking and its control.
- Management adapted in practice to the liquidity needs of each business.

### 8.2.1. Organisational model and governance

The decision-taking process regarding structural risks, including liquidity risk, is carried out by local asset and liability committees (ALCO) in coordination with the markets' committee.

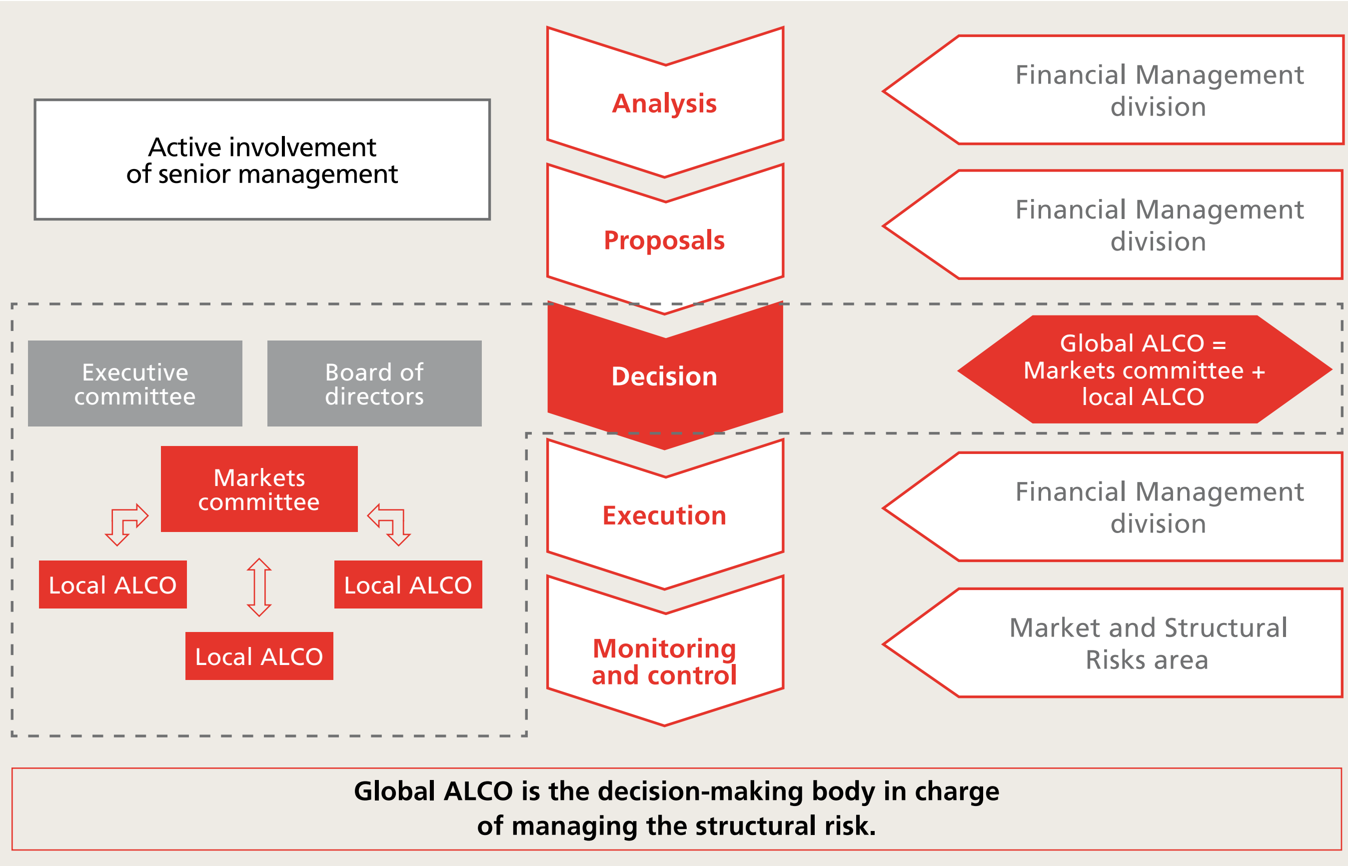
The markets' committee is the main body at Group level, which coordinates and supervises all the global decisions that influence measurement, management and control of liquidity risk. It is headed by the chairman of the Bank and comprises the 2nd vice-chairman (who is, in turn, the chairman of the delegated risk committee), the chief executive officer, the chief financial officer, the senior vice-chairman for risk and certain executives responsible for the business and analysis units.

In line with these principles, the local ALCO committees set the strategies that ensure and/or anticipate the funding needs of their business. They are supported by the Financial Management and Market Risks areas, which present analysis and proposals, and control compliance with the limits set.

In line with the best governance practices, 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).

GRUPO SANTANDER GOVERNANCE: LIQUIDUTY RISK AND FUNDING

Structure of decision-taking and functions




This governance model has been strengthened by being integrated within a more global view of the Group's risks (Santander's risk appetite framework), which responds to the demand of regulators and market players emanating from the financial crisis to strengthen risk management and control systems.

As regards the liquidity risk profile and appetite, the Group's strategy for developing its businesses aims to structure the balance sheet in the most resistant way possible to potential liquidity tension scenarios. Liquidity appetite metrics are articulated by applying at the individual level the principles of the Group's liquidity management model, with specific levels for the ratio of structural funding and minimum liquidity horizons under various tension scenarios, as set out below.

### 8.2.2. Balance sheet management and measurement of liquidity risk

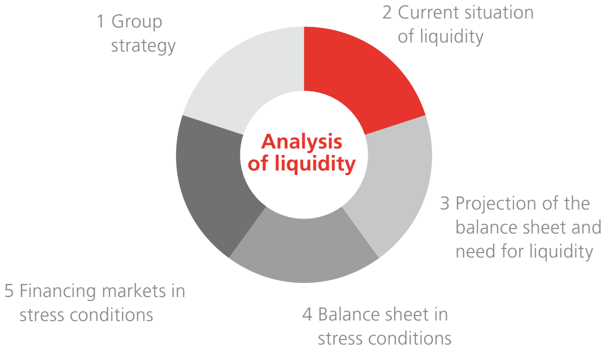
Decision-making on financing and liquidity is based on a deep understanding of the Group's current situation (environment, strategy, balance sheet and state of liquidity), of future liquidity needs generated from businesses (projection of liquidity), as well as from access to and current situation of funding 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 with stable funding sources, 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.

At the same time, various tests are also conducted taking into account the additional needs that could arise from various extreme, unlikely but possible, events. These could affect the various items of the balance sheet and/or funding sources differently (degree of renewal of wholesale funding, deposit outflows, deterioration in the value of liquid assets, etc.), whether for global market reasons or specific ones of the Group.

## ANALYSIS OF THE BALANCE SHEET AND MEASUREMENT OF LIQUIDITY RISK




The inputs for drawing up the various contingency plans for the Group are obtained from the results of the analysis of balance sheets, forecasts and scenarios which, in turn, enable a whole spectrum of potential adverse circumstances to be anticipated.

All these actions are in line with the practices being fostered by the Basel Committee in order to strengthen the liquidity of banks, whose objective is to define a framework of principles and metrics that, in some cases, is still under observation and, in others, being developed.

Greater detail on the measures, metrics and analysis used by the Group and its subsidiaries to manage and control liquidity risk is set out below:

**Methodology for monitoring and controlling liquidity risk**

The objectives of the Group's liquidity risk measures are:

- **To achieve greater efficiency** in measuring and controlling liquidity risk.
- **To support financial management,** for which the measures are adapted to the form of managing the Group's liquidity.
- **Alignment with BIS III** to avoid "conflicts" between the various limits and facilitate their management.
- **Be an early warning system,** anticipating potential risk situations by monitoring certain indicators.
- **Attain the involvement of countries.** The metrics are developed on the basis of common and homogeneous concepts that affect liquidity, but the analysis and adaptation of each unit is needed.

There are two types of basic metrics used to control liquidity risk: short term and structural. The first category basically includes the liquidity gap and the second one the balance sheet's net structural position. As an additional element, the Group develops various stress scenarios. These three metrics are as follows:

### a) Liquidity gap

The liquidity gap provides information on the potential contractual and estimated (by hypothesis) cash inflows and outflows for a certain period of time, for each of the currencies in which the Group operates.

The gap provides information on the sources and uses of funds expected in specific time periods, in relation to the total on-and off-balance sheet items. This analysis tool is obtained from the net of the structure of maturities and flows for each period established. The liquidity available is contrasted with the needs arising from maturities.

In practice, and given the different performances of a same item in the Group's subsidiaries, there are common standards and methodologies to homogenize the building of liquidity risk profiles for each unit as well as be presented in a comparable way to the Bank's senior management.

As a result, and given that this analysis must be done at the individual level of each subsidiary by its autonomous management, a consolidated view of the liquidity gaps is of very limited use for managing and understanding liquidity risk.

Of note in the various analysis made using the liquidity gap is that for **wholesale funding.** On the basis of this analysis a **metric** has been defined whose objective is to guarantee that sufficient liquid assets are maintained in order to attain a minimum **liquidity horizon,** in a scenario in which wholesale funding is not renewed at its maturity. This minimum horizon at Santander is 90 days.

The minimum liquidity horizons are determined in a corporate and homogeneous way for all units/countries, which must calculate their wholesale liquidity metric in the main currencies in which they operate.

Bearing in mind the market tensions in the last few years, this wholesale liquidity gap is closely monitored in the parent bank and in the euro zone units.

**At the end of 2013,** all units were in a comfortable position in the horizons established for this scenario.

### b) Net structural position

The objective of this metric is to determine the reasonability of the financing structure of the balance sheet. The Group's criterion is to ensure that the structural needs (lending, fixed assets, etc.) are covered by an adequate combination of wholesale sources and a stable base of retail deposits.

Each unit draws up its liquidity balance sheet in accordance with the features of their businesses and compare them with the various funding sources they have. The main factors taken into account when determining this metric are the recurrence of the businesses to be financed, the stability of funding sources and the capacity of assets to become liquid.

In practice, each subsidiary draws up its liquidity balance sheet (different from the accounting one) by classifying the various asset and liability items and off-balance sheet ones on the basis of their type for the purposes of liquidity. This determines the financing structure that must be met at all times with a key premise: basic businesses must be financed with stable funds and medium-and long-term funding. All of this guarantees the Bank's sound financial structure and the sustainability of business plans.

**At the end of 2013,** the Group had a structural liquidity surplus of around EUR 150,000 million (16% of net liabilities), a level that compares very favourably with those at the beginning of the crisis (EUR 33,000 million and 4% of net liabilities in December 2008), following improvements in recent years.

#### c) Analysis of scenarios

As an additional element to the metrics, the Group develops various stress scenarios. The main objective is to identify the critical aspects in each potential crisis and define the most appropriate management measures to tackle each of these situations.

Generally speaking the units take into account three scenarios in their liquidity analysis: systemic, idiosyncratic and hybrid, which, given the Group's characteristics, have been adapted to take into account a local systemic crisis and a global one. These scenarios represent the minimum standard analysis established for all the Group's units and which are provided to senior management. Each of the units also develops ad hoc scenarios that replicate significant historic crises or specific liquidity risks of their environment.

The main features of the three basic scenarios are:

- An idiosyncratic crisis only affects the Bank but not its environment. This is basically reflected in wholesale funds and in retail deposits, with various percentages of outflows depending on the severity defined.

  Within this category a specific crisis scenario that a local unit could suffer as a result of a crisis in the parent bank (Banco Santander) is studied. This scenario was particularly relevant in 2013 because of tensions suffered by countries on the periphery of the euro zone.

- A systemic crisis is an attack by the international financial markets on the country where the local unit is located. Each unit would be affected to varying degrees, depending on its relative position in the local market and the image of soundness it has. Among other factors which would be affected in this scenario are, for example, the wholesale funding lines from the closure of markets or the liquid assets linked to the country that would be significantly reduced.

- Hybrid crisis. In this scenario some of the factors mentioned in the scenarios above are stressed. Particular attention is paid to the most sensitive aspects from the standpoint of the unit's liquidity risk.

These metrics and scenarios are directly linked to the process of drawing up and executing the contingency plan by the financial management area.

**At the end of 2013,** and in a scenario of a potential systemic crisis affecting the wholesale funding of units in Spain, Grupo Santander had an appropriate liquidity position[35]. The wholesale liquidity metric horizon in Spain (included within the liquidity gap measures) showed levels of more than 90 days during which the liquidity reserve would cover all the maturities of wholesale funding, in the event of not being renewed.

As well as these three metrics a series of internal and market variables was defined as **early warning indicators of possible crises**, which can also state their nature and severity. Their integration in daily liquidity management enables situations that could affect the Group's liquidity risk to be anticipated. Although these alerts vary from country to country and from bank to bank on the basis of specific determinants, some of the parameters used are common in the Group, such as Banco Santander's level of CDS, the evolution of deposits from customers and the official interest rate trend of central banks.

### 8.2.3. Management adapted to business needs

As already pointed out, Grupo Santander's liquidity management is carried out at the level of subsidiaries and/or business units in order to finance their recurring activities in appropriate maturities and prices. The main balance sheet items related to business and financing of the Group's largest business units are as follows:

35. Spain was the market with the greatest Group presence subject to the strongest tensions during 2012, and more so in 2013.

**MAIN UNITS AND BALANCE SHEET ITEMS**
December 2013. Billion euros

| | Total assets | Net loans | Deposits* | M/LT funding** |
|---|---|---|---|---|
| Spain | 280.5 | 159.8 | 184.7 | 67.9 |
| Portugal | 41.8 | 24.5 | 24.2 | 2.1 |
| SCF | 70.4 | 56.0 | 30.9 | 10.2 |
| Poland | 25.1 | 16.2 | 18.5 | 0.5 |
| UK | 323.7 | 231.0 | 187.5 | 66.6 |
| Brazil | 133.9 | 66.4 | 61.5 | 20.4 |
| Mexico | 48.4 | 22.3 | 24.7 | 1.6 |
| Chile | 38.6 | 28.8 | 21.0 | 6.8 |
| Argentina | 7.9 | 5.1 | 5.9 | 0.0 |
| US | 54.6 | 37.7 | 35.5 | 8.4 |
| **Group total** | **1,115.5** | **668.9** | **611.4** | **184.5** |

* Including retail commercial paper in Spain.
** M/LT issues in markets, securitisations and other collateralised funding in the market and funds taken from FHLB lines. All in their nominal value.

In practice, and in line with the financing principles set out, liquidity management in these units consists of:

- Drawing up every year a liquidity plan based on the funding needs derived from the budgets of each business and the methodology already described. On the basis of these liquidity needs and taking into account prudent limits of recourse to short-term markets, the Financial Management area establishes an issuance and securitisation plan for the year for each subsidiary/global business.

- Monitor during the year the evolution of the balance sheet and of the funding needs of the subsidiaries/ businesses, which gives rise to updating the plan.

- Maintain an active presence in a large number of wholesale funding markets that enables an appropriate structure of issues to be sustained, diversified by products and with an average conservative maturity.

The effectiveness of this management is based on implementation in all subsidiaries. Each subsidiary budgets the liquidity needs based on their activity of intermediation and assesses its capacity of recourse to wholesale markets in order to establish an issuance and securitisation plan, in coordination with the Group.

Traditionally, the Group's main subsidiaries have been self-sufficient as regards their structural financing. The exception is Santander Consumer Finance (SCF) which needs the support of other Group units, particularly that of the parent bank, given its nature as a consumer finance specialist operating mainly via dealers.

This support, always done at the market price on the basis of the maturity and internal rating of the borrowing unit, has been reduced considerably in the last few years (from EUR 15,000 million in 2009 to around EUR 5,000 million in 2012), backed by a self-financing process that has entailed developing internal structures and opening new markets. This constitutes a good example of the subsidiaries managing and developing autonomous sources of liquidity.

The issuance and securitisation effort in 2013 by SCF's Continental European units enabled this process to be completed, ending the fourth quarter with a net recourse to the parent bank of virtually zero. The area more than doubled the volume obtained through medium and long term issues, securitisations and structured financings, exceeding the EUR 6,000 million captured in eight of the 12 countries in which it operates.

## 8.3. Funding strategy and evolution of liquidity in 2013

### 8.3.1. Funding strategy

Santander's financing activity over the last few years has achieved its objective of adequately funding the Group's recurring activity in a very demanding environment characterized by a greater perception of risk, scant liquidity in certain maturities and its higher cost.

This good performance was supported by extending the management model to all the Group's subsidiaries, including the new incorporations, and, above all, adapting the subsidiaries' strategy to the increasing requirements of markets. These requirements have not been the same for all markets and have attained much higher levels of difficulty and pressure in some areas, such as on the periphery of Europe.

It is possible, however, to extract a series of **general trends** implemented by Santander's subsidiaries in their financing and liquidity management strategies in the **last five years.** They are the following:

- **Strong liquidity generation from commercial business due to lower growth in lending and greater emphasis on capturing funds from customers.**

  The evolution of the Group's lending is the result of combining sharp falls in the units in Spain and Portugal, due to the strong deleveraging of these economies, with growth in other countries, either through the expansion of units and businesses under construction (United States, Germany, Poland, UK companies), or through sustained growth in emerging countries (Latin America). Overall, since December 2008, lending excluding repos has increased by EUR 47,000 million (+7%).

At the same time, the focus on liquidity during the crisis together with the Group's capacity to attract retail deposits via branches, made possible a rise in customer deposits (excluding repos and including retail commercial paper) of more than EUR 190,000 million. This was around 50% above the December 2008 balance and four times the rise in lending during this period. All the commercial units boosted their deposits, both the units in countries undergoing deleveraging as well as those in growth areas where they matched their evolution to that of loans.

This liquidity generation was particularly intense in Spain. The reduction in private sector indebtedness during the crisis and the strong capturing of deposits in an environment of savers seeking security resulted in turning a surplus of loans over deposits in 2008 into the current surplus of deposits. This was made possible by generating around EUR 100,000 million of liquidity in five years.

- **Maintaining adequate and stable levels of medium and long term wholesale funding at the Group level.** This funding represented 20% of the balance of liquidity at the end of 2013, very similar to the 21% in 2010 but significantly below the 28% in December 2008, when wholesale liquidity was an abundant recourse and at a reduced cost globally.

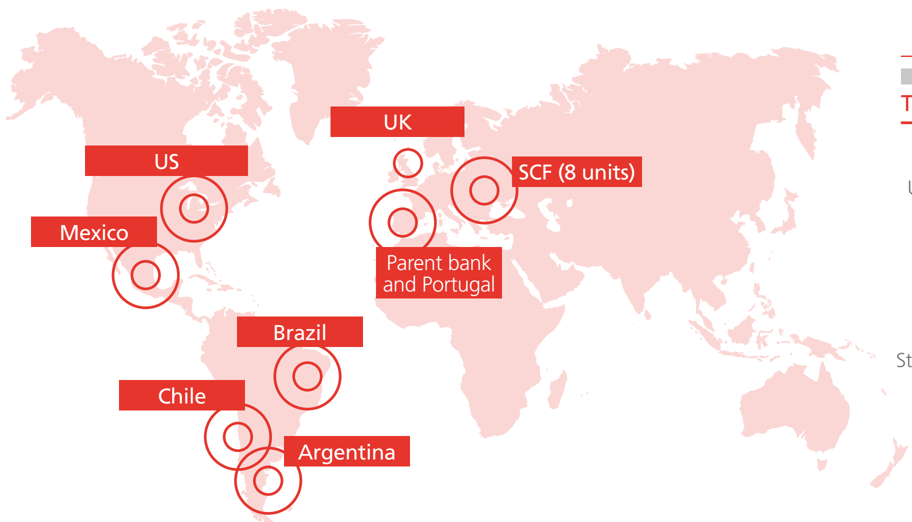
Following the tightening of conditions in wholesale markets, the Group's decentralised model of subsidiaries, with its own issuance programmes and ratings, helped to maintain Santander's strong participation in developed wholesale markets, even in the most demanding periods such as 2011-2012.

Of note in this period was the United Kingdom's issuance capacity, the re-launch of the activity of large Latin American countries and the incorporation of new units to the pool of the Group's important issues, both in the United States (issues from its holding and securitisations of the specialised consumer unit) as well as in Europe. In this continent, Santander Consumer Finance extended its securitisation activity to new markets such as Finland, Sweden, Norway and Denmark, converting its units into pioneers of auto finance securitisation and laying the foundations of its self-financing.

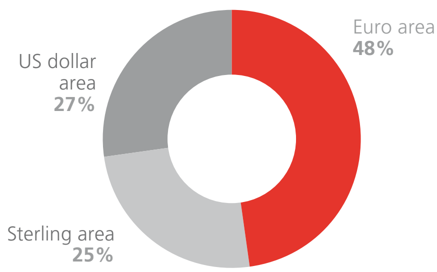
In general, this wholesale activity has been modulated in each unit on the basis of the requirements of regulation, the generation of internal funds of business and decisions to ensure sufficient liquidity reserves, A good example is Spain where, despite the strong generation of liquidity from the aforementioned business, the Group has implemented a conservative issuance policy. Over the last three years, the tensest of the crisis, Santander has issued close to EUR 40,000 million of medium- and long-term debt, backed by the strength of the Santander brand and its high credit quality.

## COMFORTABLE ACCESS TO WHOLESALE MARKETS THROUGH AUTONOMOUS SUBSIDIARIES, WITH OWN ISSUANCE PROGRAMMES AND RATINGS

Main issuing units




### M/L TERM FUNDING CAPTURED IN THE MARKET IN 2013*




*Including issues, securitisations and structured financing.

- **Ensure a sufficient volume of assets that can be discounted in central banks and other public institutions** as part of the liquidity reserve (as defined on page 245 of this section) to cater for stress situations in wholesale markets.

  The Group increased its total discounting capacity in the last few years to around EUR 145,000 million (close to EUR 85,000 million at the end of 2008). This volume at the end of 2013 was the equivalent of two and a half times the commercial gap (i.e. the difference between net loans and deposits), as a result of the aforementioned business dynamics which continued to reduce this gap.

  The growth in the volume that can be discounted is due to a continuous strategy developed by the subsidiaries to generate assets eligible for discount in order to compensate for the reduction in the value of guarantees, as a result of the downgrading of ratings in this period, particularly of sovereign debt and related assets[36]. A large part of this total discounting was generated by units in the euro zone following the extraordinary monetary policy measures implemented by the European Central Bank (ECB) at the end of 2011 and the beginning of 2012 (basically, increased collaterals and three-year liquidity auctions) to ensure the area's liquidity buffer.

  During 2012, and faced with the tensions in the euro markets, Santander pursued a prudent strategy of depositing in the central banks included in the Eurosystem most of the funds raised from them in the three-year auctions, as an immediate liquidity reserve, while maintaining a very limited global net position. **The reduction in tensions enabled the Group in 2013 to return to the ECB all the funds borrowed from Spain in the three-year auctions. Net recourse at the end of the year was at a five-year low, mainly concentrated in Portugal.**

All these developments, made on the foundations of a solid liquidity management model, enabled Santander to enjoy a very robust **funding structure**. The **basic features** of this structure are:

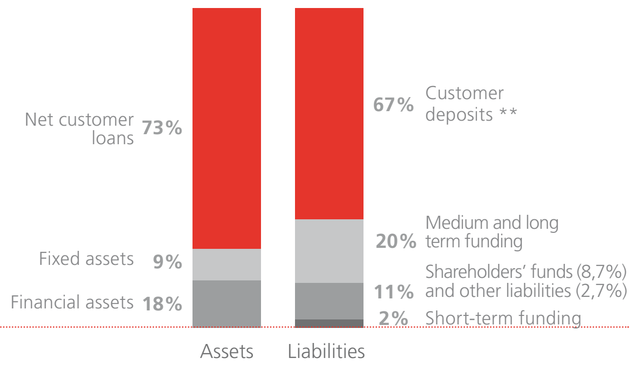
- **High relative share of customer deposits in an essentially retail banking balance sheet.**

  Customer deposits are the main source of the Group's financing. Including retail commercial paper (given its role as replacing time deposits in Spain), they accounted for around two-thirds of the Group's net funding (i.e. of the balance of liquidity) and 91% of net loans at the end of 2013.

  They are also very stable funds given their origin of mainly business with retail customers (88% of the Group's deposits come from retail banks and the remaining 12% corresponding to large corporate and institutional clients).

GRUPO SANTANDER LIQUIDITY BALANCE SHEET, 2013 YEAR-END*

%




* Balance sheet for the purposes of liquidity management: total balance sheet net of trading derivatives and interbank balances.

** Including retail commercial paper in Spain.

- **Diversified wholesale funding focused on the medium and long term and with a very small relative share of short term.**

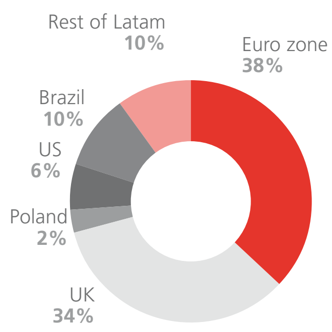
  Medium and long term funding accounts for 20% of the Group's funding and comfortably covers the rest of lending not financed by customer deposits (commercial gap).

  This funding is well balanced by instruments (approximately 1/3 senior debt, 1/3 covered bonds, 1/3 securitisations and the rest) and also by markets so that those with the highest shares in issues are those where investor activity is the strongest.

  The charts showing the geographic distribution of loans and of medium and long term funding are shown below so that their similarity can be appreciated.

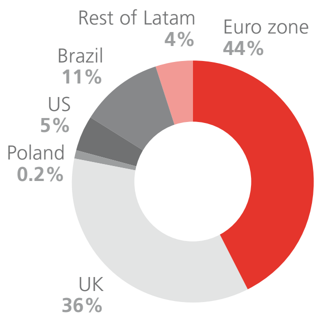
GROSS LOANS

December 2013




M/LT WHOLESALE FUNDING

December 2013




The bulk of medium and long term wholesale funding consists of debt issues. Their outstanding balance at the end of 2013 was EUR 132,789 million nominal, with an adequate profile of maturities (average maturity of 3.7 years), without concentrations.

36. The Kingdom of Spain debt rating was cut from AAA to BBB- between June 2010 and June 2012.

Its recent evolution reflects the lower liquidity need by businesses which made it unnecessary to renew all maturities. Another factor was the impact of exchange rates which in 2013 accounted for around one-quarter of the decline in volumes.

The distribution by instruments, the evolution over the last three years and their maturity profile were as follows:

### MEDIUM AND LONG TERM DEBT ISSUES, GRUPO SANTANDER

Million euros

| | Evolution of outstanding balances in nominal value | | |
|---|---|---|---|
| | December 2013 | December 2012 | December 2011 |
| Preferred shares | 4,376 | 4,765 | 5,657 |
| Subordinated debt | 10,030 | 11,004 | 14,184 |
| Senior debt | 60,195 | 69,916 | 73,693 |
| Covered bonds | 58,188 | 67,468 | 68,240 |
| **Total*** | **132,789** | **153,152** | **161,774** |

| | Distribution by maturity, December 2013* | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 0-1 months | 1-3 months | 3-6 months | 6-9 months | 9-12 months | 12-24 months | 2-5 years | Over 5 years | Total |
| Preferred shares | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 4,376 | 4,376 |
| Subordinated debt | 0 | 0 | 0 | 0 | 183 | 142 | 4,130 | 5,576 | 10,030 |
| Senior debt | 882 | 5,649 | 5,332 | 4,451 | 5,057 | 15,907 | 17,055 | 5,862 | 60,195 |
| Covered bonds | 2 | 4,487 | 1,807 | 2,951 | 874 | 13,932 | 20,003 | 14,131 | 58,188 |
| **Total*** | **884** | **10,136** | **7,139** | **7,403** | **6,114** | **29,981** | **41,188** | **29,945** | **132,789** |

* In the case of issues with put option in favour of the holder, the maturity of the put option will be considered instead of the contractual maturity.
Note: the entire senior debt issued by the Group's subsidiaries does not have additional guarantees.

As well as debt issues, the medium and long term wholesale funding is completed by lines from the Federal Home Loan Banks in the US (EUR 6,500 million at the end of 2013) and by funds obtained from securitisation activities. The latter includes securitisation bonds placed in the market, collateralised financing and other special ones for a total amount of close to EUR 45,000 million and an average maturity of around two years.

**The wholesale funding of short-term issuance programmes** is a marginal part of the structure as it accounts for less than 2% of financing (excluding the aforementioned retail commercial paper) and is well covered by liquid financial assets.

The outstanding balance at the end of 2013 was around EUR 15,000 million, mainly captured by the UK unit and the parent bank through existing issuance programmes: various programmes of CDs and commercial paper of the UK (54%); European commercial paper and US commercial paper and domestic programmes of the parent bank (22%), and from other units (24%).

In short, Santander enjoys **a very solid financing structure** based on an essentially retail banking balance sheet that enables the Group to cover comfortably its structural liquidity needs (loans and fixed assets) with permanent structural funds (deposits, medium and long term funding and equity), which generates a large surplus of structural liquidity.

## 8.3.2. Evolution of liquidity in 2013

The key aspects of liquidity in 2013 were:

- Further improvement in liquidity ratios, backed by the generation of liquidity in businesses (EUR 23,500 million), which is added to more selective issuance activity (EUR 28,800 million of medium and long term issues and securitisations).

- At the end of 2013, LCR levels of more than 100%, both at the level of the Group and its subsidiaries compared to a minimum requirement of 60% as of 2015.

- Strengthened position with a high liquidity reserve (EUR 199,750 million), which reflects the return by the parent bank of all the balances available in the European Central Bank.

- Reduced weight of encumbered assets in medium and long term wholesale funding operations (around 14% of the Group's balance sheet at the end of 2013).

From the funding standpoint, 2013 was more relaxed in the markets than in previous years. The gradual recovery of developed economies, the firm monetary stimulus of the main central banks (large injections of liquidity with record low interest rates), and the progress made in European governance that diluted doubts about the euro, led to a sharp fall in sovereign debt risk premiums of periphery countries in the euro zone. Only fears of a sudden change in the Federal Reserve's liquidity injection policy generated one-off tensions in currencies and Latin American markets, which eased when it became clear that the change would be more gradual.

In Europe, this easing made possible more issues in the wholesale markets of large financial and non-financial companies as they benefited from greater investor appetite, particularly for assets of companies and countries on the European periphery subjected to excessive pressure in previous years. At the same time, greater liquidity reduced the competitive pressure on retail deposits in most European markets and enabled their remuneration to be lowered.

In this context Santander maintained its **comfortable liquidity position in 2013 which is reflected in four basic aspects:**

**Further improvement in basic liquidity ratios**
The table shows the evolution in the last few years of the basic metrics for monitoring liquidity at the Group level:

GRUPO SANTANDER MONITORING METRICS

| | 2008 | 2011 | 2012 | 2013 |
|---|---|---|---|---|
| Net loans/net assets* | 79% | 77% | 74% | 73% |
| Net loan-to-deposit ratio | 150% | 117% | 113% | 109% |
| Customer deposits and medium and long term funding/net loans | 104% | 113% | 118% | 119% |
| Short term wholesale funding/ net liabilities* | 7% | 2% | 2% | 2% |
| Structural liquidity surplus (% / net liabilities*) | 4% | 13% | 16% | 16% |

* Balance sheet for liquidity management purposes.
Note: in 2011, 2012 and 2013 customer deposits include retail commercial paper in Spain (excluding from short-term wholesale funding).

At the end of 2013, and compared to 2012, Grupo Santander registered:

- A slight fall in the ratio of loans/net assets (total assets less trading derivatives and interbank balances) to 73% due to the decline in lending in a deleveraging environment in mature markets. The ratio reflects the retail nature of Santander's balance sheet.

- An improvement in the net loan-to-deposit ratio (LTD) to 109% (including retail commercial paper) from 113% in 2012. This continued the downward trend started in 2008 (150%), the result of the ability to generate liquidity and to attract retail deposits throughout the Group's units.

- The ratio customer deposits and medium and long term financing/lending also improved, combining the improvement in liquidity from business management with the issuance capacity to capture wholesale funds of the Group's units. The ratio was 119% (118% in 2012), well above 104% in 2008.

- At the same time, recourse to short-term wholesale funding remained low, at below 2%, in line with previous years.

- Lastly, the Group's structural surplus (i.e., the excess of structural funding resources - deposits, medium and long term funding and capital - over structural liquidity needs - fixed assets and loans -) stood at EUR 150,000 million at the end of 2013. This covered 16% of the Group's net liabilities, similar to 2012.

This improvement in the Group's liquidity position in 2013 is the result of the evolution of several subsidiaries. Of note were the improvements in the United Kingdom, Spain and Portugal, reflected in both the LTD as well as in deposits and medium and long term funding over net loans. Spain and Portugal ended 2013 with LTD ratios of 87% and 101%, respectively, which improved the Group's average significantly after widening their advantage during the year.

The table below sets out the most frequently used liquidity ratios for Santander's main units at the end of 2013:

### LIQUIDITY RATIOS FOR THE MAIN UNITS
December 2013. Percentages

| | Net loan-to-deposit ratio | Deposits+M & LT funding/net loans |
|---|---|---|
| Spain | 87% | 158% |
| Portugal | 101% | 108% |
| Santander Consumer Finance | 181% | 73% |
| Poland | 88% | 117% |
| UK | 123% | 110% |
| Brazil | 108% | 123% |
| Mexico | 90% | 118% |
| Chile | 137% | 96% |
| Argentina | 87% | 116% |
| US | 106% | 116% |
| **Total Group** | **109%** | **119%** |

Note. In Spain, including retail commercial paper in deposits.

Generally speaking, there were two main **drivers** in 2013 behind the improvements at Group level and its subsidiaries in the liquidity position:

1. A further reduction in the Group's commercial gap due to the decline in the gap in mature markets combined with balanced growth in business in emerging markets.

2. More selective issuance activity, with lower recourse to wholesale markets due to the comfortable liquidity position reached by the Group and its subsidiaries.

As regards the first driver, the Group reduced the gap between net loans and deposits by EUR 23,500 million. This liquidity was entirely generated by the decline in lending in mature markets, in line with the deleveraging of their economies. At the same time, the evolution of their deposits reflected a management focus of lowering their cost after the effort made in 2012 to capture funds. This management is reflected in outflows of expensive deposits and in the shift of balances to mutual funds. This focus benefited from the better situation of markets and less competition for retail savings.

In mature countries, these trends were sharper in the units in Spain and Portugal, affected by economies in recession.

In the Latin American units, balanced growth of loans and deposits produced a small rise in commercial gaps, amply covered by the good liquidity starting point and the increasing capacity of access to markets.

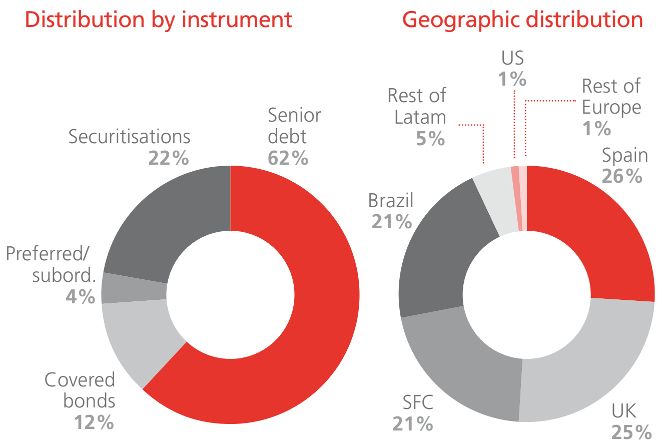
The second driver is the result of the liquidity generated by business in 2013 which, together with the position attained in previous years, reduced significantly the need to capture funds in wholesale markets. In 2013, the Group captured EUR 28,800 million in the medium and long term wholesale markets, 33% less than in 2012.

By type of instrument, medium and long term fixed income issues (senior debt, covered bonds and subordinated debt) amounted to EUR 22,500 million, with a greater share of senior debt than covered bonds. Spain was the largest issuer followed by the UK and Brazil. The three countries accounted for more than 80% of the volume issued.
The other EUR 6,300 million related to securitisations, concentrated in the units of Santander Consumer Finance and the UK.

All countries reduced their wholesale capturing of funds, mostly mature markets for the trends already mentioned. Larger declines in Spain and the UK (more than 50%), in the first case due to the surplus of deposits over loans and in the second to lower regulatory requirements in liquidity. Both remained among the Group's most active units in issuance. Among the largest units only Santander Consumer Finance registered a significant increase in capturing funds in relation to its balance sheet: more than EUR 6,100 million, 2.7 times more than in 2012 and more than 10% of its loan portfolio.

The chart below sets out in greater detail their distribution by instruments and geographic areas:

### MEDIUM AND LONG TERM ISSUES AND SECURITISATIONS PLACED IN THE MARKET
January-December 2013




Note: In securitisations, other collateral financing is included.

In short, Grupo Santander maintained comfortable access to the various markets in which it operates, strengthened by the incorporation of new issuance units. It made issues and securitisations in 2013 in 11 currencies, in which 17 issuers from 14 countries participated and with an average maturity of around 3.7 years.

**Compliance with regulatory coefficients**

As regards the regulatory ratios, the Basel Committee in 2013 approved the definitive implementation of the short-term liquidity coverage ratio (LCR), both as regards defining the eligible assets to include in the liquidity buffer, as well as the period for their gradual introduction. Implementation will begin on 1 January 2015, with 60% coverage which will be gradually raised by 10 points a year to 100% in 2019.

At the end of 2013, Grupo Santander and its subsidiaries comfortably met the full requirements of the new LCR ratio as regards its complete application. The Group and the main subsidiaries had LCR levels of more than 100% at the end of 2013, calculated under international criteria.

These levels, in turn, enable full compliance with the short-term liquidity requirements established in the European CRD IV approved in June 2013. The report of these requirements will begin to be required as of 2014 within a period of gradual application similar to that raised by Basel.

As regards the net stable funding ratio, this is undergoing a period of observation and still pending its final definition. At the beginning of 2014, the Basel Committee made adjustments to both the numerator as well as the denominator of the ratio that introduce, in general, a more favourable framework. In the case of retail banks, of note is the better treatment of customer deposits and lower funding requirements for mortgages. Once the definition is closed, the ratio will enter into force in 2018.

**Strengthened position with a high liquidity reserve**
This is the third main aspect reflecting the Group's comfortable liquidity position during 2013.

The liquidity reserve is the total of the highly liquid assets of the Group and its subsidiaries. It serves as a last resort recourse at times of maximum stress in markets, when it is impossible to obtain funding with adequate maturities and prices.

As a result, this reserve includes deposits in central banks and cash, unencumbered sovereign debt, the discounting capacity in central banks, as well as those assets eligible as collateral and undrawn credit lines in official institutions (FHLB, etc.). All of which reinforce the solid liquidity position of the Group and its subsidiaries.

At the end of 2013, Grupo Santander's liquidity reserve amounted to EUR 199,750 million (over 20% of the total Group's external funding). The structure of this volume by type of asset according to the effective value (net of haircuts) was as follows:

LIQUIDITY RESERVE AT 31/12/2013
Effective value (net of haircuts) in million euros

| | 31/12/2013 | Avg. 2013 | 31/12/2012 |
|---|---|---|---|
| Cash and holdings at central banks | 45,091 | 46,829 | 83,908 |
| Unencumbered sovereign debt | 36,382 | 50,244 | 41,929 |
| Undrawn credit lines granted by central banks | 107,520 | 99,479 | 79,115 |
| Assets eligible as collateral and undrawn credit lines | 10,757 | 12,377 | 12,120 |
| **Liquidity reserve** | **199,750** | **208,928** | **217,072** |

Note: the reserve excludes other assets of high liquidity such as listed fixed income and equity portfolios.

The total volume was relatively stable in 2013, although not by components. The main changes reflect the return during the year of funds raised from the European Central Bank (ECB) through the three-year auctions at the end of 2011 and the beginning of 2012, which were basically deposited in the ECB as a liquidity insurance. Their gradual return (totally in the case of the Spain unit) enabled the discounting available in central banks to be increased while reducing the liquidity deposited in them.

As regards subsidiaries and liquidity management units, the main ones have adequate levels of reserve. In terms relative to the total volume of wholesale funding in markets, including short term, all of them covered with their liquidity reserve more than 60% of it, except for Santander Consumer Finance (around 25%).

**Reduced weight of encumbered assets-funding**
Lastly, it is worth mentioning the moderate use of encumbered assets for obtaining medium and long term funding, and its reduction since 2012.

Encumbered assets are those on the balance sheet which have been contributed as collateral or guarantee with respect to some of the Bank's liabilities, mostly in order to obtain funding and thus not available.

In 2013, the Group continued to reduce its volume of encumbered assets as a result of returning to the European Central Bank all the funds borrowed by the parent bank, and the lower use of funding with collateral in units with high reserves of liquidity such as the US and the UK.

Of the Group's total encumbered assets in funding operations, it is necessary to distinguish two groups with very different features:

- One is a group of assets (around 40% of the total), which are mainly public debt securities delivered in very short-term repo operations. Other financial assets are also included in this category such as corporate bonds or bonds of quasi government institutions, as well as reverse repos used with the same purpose.

  Most of these encumbered financial assets are related to repo market activities whose average maturity tends to be less than three months and therefore do not contribute to finance the Group's commercial activity.

The structure is as follows:

**ENCUMBERED FINANCIAL ASSETS IN FUNDING OPERATIONS (REPOS)**

| | December 2013 | |
|---|---|---|
| | Billion euros | Maturity in years |
| Public debt | 87 | 0.1 |
| Other financial assets | 5 | 1.3 |
| **Total encumbered financial assets** | **92** | **0.2** |

Note: assets estimated to obtain the volume of financing with collateral existing at the end of the year, applying the corresponding degree of over collateralisation and haircut of liquidity in each case.

- The second group of encumbered assets (around 60% of the total) relates to loans that have been securitised or contributed as collateral in covered bonds to be sold to wholesale markets. Also included are loans used to generate eligible securities delivered as collateral in central banks' liquidity facilities.

  Unlike the first group, these assets do contribute to the Group's medium and long term funding with average maturities of between two and three years. Their volume at the end of 2013 was around EUR 154,000 million, putting the encumbered "structural" percentage at 14% of the Group's total assets.

  Their structure is as follows:

**ENCUMBERED LOANS IN FUNDING OPERATIONS (MEDIUM AND LONG TERM)**

| | December 2013 | |
|---|---|---|
| | Billion euros | Maturity in years |
| Securitised loans (in the market) | 46 | 2.2 |
| Other loans | 109 | 2.8 |
| **Total encumbered loans** | **154** | **2.6** |

Note: assets estimated to obtain the volume of financing with collateral existing at the end of the year, applying the corresponding degree of over collateralisation and haircut of liquidity in each case.

## 8.4 Funding outlook for 2014

Grupo Santander began 2014 with a comfortable liquidity position and with lower issuance needs in the medium- and long-term, due to the deleveraging process still taking place in developed markets and the more balanced growth in emerging markets.

It does not have any relevant concentration of maturities in the coming quarters, the result of a reduced wholesale funding position in short-term markets and lower maturities of medium and long term issues than a year ago. Also, various dynamics of the business from areas and markets, together with surplus liquidity positions in some units, make it unnecessary to renew all the maturities. Furthermore, the generally more favourable market environment enables issuance with lower spreads and longer maturities, even in countries subjected to strong tensions in the last few years such as the countries on the periphery of Europe.

As a result, the Group has great flexibility in 2014 to develop differentiated strategies in countries and units on the basis of the business needs and opportunities.

Spain will continue to enjoy a very comfortable liquidity position to facilitate business growth: it starts with a surplus of deposits over loans, giving it a very favourable situation in the wholesale markets, and with medium and long term maturities in 2014 which are 30% lower than in 2013. Portugal, benefiting from the enhanced perception of the country, could begin to reduce its recourse to the ECB.

Of note in the rest of units is the continuation of Santander Consumer Finance's strategy in issues and securitisations. It will continue to increase its participation in wholesale European markets, both for unsecured debt as well as securitisations, backed by its business strength and the quality of its assets. Poland, with no maturities of wholesale issues and a surplus of deposits over loans, will focus on maintaining this comfortable situation while also improving the profitability of its deposits.

In the UK, the liquidity surplus accumulated will be used to keep on financing the growth of the unit and part of the maturities of issues, while reinforcing and optimising its deposits base. Deposits in the US will continue to accompany Santander Bank's lending evolution, while its specialised consumer credit unit will continue its intensive recourse to the securitisations' market to finance its strong growth.

Latin America will continue to focus on deposits to finance commercial activities, while strengthening issuance in wholesale markets opened to the Group's large units.

Under this general framework, various of the Group's units took advantage of the good market conditions at the beginning of 2014 to make issues and securitisations at lower spreads. They captured more than EUR 5,000 million in January. Among the most active units were the UK, Santander Consumer Finance (of note, EUR 1,000 million senior debt issue with a maturity of 24 months) and a specialised consumer unit in the US. Also noteworthy was the quality of some issues such as the one made in Chile, underscoring the market's attractiveness for the risk of the Group's units.

# 9. OPERATIONAL RISK

## 9.1 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 Group's objective in control and management of operational risk is to identify, measure/assess, 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 has been giving consideration to opting to use the standard method for calculating regulatory capital by operational risk, envisaged in the BIS II rules. In this respect, the Group began in 2014 a project to evolve towards advanced models (AMA), for which it already has met most of the regulatory requirements. It is important to note that the short-term priority in operational risk management continues to be focused on its mitigation.

The report on Prudential Significance/Pillar III in section 11 includes information on calculating the equity requirements by operational risk.

## 9.2 Corporate governance and organisational model

The organisational model for controlling and managing risks is in line with the Basel guidelines and establishes three lines of defence:

- First line: identification, management and control functions conducted by the business units and supported by the Group. The Group's different corporate areas are in themselves an additional level of control over the execution of the different local units.

- Second line: functions independent of control that ensure that risks are adequately identified and managed by the first lines of defence, within the general frameworks established.

  The Group strengthened the operation risk control function during 2013, creating within the general directorate of risks the non-financial risk control area, supplementary to the control function carried out by the integral risk control and internal validation area (CIVIR).

- Third line: verification functions carried out on a recurring basis by the internal auditing division.

All local areas are responsible for implementation, integration and local adjustment of policies and guidelines established by the corporate area, carried out by the operational risk executives in each of the units.

This operational risk management structure is based on the knowledge and experience of the executives and professionals of the Group's various units. Particular importance is given to the role of local executives.

The two committees for managing and controlling the Group's operational risk are:

- Corporate committee of technological and operational risk, which comprises executives from the various divisions related to management and control of this risk: its objectives are to provide a broad view of operational risk in the Group and establish effective measures and corporate criteria in the areas of management, measurement, monitoring and mitigation of this risk.

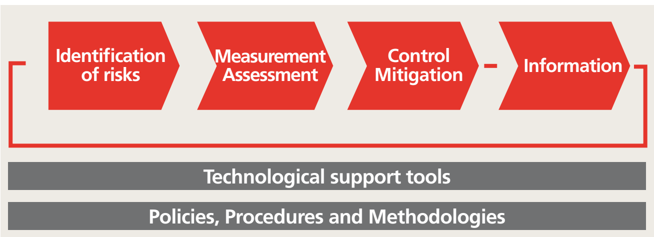
- Corporate committee of the function of controlling technological and operational risk, which meets twice a month. It monitors the corporate area's projects and the Group's exposure to risk. Local executives and those from integral control of risks are also involved.

The Group monitors and controls technological and operational risk through its governance bodies. The board, the executive committee and the Group's management committee regularly include treatment of relevant aspects in management and mitigation of operational risk.

The Group, through approval in the risk committee, also establishes every year operational risk limits. A risk appetite is set which must be situated in low and medium-low profiles, which are defined on the basis of the level of the various ratios. Limits are set by country and for the Group on the basis of the net loss/gross income ratio. In addition, the state of operational risk management in countries, in accordance with internal indicators, is verified.

## 9.3 Risk management model

The Group's operational risk management incorporates the following elements:




The various phases of the technological and operational risk management model are:

- 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, 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 monitored and controlled and integrated into the Group's daily management, taking advantage of existing technology and seeking the maximum automatizing 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

Almost all the Group's units are incorporated to the model and with a high degree of uniformity. However, due to the different pace of implementation, phases, schedules and the historical depth of the respective databases, the degree of progress varies from country to country.

In general, all the Group's units continue to improve all aspects related to operational risk management. This can be seen in the annual review by the internal auditing unit.

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 in the local units.

- Training and interchange of experiences: communication 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 of activities carried out by third parties in order to meet potential critical situations.

- Provide 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.).

The corporate framework for agreements with third parties and control of suppliers, which is applied to all the institutions where Grupo Santander has effective control, was approved in 2013. The framework develops and sets out the principle of operational responsibility and establishes the references to be taken into consideration in agreements with suppliers. The first objective is to establish the principles that regulate the relations of the Group's institutions with themselves, from the beginning to their end, and paying particular attention to:

- The decision to outsource new activities and services.

- The selection of the supplier.

- Establishing the rights and obligations of each of the parties.

- Control of service and regular review of agreements made with suppliers.

- The ending of agreements established.

Meanwhile, this framework also establishes the necessary responsibilities, respecting an adequate segregation of functions, in order to ensure correct identification of risks, control of service and maintaining supervision within the Group.

## 9.4. Measurement model and risk assessment

A series of quantitative and qualitative corporate techniques/tools have been defined to measure and assess technological and operational risk, which are combined to make a diagnosis (on the basis of the risks identified) and obtain an assessment (through measurement/evaluation) of the area/unit.

The quantitative analysis of this risk is carried out mainly with tools that register and quantify the level of losses associated with operational risk events.

- An internal database of events, whose objective is to capture all the Group's losses from operational risk. The capturing of events related to operational risk is not restricted by setting thresholds (i.e. there are no exclusions for reasons of amount) and there are both events with accounting impact (including positive effects) as well as non-accounting ones.

  Accounting conciliation processes have been established that guarantee the quality of the information gathered in the databases. The main events of the Group and of each operational risk unit are particularly documented and reviewed.

- An external database of events, as the Group participates in international consortiums, such as the Operational Risk Exchange (ORX).

- Capital calculation by the standard method (see the corresponding section in the report on Prudential Relevance Report/Pillar III).

The tools defined for qualitative analysis seek to assess aspects (coverage/exposure) linked to risk profile, enabling the environment of existing control to be captured. These tools are mainly:

- Map of processes and risks and self-assessment questionnaires. An adequate evaluation of the risks, on the basis of the expert criterion of the managers, enables a qualitative view of the Group's main focuses of risk to be obtained, regardless of having materialised before.

- Corporate system of operational risk indicators, in continuous evolution and coordination with the internal control area. They are various types of statistics or parameters that provide information on an institution's exposure to risk. These indicators are regularly reviewed in order to alert them to changes that could reveal problems with risk.

- Auditing recommendations. Relevant information provided on inherent risk due to internal and external factors and enabling weaknesses in controls to be identified.

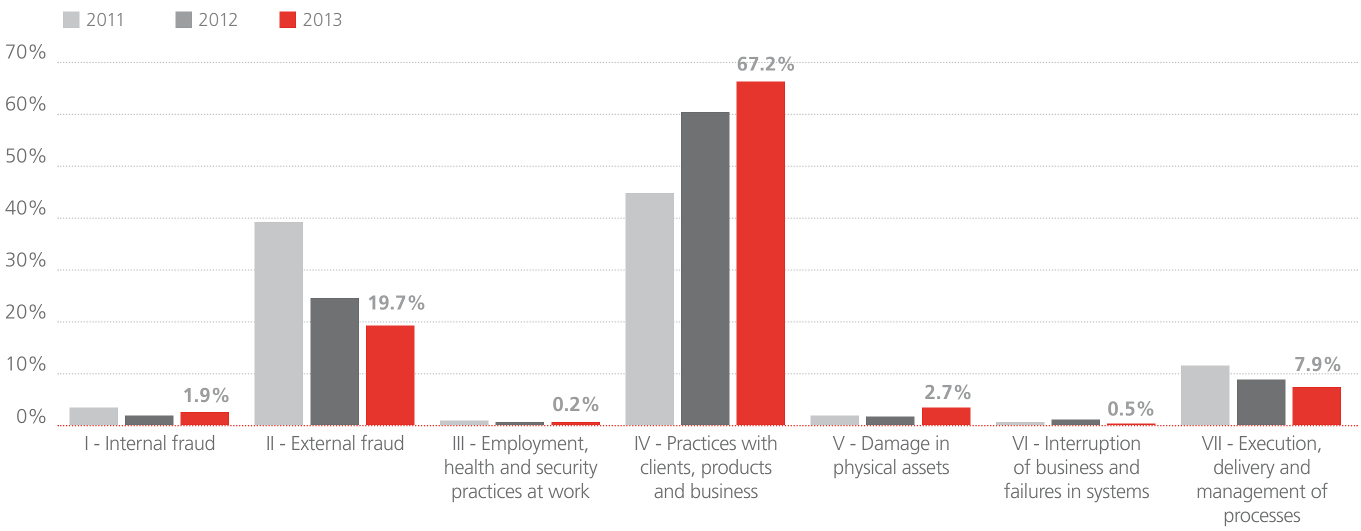
The Group's units in 2013 continued to make progress in exercises of risk self-assessment. This evolution focused on the bases of risks to be evaluated, as well as on incorporating to the methodology the estimated inherent and residual loss and the qualitative VaR according to the map of processes and risks. Experts from the various business and support areas assessed the risks associated with their processes and activities, estimating the average frequency of occurrence of the materialisation of risks as well as the average severity. The exercise also incorporated evaluating the greatest loss, the environment of control and linkage to compliance and reputational risk. The information obtained is analysed locally and corporately and integrated within the strategy of reducing operational risk through measures to mitigate the main risks.

As part of the process of moving toward advanced models (AMA), a corporate methodology of scenarios is being developed in 2014. Such a model has already been developed in the UK unit and is participating in the exercise led by the ORX consortium.

## 9.5. Evolution of the main metrics

As regards the databases of events, and consolidating the total information received, the evolution of net losses by Basel risk category in the last three years is set out below:

**DISTRIBUTION OF NET LOSSES BY OPERATIONAL RISK CATEGORY[37]**
% of total




The evolution of losses by category shows a reduction in relative terms of external fraud and execution, delivery and management of processes thanks to the measures taken for their mitigation.

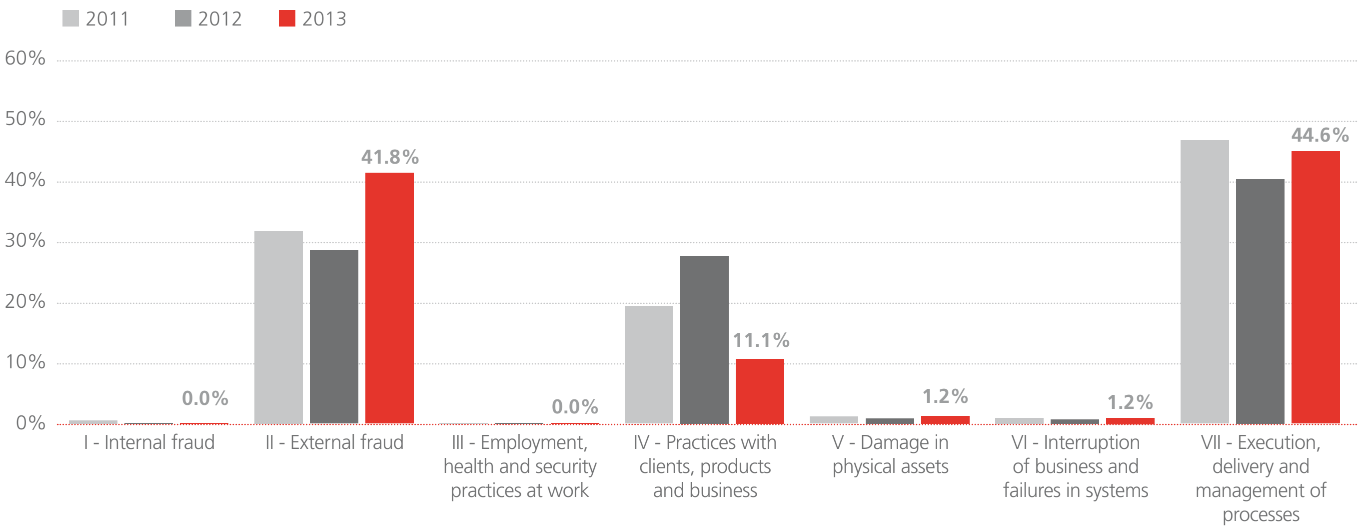
The category of practices with clients, products and business – which includes customer complaints on erroneous marketing, incomplete information and inexact products – increased in relation to the rest of categories. However, despite the increase in the relative share of this category, the net losses were lower than in 2012. Of note among the main elements was the increase in judicial cases in Brazil, as well as compensation for clients in the UK (payment protection insurance). In the latter case, the complaints presented to the Group relate to a general problem in the UK banking sector, and the volume of

37. In accordance with local practice, employee compensation in Brazil is managed as part of the personnel cost without detriment to its treatment according to the categorisation applicable in the Basel operational risk framework, as a result of which it is not included.

complaints against the bank is considered proportionate to its market share. Although these events were sufficiently provisioned in 2011 by the Group, the settlements for these clients was maintained in 2013, in accordance with the planning by the unit.

The chart below sets out the evolution of the number of operational risk events by Basel category over the last three years.

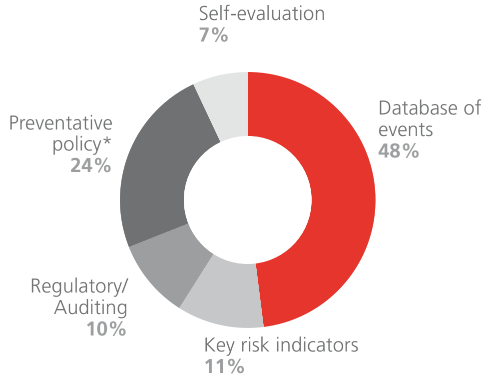
DISTRIBUTION OF NUMBER OF EVENTS BY OPERATIONAL RISK CATEGORY[38]
% of total




## 9.6 Mitigation measures

The Group has a stock of mitigation measures (more than 700 active ones), established in response to the main risk sources. They have been identified by analysing the tools used to manage operational risk, as well as the organisational and development model and by implementing preventive policies and procedures for managing and controlling risk.

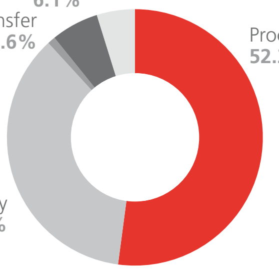
The percentage of measures on the basis of the source and management tool, which identified the risk necessary to mitigate was as follows:




* The preventative policy concept includes measures from the corporate and local committees, the business continuation plan, training for employees and continuous improvement in the controls established.

38. In accordance with local practice, employee compensation in Brazil is managed as part of the personnel cost without detriment to its treatment according to the categorisation applicable in the Basel operational risk framework, as a result of which it is not included.

The measures referred to are turned into action plans which are distributed in the following spheres:




The main mitigation measures centred on improving the security of customers in their usual operations, as well as continued improvements in processes and technology and in management for a sale of products and providing adequate services.

Regarding the reduction of fraud, the main specific measures were:

- **Electronic fraud.** Measures were established at the corporate and local levels, such as:
  - Improvements in the monitoring of customers' operations conducted by electronic banking, mobile phones and telephone banking (teams with specialised staff and intelligence software. These expert systems of scoring enable anomalies to be detected in the movements of customers and warn them of suspicious operations.
  - Increased security in confirming customers' operations using strong procedures for the signature of operations. These measures are locally implemented in the Group's various countries such as the OTP-SMS passwords or physical devices that generate access codes (physical token).
  - Strengthening mechanisms to identify operations. Validation processes for activating telematic channels.
  - Technical measures for detecting and warning of the theft of customers' credentials (phishing).
- **Fraud in the use of cards.**
  - Migration to card technologies with chip (EMV).
  - Improvements in ATM security, including mechanisms to detect the falsification of cards (anti-skimming). These mechanisms are specifically orientated to prevent the cloning of cards or the capturing of PINs.
  - Security improvements in online purchases, with the establishment of two different types of measures: code of security for debit and credit card purchases (3DSecure) and mechanisms that enable authentication of the transaction, according to a specific risk analysis, to be adapted.

Meanwhile, as regards measures relating to practices with clients, products and business, Grupo Santander establishes corporate policies for the marketing of products and services, as described in 10.4 "Compliance and reputational risk management model."

## Structure of data processing centres

A notable technological milestone for the Group in 2013 was the opening of three large data processing centres in Campinas (Brazil), Querétaro (Mexico) and Carlton Park (UK), which, together with the ones in Boadilla and Cantabria (Spain), complete the strategic map of five federated corporate centres via our global network.

Each of these centres consists of two twin centres, separated and carrying our simultaneously the same tasks (functioning in active-active mode). They are endowed with a double electric connection from two different sub stations, with connections of various communication operators, with high-energy efficiency and availability of installations. This design enables, in the event of a problem in one of the centres, the other one to continue the processes immediately, without any interruption in the service.

In addition and as an extra level of security in the event of a regional disaster, a third copy of data and systems will be available (remote disaster recovery or RDR). In this way, the infrastructure of an entity located in a data processing centre will have a RDR in another country, thereby reducing operational risk even more.

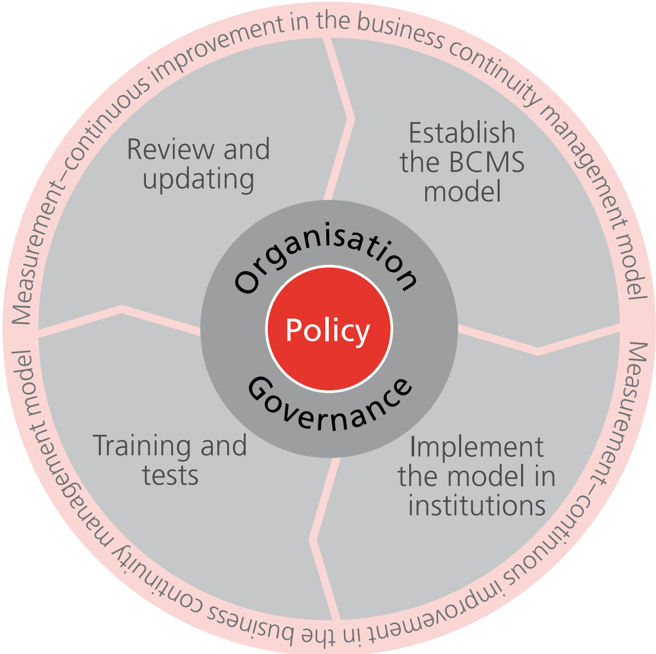
## Anti-cyber-risk measures

Society, in general, and regulatory bodies, in particular, have shown their concern at threats such as hacking, cyber crime and espionage in what has become known as cyber risk. In order to mitigate these threats, a cyber risk model has been created.

This model includes provisions on government, the management framework, technological measures and taxonomy of risks, among other relevant issues. At the same time, the model follows a continuous cycle of improvement that guarantees its updating and implementation in accordance with specific needs that arise. It will be adopted gradually over the coming years.

## 9.7 Business continuity plan

The Group has a business continuity management system (BCMS), which ensures that the business processes of our institutions continue to operate in the event of a disaster or serious incident.




The basic objective is to:

- Minimise the possible damage from an interruption in normal business operations on people and financial impacts and adverse business for the Group.
- Reduce the operational effects of a disaster, supplying a series of predefined and flexible guides and procedures to be used to relaunch and recover processes.
- Renew business operations and associated support functions, sensitive to time, in order to achieve business continuation, stability of earnings and the growth planned.
- Re-establish technological and support operations for business transactions, sensitive to time, in the event of the existing technology not working.
- Protect the public image of and confidence in Grupo Santander.
- Meet the Group's obligations with its employees, customers, shareholders and other interested third parties.

## 9.8. Other aspects of control and monitoring of operational 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. In 2013, it continued to improve the control model of this business, attaching particular importance to the following points:

- Analyse the individual operations of each Treasury operator in order to detect possible anomalous behaviour.
- Improve the monitoring of communications with counterparties via the different authorised means of contracting.
- Implantation underway of a new tool that enables compliance with the new requirements in record keeping.
- Strengthen controls on the contributions of prices to market indexes.

The business is also undergoing a global transformation that involves modernising the technological platforms and operational processes that incorporate a robust control model which enables the operational risk associated with business to be reduced.

### Operational risk information system

The Group has a corporate information system that supports the operational risk management tools and facilitates information and reporting functions and needs at both the local and corporate levels.

This system has modules to register events, risks and assessment map, indicators, mitigation and reporting systems, and is applied to all the Group's units.

As part of the move toward advanced models that the Group envisages facing in the coming months, it will continue to invest in the integral solution platform, incorporating elements that contribute to continuous improvement.

The various areas that the platform covers are:

## CORPORATE OPERATIONAL RISK SYSTEM

**1**

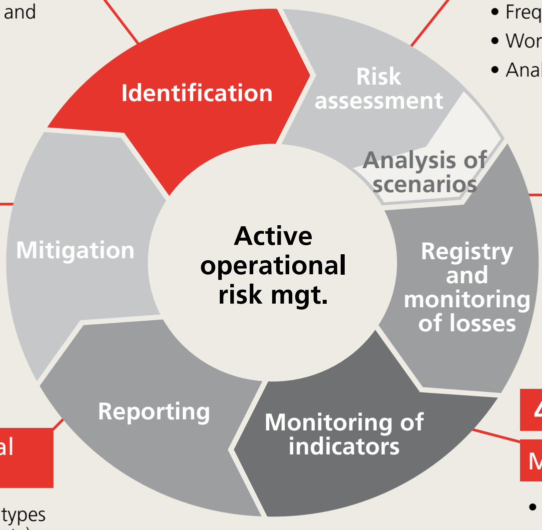
**General administration module**

- Identification of operational risks
- Association with processes, business lines and organisation
- Administration of static data

**2**

**Map of risks and evaluation**

- Map of risks and controls
- Frequency estimates and severity
- Workflow of questionnaires
- Analysis of scenarios: specific model




**6**

**Mitigation model**

- Identification plans for mitigation
- Monitoring of mitigation plans
- Evaluation of mitigation plans implemented

**3**

**Module of losses**

- Registry of losses and recoveries
- Individual registration, massive or interphase
- Workflow of capturing and filters of quality
- Management of multi-impact events

**5**

**Reporting module (partial at local level)**

- Generation of reports focused on various types of users (senior management, OR expert, etc)
- Executive reports (command tables)
- Static and dynamic reports (not yet in local units)

**4**

**Module of indicators**

- Registry of indicators, considering OR, TR and control indicators
- Individual capturing, massive or by interphase
- Application of normalisation methodology and aggregation of the Group
- Tracking of indicators and setting of alert thresholds

### 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 drawn up:

- Operational risk management model in Grupo Santander and the Group's main units and countries.
- Perimeter of operational risk management.
- Analysis of the internal database of incidents and relevant external incidents.
- Assessment and analysis of risk 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 databases 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 the unit for global sourcing of insurance, the Group's maximum technical body for defining coverage strategies and contracting insurance.

# 10. COMPLIANCE AND REPUTATIONAL RISK

## 10.1 Definitions and objective

The compliance risk is the risk of receiving economic or other sanctions, or other types of disciplinary measures by supervisory bodies for not complying with laws, regulations, rules, standards of self-regulation or codes of conduct applicable to the activity developed.

Reputational risk is that linked to the perception of the Group 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.

The Group's objective in the sphere of managing compliance and reputational risks is: (i) to minimise the probability that irregularities occur; and (ii) that the irregularities that could eventually occur are identified, reported and quickly resolved. As for reputational risk, bearing in mind the diversity of sources from which it can arise, the objective of management is to identify them and ensure that they are duly tended to so that their probability is reduced and the eventual impact is mitigated.

## 10.2. Corporate governance and the organisational model

In the exercise of its general function of supervision, the Bank's board is responsible for approving the general policy of risks. In the sphere of compliance and reputational risk, the board is the owner of the Group's General Code of Conduct, the global policy for the prevention of money laundering and the financing of terrorism and the marketing policy for products and services.

The delegated risks committee proposes to the board the Group's risk policy. Furthermore, as the organ responsible for global risk management, it assesses the reputational risk of its sphere of action and decisions.

The audit and compliance committee is entrusted with, among others, the functions of supervising compliance with legal requirements, watching over the effectiveness of internal control systems and risk management, supervising compliance with the Group's code of conduct in the securities markets, with the manuals and procedures for the prevention of money laundering and, in general, with the Bank's rules of governance and compliance, and make the necessary proposals for their improvement, as well as review compliance with the actions of the administrative authorities responsible for supervision and control.

The compliance function reports constantly to the board, mainly via the audit and compliance committee, to which the Group's compliance director reported during the 12 meetings it held in 2013. The compliance director also reported in 2013 to a meeting of the delegated risks committee, without detriment to attending other sessions of this committee when it considered operations with a possible impact from the standpoint of reputational risk, and twice to the board.

Lastly, as collegiate bodies with basic powers, are the corporate committees of compliance with rules, of analysis and resolving and marketing (the latter two specialised in their respective matters: prevention of money laundering and marketing of products and services), with a global scope (every country, every business) and which are replicated at the local level.

The risks division supervises the control framework applied in the compliance sphere, from both the area of integral control and internal validation of risks (CIVIR), in the exercise of its functions of supporting the delegated risks committee, as well as from non-financial risk control area created in 2013.

The organisational model revolves around the corporate area of compliance and reputational risk, integrated into the division of the general secretariat, which is entrusted with managing the Group's compliance and reputational risks. Within the area, led by the head of the Group's compliance, is the corporate office of reputational risk and the corporate office of prevention of money laundering and financing of terrorism (COPML) and the corporate unit of financial intelligence (CUFI), with powers in matters of prevention of money laundering and of the financing of terrorism. This structure is replicated at the local level and also in global businesses, having established the opportune functional reports for the corporate area.

## 10.3. Risk appetite model

The delegated committee of risks was informed at its meeting on 22 October 2013 of the Group's risk appetite model applied to compliance and reputational risk. This model has three elements:

- It stems from a zero appetite declaration for the sphere of compliance and reputational risk.
- The Group's objective is to minimise compliance and reputation risk incidents. Systematic monitoring is carried out via the compliance and reputational risk indicator resulting from assessment matrices prepared for each country.
- Quarterly monitoring of the risk appetite is conducted country by country.

The assessment matrix is fed with data from the communications received every month from the various supervisors. Each one of these communications is assigned a score on the basis of the risk they represent as regards: (i) costs from fines; (ii) reorganisation of processes; and (iii) the impact on the brand and reputational risk. These assessments are complemented by Internal Audit ratings in the compliance area.

Each local unit is assigned a weighting depending on its attributable profit and volume of assets, with which a complete score for the Group is obtained.

## 10.4 Risk management model

The main responsibility of compliance and reputational risk management is shared between the compliance area and the different business and support units, which conduct the activities that give rise to risk. The responsibility for developing policies and implementing the corresponding controls lies with the compliance area, which is also responsible for advising senior management on these matters and fostering a culture of compliance, all of this in a framework of an annual programme whose effectiveness is regularly evaluated.

The area directly manages the basic components of these risks (money-laundering, codes of conduct, marketing of products, etc.) and ensures that the rest is duly tended to by the corresponding unit of the Group (responsible financing, data protection, customers' complaints, etc), having established the opportune control and verification systems.

The correct execution of the risk management model is supervised by the integral control and internal validation of risk area. One of the functions of internal auditing is to carry out the tests and reviews required to ensure that the rules and procedures established in the Group are being fulfilled.

The central element of the Group's compliance programme is the general code of conduct. This code, which enshrines the ethical principles and rules of conduct that must govern the actions of all Grupo Santander's employees, is complemented in certain matters by the rules that are in the codes and manuals of the various sectors[39].

39. The following form part of the codes and manuals of sectors: the Manual for the Prevention of Money-laundering and Financing of Terrorism, the Code of Conduct in the Securities Markets, the Manual of Procedures for the Sale of Financial Products, the Code of Conduct for Analysis Activity, the Research Policy Manual, the Manual of Conduct in Information and Communication Technologies (ICT), the Manual of Conduct in the Management of Foreclosed Properties, the Manual of Conduct in the Management of Purchases, etc., as well as the notes and circulars that develop specific points of these codes and manuals.

The code also establishes: i) the functions and responsibilities in matters of compliance of the governance organs and of the Group's management areas affected; ii) the rules that regulate the consequences of non-compliance; and iii) a whistleblowing channel for formulating and handling communications for presumably illicit activity.

The corporate office of compliance is responsible, under the supervision of the audit and compliance committee and the committee for compliance with rules, for supervising the effective implementation and monitoring of the general code of conduct.

The rule compliance committee, chaired by the Group's secretary general, has powers in all matters inherent in the compliance function, without detriment to those assigned to the two existing specialised organs in the area (the corporate marketing committee for the marketing of products and services and the analysis and resolution committee for prevention of money laundering and financing of terrorism). It is made up of representatives of internal auditing, the general secretariat, financial management, human resources and the most directly affected business units.

The committee held five meetings in 2013.

The Group's compliance management has the following functions as regards management of compliance and reputational risks:

1. Implement the Group's general code of conduct and other codes and manuals for sectors.

2. Supervise the training activity of the compliance programme conducted by the human resources area.

3. Direct investigations into the possible committing of acts of non-compliance. Help can be sought from internal auditing and the sanctions that might arise be proposed to the irregularities committee.

4. Cooperate with internal auditing in the regular reviews of compliance with the general code and with the codes and manuals of sectors, without detriment to the regular reviews which, on matters of rule compliance, are conducted by compliance management directly.

5. Receive and handle the accusations made by employees or third parties via the relevant whistleblowing channel.

6. Advise on resolving doubts that arise from implementing codes and manuals.

7. Draw up an annual report on implementing the compliance programme for the audit and compliance committee.

8. Regularly inform the general secretary, the audit and compliance committee and the board on implementation of the compliance policy and programme.

9. Assess every year the changes that need to be introduced into the compliance programme, particularly in the event of detecting unregulated business areas and procedures susceptible to improvement, and propose the changes to the audit and compliance committee.

As regards the codes and manuals of the sectors, the focus of the compliance programme is on the following operational spheres, among others:

- Prevention of money laundering and financing of terrorism.

- Marketing of products and services.

- Conduct in the securities markets.

- Criminal risk prevention.

- Relations with regulators and supervisors.

- Drawing up and disseminating the Group's institutional information.

## Prevention of money laundering and financing of terrorism

**Policies**

As a socially responsible institution, it is a strategic objective for Grupo Santander to have an advanced and efficient system to prevent money laundering and the financing of terrorism, constantly adapted to the latest international regulations and with the capacity to confront the appearance of new techniques of criminal organisations.

The function of the prevention of money laundering and of financing of terrorism revolves around policies that set minimum standards that Grupo Santander's units must observe and is formulated in accordance with the principles contained in the 40 recommendations of the Financial Action Task Force (FATF) and the obligations in Directive 2005/60/EC of the European Parliament and of the Council of 26 October, 2005, on the prevention of using the financial system to launder money and finance terrorism.

The corporate policy and rules that develop it have to be fulfilled by all the Group's units in the world. By units we mean all those banks, subsidiaries, departments or branches of Banco Santander, both in Spain and abroad, which, in accordance with their legal statute, must submit to the regulations on prevention of money laundering and the financing of terrorism.

**Governance and organisation**

The organisation of the function of the prevention of money laundering and of the financing of terrorism rests on three areas: the analysis and resolution committee (ARC), the corporate unit of financial intelligence (CUFI) and prevention executives at various levels.

The ARC is a collegiate body of corporate scope chaired by the Group's general secretary and comprising representatives of internal auditing, the general secretariat, human resources and the most directly affected business units. It held four meetings in 2013.

The CUFI establishes, coordinates and supervises the systems and procedures for the prevention of money laundering and of the financing of terrorism in all the Group's units.

There are also prevention executives at four different levels: area, unit, branch and account. In each case their mission is to support the CUFI from a position of proximity to clients and operations.

At the consolidated level, a total of 781 people (three-quarters of them full time) work in prevention activities and tend to 173 units in 36 countries.

Grupo Santander has established in all its units and business areas corporate systems based on decentralised IT applications. These enable operations and customers who, because of their risk, need to be analysed to be presented to the branches of the account or customer relation managers. The tools are complemented by others of centralised use which are operated 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.

Banco Santander is a founder member of the Wolfsberg Group, and forms part of it along with 10 other large international banks. The Group's objective 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 which have treated issues such the prevention of money laundering in private banking, correspondent banking and 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.

**Main actions**

The Group analysed a total of 27.6 million operations in 2013 (21.1 million in 2012) both by the commercial networks as well as by money laundering prevention teams, of which more than one million were by the units in Spain.

The CUFI and the local departments of prevention conduct annual reviews of all the Group's units in the world.

In 2013, 146 units were reviewed (162 in 2012), 26 of them in Spain and the rest abroad, and reports were issued in all cases stating the measures to be taken (recommendations) to improve and strengthen systems. In 2013, 201 measures to be adopted were established (242 in 2012), which are being monitored until their full and effective implementation.

Training courses were given in 2013 for the prevention of money laundering to a total of 108,592 employees (105,664 in 2012).

Lastly, many units are submitted to regular reviews by external auditors. PwC carried out in 2013 a review of the monitoring of measures in the 2012 report on the global system of prevention of money laundering in the parent bank and in the rest of the units in Spain. The report issued on 18 June, 2013 did not find any evidence of material weakening of the system, limiting itself to formulating an eventual recommendation of the rectification suggested.

MAIN INDICATORS OF ACTIVITY

| 2013 | Subsidiaries reviewed* | Cases investigated | Communications to authorities | Employees trained |
|---|---|---|---|---|
| **Total** | **146** | **68,573** | **21,298** | **108,592** |

* By CUFI and local money laundering prevention units.

## Marketing of products and services

**Policies**

At Grupo Santander management of the reputational risk that could arise from an inadequate sale of products or from an incorrect provision of services by the Group is conducted in accordance with the corporate policies of marketing of products and services.

These corporate policies aim to set a single corporate framework for all countries, businesses and institutions: (i) strengthening organisational structures; (ii) ensuring that the decision-making committees oversee not only the approval of products or services, but also the monitoring of them during their whole life and (iii) setting the guidelines for defining uniform criteria and procedures for the whole Group for the marketing of products and services, covering all phases (admission, pre-sale, sale and post-sale).

The developments and specific adjustment of these policies to the local reality and to local regulatory requirements is carried out through local internal rules in the Group's various units, following authorisation by the corporate area of compliance and reputational risk.

**Governance and organisation**

The corporate and local marketing committees, the global consultative committee, the corporate committee of monitoring and the corporate and local offices comprise the organisational structure of the risk that could arise from an inadequate marketing of products and services.

The corporate committee of marketing (CCM) is the maximum decision-making body for approving products and services and is chaired by the Group's secretary general. It is made up of representatives of the divisions of risks, financial management, technology and operations, the general secretariat, general audit and control, internal auditing, retail banking, global wholesale banking, private banking, asset management and insurance.

The CCM attaches particular importance to adjusting products and services to the framework where they are going to be marketed, paying special attention to ensuring that:

- Each product or service is sold by suitable staff.
- Customers are provided with the necessary and adequate information.
- The product or service is adjusted to the customer's risk profile.
- Each product of service is assigned to the right market, not only for legal or tax reasons, but also to meet the market's financial culture.
- The products and services fulfil the requirements of the corporate marketing policies and, in general, the applicable internal and external rules.

At the local level, local marketing committees (LCM) are established, which channel toward the CCM proposals to approve new products - after a favourable opinion has been issued as initially they do not have powers delegated in them – and approve products that are not new and their marketing campaigns.

The marketing committees, in the respective approval processes, take a risk-focused stance from the double perspective of bank/client.

The global consultative committee (GCC) is the advisory body of the corporate marketing committee and consists of representatives of the areas that provide a view of regulatory and market risk. The GCC, which meets around every three months, can recommend a review of products that are affected by changes in markets, deterioration of solvency (country, sectors or companies) or by changes in the Group's view of the markets in the medium- and long-term.

The corporate monitoring committee (CMC) is the Group's decision-making body for the monitoring of products and services. It is chaired by the secretary general and has representatives from internal auditing, legal advice, compliance, customer attention and the business areas affected (permanent representation of the retail network). It meets every week to raise and resolve specific issues related to the marketing of products and services at the local level as well as by the Group's units abroad.

The corporate office of reputational risk management (CORRM) provides the governance bodies with the information needed for: (i) adequate analysis of risk in approvals, from the standpoint of the Bank and the impact on the client; and (ii) monitoring of products throughout their life cycle.

At the local level there are reputational risk management offices, which are responsible for promoting the risk culture and ensuring that approval and monitoring of products is developed in their respective local sphere in line with the corporate guidelines.

**Main actions**

The CCM met 12 times in 2013 (14 in 2012 and 19 in 2011) and analysed 151 new products/services. The corporate office of reputational risk was presented with 54 products/services considered not new for approval and resolved 167 consultations from areas and countries. The GCC held two meetings (3 in 2012 and 3 in 2011).

Monitoring of products and services approved is done locally (local committee of monitoring of products or equivalent local body, such as the LCM). The conclusions are set out in reports every four months for the CORRM, which prepares integrated reports on all the Group's monitorings for the CMC.

The CMC held 41 meetings in 2013 (44 in 2012 and 42 in 2011) at which incidents were resolved and information analysed on the monitoring of products and services, at both the local level as well as the Group's units abroad.

## Code of Conduct in the Securities Markets (CCSM)

**Policy**

This is set by the code of conduct in the securities markets (CCSM), complemented, among others, by the code of conduct for analysis activity, the research policy manual and the procedure for detecting, analysing and communicating operations suspected of market abuse.

**Governance and organisation**

The organisation revolves around the compliance corporate office together with local compliance management offices and that of subsidiaries.

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. Maintain 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 relevant personnel.

6. Manage failures to comply.

7. Resolve doubts on the CCSM.

8. Register and resolve, 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 the regulators.

12. Organise the training and, in general, conduct the actions needed to apply the code.

13 Analyse activities suspicious of constituting market abuse and, where appropriate, report them to the supervisory authorities.

**Main actions**

The compliance corporate office together with local compliance executives and of the subsidiaries ensure that the obligations contained in the CCSM are observed by around 8,000 Group employees throughout the world.

The market abuse investigation unit continued to review many transactions that gave rise to the opportune communications to the National Securities Market Commission. Training actions were also taken, in accordance with the plan approved by the rule compliance committee.

## Prevention of penal risks

The Group's senior compliance executives are also entrusted with managing the model for the prevention of penal risks emanating from the entry into force of Organic Law 5/2010, which introduced the penal responsibility of companies for crimes committed for their benefit by managers or their representatives and by employees as a result of the lack of control.

In the last months of 2013, the Group's model was reviewed by an external expert, who verified: i) the effective establishment of the Group's internal rules; ii) the existence of general control measures, and; iii) the existence of specific control measures. The conclusion was satisfactory. The penal code reform project underway was also monitored, in order to anticipate as far as possible the adjustments needed.

## Relations with the supervisory authorities and dissemination of information to the markets

Compliance management is responsible for tending to the information requirements of the regulatory and supervisory bodies, both those in Spain as well as in other countries where the Group operates, monitoring implementation of the measures resulting from the reports or inspections of these bodies and supervising the way in which the Group disseminates institutional information in the markets transparently and in accordance with the regulators' requirements. The audit and compliance committee is informed of the main issues at each of its meetings.

Banco Santander made public in Spain 77 relevant facts in 2013, which are available on the Group's web site and that of the National Securities Market Commission.

## Other actions

Compliance management continued to carry out other activities in 2013 inherent to its sphere (reviewing the bank's internal rules 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 consultancies in this area, sending periodic regulatory information to the supervisory bodies, etc). It also co-operated in new corporate projects such as the Group's adjustment to the US laws FATCA and Dodd-Frank.

The losses incurred by the Group from compliance and reputational risk are included in the data base of incidents managed by the Group's corporate area of technical and operational risk.

# 11. CAPITAL

## 11.1 Adjusting to the new regulatory framework

The regulations known as Basel III came into force in 2014, setting new global standards for banks' capital and liquidity.

From the standpoint of capital, Basel III redefines what is considered as available capital in financial institutions (including new deductions and raising the requirements of eligible capital instruments), increases the minimum capital required, demands that institutions operate permanently with capital buffers and adds new requirements in the risks considered.

Grupo Santander shares the ultimate objective that the regulator pursues with this new framework, which is to make the international financial system more stable and solid. In this sense, for years we have participated in the 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.

In Europe, the new regulations have been implemented via EU directive 2013/36, known as CRD IV, and its regulations (CRR) which is directly applied in all EU countries (single rule book). In addition, these rules are subject to legal developments entrusted to the EBA, some of which will be produced in the coming months/years.

This regulation entered into force on January 1, 2014, with many of the regulations subject to different schedules of implementation. This phase of implementation mainly affected the definition of funds that are eligible as capital and will be completed at the end of 2017, except for the deduction of deferred tax credits (DTAs) whose schedule lasts until 2023.

Following the European legislative process and the corresponding transfer to national law, the Basel Committee continued to publish additional regulations, some of them as public consultation, which will entail a future modification of the CRD IV directive and of its regulations. Grupo Santander will continue to support regulators, with its opinions and participation in impact studies.

Santander has solid capital ratios, appropriate for its business model and risk profile which, together with the Group's considerable capacity to generate capital organically and the schedule of gradual implementation of the new requirements contemplated in the regulations, will put it in a position to comply comfortably with Basel III.

As regards credit risk, Grupo Santander continued its plan to implement Basel's advanced internal rating-based (AIRB) approach for almost all the Group's 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 for 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 cooperation 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 2013 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, UK, Portugal, and certain portfolios in Mexico, Brazil, Chile, Santander Consumer Finance Spain and the US. The strategy of implementing Basel in the Group is focused on achieving use of advanced models in the main institutions in the Americas and Europe.

In operational risk, Grupo Santander currently uses the standard focus for calculating regulatory capital and in 2014 began a project for evolving toward an advanced management approach (AMA), once it has gathered sufficient information on the basis of its own management model. The Group believes that development of the internal model should be largely based on the accumulated experience of management of the entity via the corporate guidelines and criteria established after assuming control and which are hallmarks of Santander.

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 treasuries in Spain, Chile, Portugal and Mexico, continuing the plan of gradual implementation for the rest of units presented to the Bank of Spain.

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 (ICAAP). This process includes regulatory and economic capital planning under various alternative economic scenarios, in order to ensure that the internal objectives of solvency are fulfilled even under plausible but unlikely adverse scenarios. Furthermore, the exercise 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, which also establishes every year the strategic elements for risk appetite and solvency objectives.

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 clearly shows the transparency requirements requested 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 European Banking Authority in order to become an international benchmark in matters of transparency to the market, as is already the case 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. This 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.

## 11.2 Economic capital

Economic capital is the capital needed, in accordance with an internally developed model, to support all the risks of business with a certain level of solvency. In the case of Santander, the solvency level is determined by the long term rating objective of AA-/A+, which means a confidence level of 99.95% (above the 99.90% regulatory) to calculate the necessary capital.

In a complementary way, Santander's economic capital model includes in its measurement all the significant risks incurred by the Group in its operations (risk of concentration, structural interest, business, pensions and others beyond the sphere of Pillar 1 regulatory capital). Moreover, economic capital incorporates the diversification impact, which in the case of Grupo Santander is vital, because of its multinational nature and many businesses, in order to determine the global risk profile and solvency.

The comparison between regulatory and economic capital requirements is distorted by the fact that there are risks, such as goodwill and others, which in regulatory terms are presented as deductions from the eligible capital base instead of including them as capital requirements. In a similar way, the economic capital needs of these risks can be presented as deductions from the internal capital base (following the regulatory way) or form part of the economic capital requirements, which is the option preferred internally. Furthermore, as we have commented on, risks that are not present in the regulatory focus are incorporated in the measurement (those denominated Pillar II risks).

The table below sets out the available and necessary economic capital, under the two alternatives of presentation mentioned. The "regulatory" presentation of the capital base and economic requirements (in that which some risks are deducted from the base) is the most comparable to the traditional regulatory vision, while the "economic" one, in which these risks are also included among the requirements, is the one used internally. In both cases, the capital surplus available over the economic capital needs is the same, as a result of which they are just two ways of presenting the same reality.

### AVAILABLE AND REQUIRED ECONOMIC CAPITAL ("REGULATORY" PRESENTATION)

| | |
|---|---|
| Capital stock | 5,667 |
| Treasury stock | (81) |
| Capital gains/losses of the AFS portfolio | 41 |
| Reserves-valuation adjustment | 64,058 |
| Attributable profit net of dividends | 3,445 |
| Minority interests | 7,682 |
| Pension deduction | (1,764) |
| Goodwill | (13,192) |
| Intangibles | (773) |
| Deferred tax assets | (1,856) |
| **Available economic capital base** | **63,226** |
| | |
| Credit | 26,213 |
| Market | 3,991 |
| Operational | 3,264 |
| Material assets | 780 |
| **Sub-total Pillar I risks** | **34,248** |
| Interest (ALM) | 5,570 |
| Business | 3,170 |
| Pensions | 1,852 |
| **Sub-total Pillar II risks** | **10,592** |
| **Economic capital needed** | **44,841** |

### AVAILABLE AND REQUIRED ECONOMIC CAPITAL ("ECONOMIC" PRESENTATION)

| | |
|---|---|
| Capital stock | 5,667 |
| Treasury stock | (81) |
| Capital gains/losses of the AFS portfolio | 41 |
| Reserves-valuation adjustment | 64,058 |
| Attributable profit net of dividends | 3,445 |
| Minority interests | 7,682 |
| Pension deduction | (1,764) |
| **Available economic capital base** | **79,048** |
| | |
| Credit | 26,213 |
| Market | 3,991 |
| Operational | 3,264 |
| Material assets | 780 |
| **Sub-total Pillar I risks** | **34,248** |
| Goodwill | 13,192 |
| Interest (ALM) | 5,570 |
| Business | 3,170 |
| Intangibles | 773 |
| Pensions | 1,852 |
| Deferred tax assets | 1,856 |
| **Sub-total Pillar II risks** | **26,414** |
| **Economic capital needed** | **60,663** |

| | |
|---|---|
| **EXCESS CAPITAL** | **18,385** |

In the case of goodwill, for example, the regulator requires its full deduction from the regulatory eligible capital base, as it considers that in a stress situation its value is almost zero. However, even though a hypothetical severe stress situation could leave at zero the value of the goodwill corresponding to an investment in some of the Group's subsidiaries, it is highly unlikely that this situation would occur at the same time in all the countries where the Group operates. Consequently, the Group would retain, even in a stress situation, part of the value of these assets, which justifies that the capital needed is less than the book value of this goodwill and which, for management purposes, is not deducted from the capital base. This situation is possible due to the features of the Santander model, based on subsidiaries autonomous in capital and very diversified geographically.

Diversification is fundamental for adequately measuring and understanding the risk profile of a global activity group such as Santander. The fact that the Group's business is developed in various countries via structure of differentiated legal entities, with a variety of customer segments and products, and also incurring different types of risk, makes the Group's results less vulnerable to adverse situations in some of the markets, portfolios, clients or particular risks. Economic cycles, despite the high current degree of globalisation of economies, are not the same and nor do they have the same intensity in different countries. Consequently, those groups with a global presence have a greater degree of stability in their results and a greater capacity of resistance to eventual crisis in markets or in specific portfolios, which means a lower risk profile. In other words, the risk and economic capital associated with the Group as a whole is less than the risk and capital of the sum of the parts considered separately.

Lastly, 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.

Economic capital is a key tool for the internal management and development of the Group's strategy, from the standpoint of assessing solvency as well as risk management of portfolios and businesses.

From the solvency standpoint, the Group uses, in the context of Basel Pillar II, its economic model for the capital self-evaluation process. For this, the business evolution and capital needs are planned under a central scenario and alternative stress scenarios. The Group is assured in this planning of maintaining its solvency objectives in the most adverse scenarios.

The metrics of economic capital also enable an assessment to be made of return-risk objectives, setting prices operations on the basis of the risk, evaluating the economic viability of projects, units or business lines, with the overriding objective of maximising the generation of shareholder value.

## Planning of capital and stress exercises

Stress exercises on capital have assumed particular importance as a dynamic evaluation tool of the risks and solvency of banks. A new model of evaluation, based on a forward looking approach, is becoming a key element for analysing the solvency of banks.

It is an assessment looking to the future, based on macroeconomic as well as idiosyncratic scenarios of little probability but plausible. It is necessary to have for it robust planning models, capable of transferring the impact defined in projected scenarios to the different elements that influence a bank's solvency.

The ultimate objective of the stress exercises is to carry out a full evaluation of the risks and solvency of banks, which enables possible capital requirements to be calculated in the event that they are needed because of banks' failure to meet the capital objectives set, both regulatory and internal.

The European Central Bank (ECB) announced that the current process of comprehensive assessment, which will be carried out during 2014 as a prior step to it becoming the single supervisory mechanism (SSM), will culminate with a stress exercise by the European Banking Authority (EBA) in cooperation with the ECB, scheduled to be completed before November. The objective is to eliminate any possible doubts on the solvency of the European banking system and contribute transparency on the strength and solvency of banks, taking the necessary measures (including eventually additional capital needs) in the event that the results of the exercise require it.

The next stress exercise will be carried out on 124 banks, covering at least 50% of each country's banking sector, measured in terms of assets. It will be conducted with a three-year time frame and will evaluate the material risks for solvency (credit, market, sovereign, securitisation and cost of funding, among others).

The capital objectives, measured in terms of solvency (common equity Tier 1), will be 8% for the baseline scenario and 5.5% for an adverse scenario. The results are expected to be published at the end of October.

As a starting point for the stress exercise and also within, in turn, the comprehensive assessment process, the ECB will carry out during 2014 an asset quality review.

Grupo Santander has defined a stress and capital planning process not only to respond to the various regulatory exercises, but also as a key tool integrated into the Bank's management and strategy.

The objective of the internal process of stress and capital planning is to ensure sufficient current and future capital, even in the most adverse economic but plausible scenarios. On the basis of the Group's initial situation (defined by its financial statements, capital base, risk parameters and regulatory ratios), the results envisaged for different business environments (including severe recessions as well as a "normal" macroeconomic picture) are estimated, and the Group's solvency ratios in a period usually of three years obtained.

The process offers an integral view of the Group's capital for the time period analysed and in each of the defined scenarios, incorporating in the analysis the metrics of regulatory capital, economic capital and available capital.

The structure of the process underway is set out in the table below:

| | |
|---|---|
| MACROECONOMIC SCENARIOS | ▸ Central and of recession<br>▸ Idiosyncratic: based on the bank's specific risks<br>▸ Multi-year time frame |
| 2 PROJECTION OF BALANCE SHEET AND P&L | ▸ Projection of volumes. Business strategy<br>▸ Margins and funding cost<br>▸ Fee income and operational costs<br>▸ Market shocks and operational losses<br>▸ Credit losses and provisions. PD and LGD PIT models |
| 3 PROJECTION OF CAPITAL REQUIREMENT | ▸ Consistent with the projected balance sheet<br>▸ Risk parameters (PD, LGD and EaD) |
| 4 SOLVENCY ANALYSIS | ▸ Available capital base. Profit and dividends<br>▸ Impact of regulations and regulators<br>▸ Capital and solvency ratios<br>▸ Meeting capital objectives |
| 5 ACTION PLAN | ▸ In the event of not meeting internal objectives or regulatory requirements |

The recent structure presented facilitates attaining the ultimate objective pursued in capital planning, by becoming an element of strategic importance for the Group which:

- Ensures the solvency of current and future capital, even in adverse economic scenarios.
- Allows integral management of capital and incorporates an analysis of specific impacts, facilitating its integration into the Group's strategic planning.
- Enables capital to be used more efficiently.
- Supports the design of the Group's capital management strategy.
- Facilitates communication with the market and supervisors.

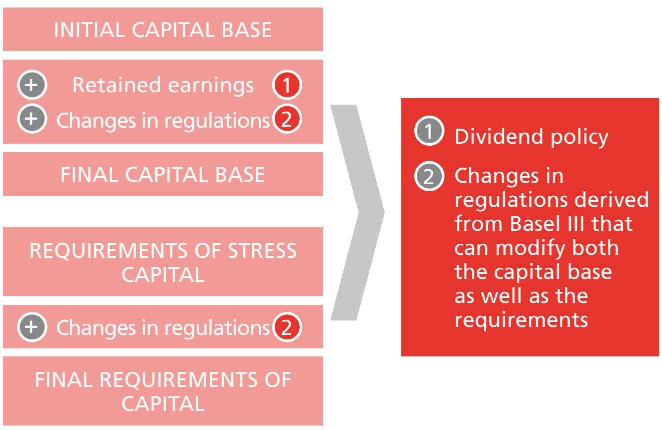
In addition, the whole process is developed with the maximum involvement of senior management and their close supervision, as well as under a framework that ensures that governance is suitable and that all elements that comprise it are subject to adequate levels of challenge, review and analysis.

One of the key elements in exercises of planning capital and stress analysis, because of its particular importance in projecting the income statement under defined adverse scenarios, consists of calculating the provisions needed under these scenarios, mainly those produced to cover losses in credit portfolios. In order to calculate its loan-loss provisions, Grupo Santander uses a methodology that ensures that at all times it has a level of provisions covering all credit losses projected by its internal models of expected loss.

This methodology is widely accepted and is similar to that used in previous stress exercises (e.g. the EBA's exercise in 2011 or the stress exercise of the Spanish banking sector in 2012).

Lastly, the process of planning capital and stress analysis culminates with the analysis of solvency under the various scenarios designed and ensures the Group meets both the objectives of capital defined internally as well as all the regulatory requirements.

## QUANTIFICATION OF THE SUFFICIENCY OF CAPITAL




Throughout the recent economic crisis, Grupo Santander has been submitted to four stress exercises in which it demonstrated its strength and solvency in the face of the most extreme and severe macroeconomic scenarios. All of them show, mainly thanks to the Group's business model and geographic diversification, that Banco Santander will continue to generate profits for its shareholders and meet the most demanding regulatory requirements.

In the first of them (CEBS 2010), the Group was the institution with the least impact on its solvency ratio, except for those banks that benefited from not distributing dividends. In the second, carried out by the EBA in 2011, Santander was not only in the small group of banks that improved their solvency in the stress scenario, but also the bank with the highest level of profits.

Lastly, in the stress exercise carried out by Oliver Wyman for Spanish banks in 2012 (top down and then bottom up), Banco Santander again demonstrated its strength to tackle with full solvency the most extreme economic scenarios. It was the only bank that improved its core capital ratio, with a surplus of capital over the minimum required of more than EUR 25,000 million.

In addition, the internal stress exercises conducted by the Bank since 2008 within its process of self-evaluation of capital (Pillar II) reflected, equally, Grupo Santander's capacity to face the most difficult scenarios, both globally as well as in the main countries in which it operates. Notably, in all cases and in spite of the toughness of the latest crisis, the reality was less severe than the scenarios defined.

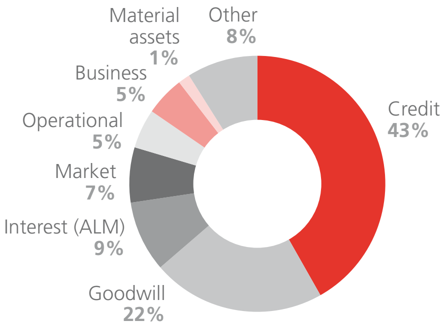
## Global risk profile analysis

The Group's risk profile at December 31, 2013, measured in terms of economic capital and distributed by types of risk and the main business units, is shown below:

### CONTRIBUTION BY RISK TYPE
Million euros

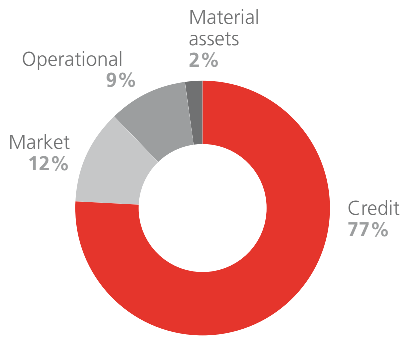
| Economic capital model | Amount |
|---|---|
| Credit | 26,213 |
| Market | 3,991 |
| Non-trading equity | 2,014 |
| FX structural | 1,654 |
| Trading | 323 |
| Operational | 3,264 |
| Material assets | 780 |
| **Subtotal risks Pillar I** | **34,248** |
| Foodwill | 13,192 |
| Interest (ALM) | 5,570 |
| Business | 3,170 |
| Tangibles | 773 |
| Pensions | 1,852 |
| Deferred tax assets | 1,856 |
| **Subtotal risks Pillar II** | **26,414** |
| **Necessary economic capital** | **60,663** |

## ALL RISKS

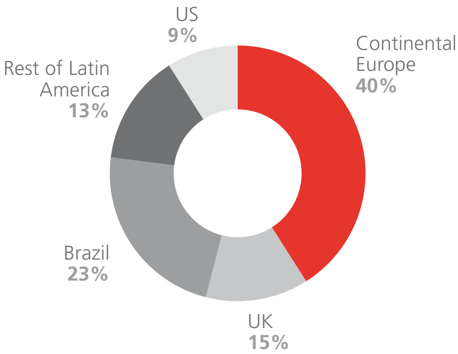



Including only Pillar 1 risks

## PILLAR 1 RISKS




## BY OPERATING AREAS




## BY OPERATING AREAS

| Main segments | Contribution |
|---|---|
| Continental Europe | 27% |
| UK | 10% |
| Brazil | 15% |
| Rest of Latin America | 9% |
| US | 6% |
| **Sub-total operating areas** | **67%** |
| Corporate centre | 33% |
| **Total Group economic capital** | **100%** |

The distribution of economic capital among the main business units reflects the diversification of the Group's activity and risk. Continental Europe accounted for 40% of the capital, Latin America including Brazil 36%, the UK 15% and the US 9%.

Outside the operating areas, the corporate centre mainly assumes the risk from goodwill and that from exposure to structural exchange rate risk (derived from stakes in subsidiaries abroad denominated in non-euro currencies) and most of the equity stakes.

At 31 December 2013 the Group's total economic capital requirements amounted to EUR 60,633 million, while available capital was more than EUR 79,048 million (corresponding to the amount of capital and reserves plus adjustments).

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 30% at the end of 2013.

## 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.
- Analyse and set prices in 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 profit used is obtained by making the necessary adjustments to the accounting 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 2013 applied to the Group's various units was 11.21%. As well as reviewing every year the cost of the Group's capital, in a parallel way and for the purposes of internal management, taking into account the specific features of each market, under the philosophy of subsidiaries autonomous in capital and liquidity, in order to assess if each business is capable of generating value individually.

A positive return from an operation or portfolio means it is contributing to the Group's profits, but it is only creating shareholder value when that return exceeds the cost of capital.

The performance of the business units in 2013 in value creation varied, though mostly downward. The Group's results, and thus the RORAC figures and value creation, are conditioned by the weakness of the economic cycle in various Group units in Europe and, particularly, in Spain.

The creation of value and the RORAC for the Group's main business areas are shown below:

### RORAC AND CREATION OF VALUE
Million euros

| Main segments | RORAC | Value creation |
|---|---|---|
| Continental Europe | 7.8% | (597) |
| UK | 18.6% | 420 |
| Latin America | 26.5% | 2,389 |
| US | 17.0% | 248 |
| **Total main business areas** | **16.9%** | **2,460** |

Also reflected are the negative results of the Corporate Activities area in which are recorded the cost of liquidity buffers, hedging of exchange rates and interest rates, and the results of equity stakes, among others. Incorporating the result of corporate activities, the Group's RORAC is 8.2%, in other words a final result that remains EUR 1,987 million below the cost of capital.

These figures are clearly determined by the phase of the cycle that some of the Group's units are undergoing, resulting in particular, in higher loan-loss provisions and a final result below the cost of capital used. In order to exclude from these results the impact of the current phase of the cycle, the expected average credit is considered, instead of the current level of loan-loss provisions. If so, the Group's RORAC would improve to 11.0%, almost in line with the Group's cost of capital.

# ANNEX

## HISTORICAL DATA[1] 2003 - 2013

| BALANCE SHEET | US$ Mill. | 2013 EUR Mill. | 2012 EUR Mill. | 2011 EUR Mill. | 2010 EUR Mill. | 2009 EUR Mill. |
|---|---|---|---|---|---|---|
| Total assets | 1,538,574 | 1,115,637 | 1,269,598 | 1,251,008 | 1,217,501 | 1,110,529 |
| Net customer loans | 922,419 | 668,856 | 719,112 | 748,541 | 724,154 | 682,551 |
| Customer deposits | 838,267 | 607,836 | 626,639 | 632,533 | 616,376 | 506,976 |
| Customer funds under management | 1,275,145 | 924,621 | 968,987 | 984,353 | 985,269 | 900,057 |
| Shareholders' equity [2] | 116,215 | 84,269 | 80,921 | 80,379 | 75,273 | 70,006 |
| Total managed funds | 1,711,196 | 1,240,806 | 1,387,740 | 1,382,464 | 1,362,289 | 1,245,420 |
| **INCOME STATEMENT** | | | | | | |
| Net interest income | 34,429 | 25,935 | 29,923 | 28,883 | 27,728 | 25,140 |
| Gross income | 52,772 | 39,753 | 43,406 | 42,466 | 40,586 | 38,238 |
| Net operating income | 26,429 | 19,909 | 23,422 | 23,055 | 22,682 | 22,029 |
| Profit before taxes | 10,158 | 7,652 | 3,582 | 7,859 | 12,052 | 10,588 |
| Attributable profit to the Group | 5,801 | 4,370 | 2,295 | 5,330 | 8,181 | 8,943 |

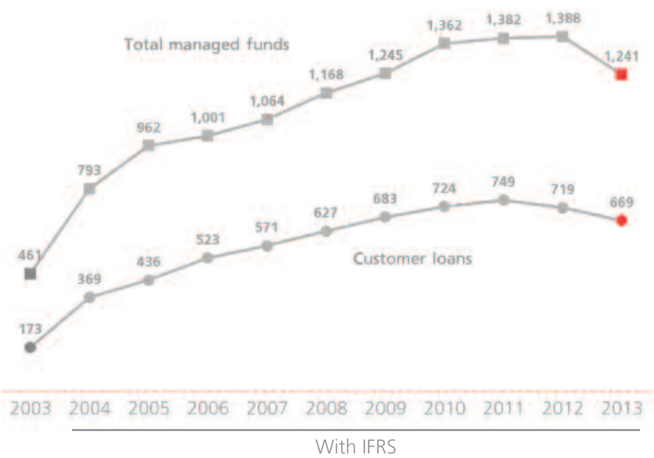
| PER SHARE DATA[3] | US$ | 2013 Euros | 2012 Euros | 2011 Euros | 2010 Euros | 2009 Euros |
|---|---|---|---|---|---|---|
| Attributable profit to the Group | 0.54 | 0.40 | 0.23 | 0.60 | 0.94 | 1.05 |
| Dividend | 0.83 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 |
| Share price | 8.972 | 6.506 | 6.100 | 5.870 | 7.928 | 11.550 |
| Market capitalisation (million) | 101,688 | 73,735 | 62,959 | 50,290 | 66,033 | 95,043 |

Euro / US$ = 1.379 (balance sheet) and 1.327 (income statement)

1 Figures on according to IFRS except for 2003.
2 In 2013, estimated data of May 2014 scrip dividend
3 Figures adjusted to capital increase in 2008.
4 Compound Annual Growth Rate.

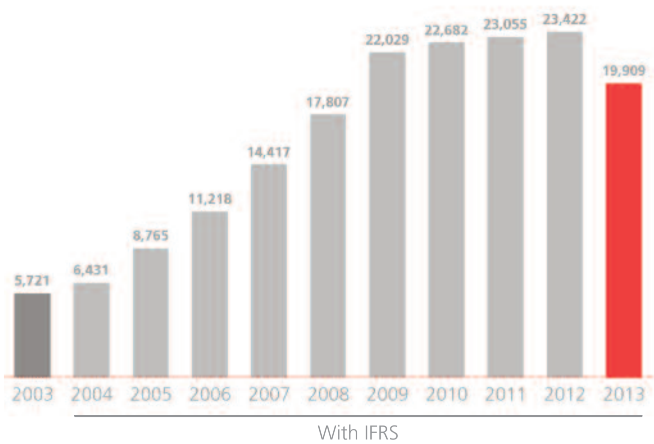
## CUSTOMER LOANSAND TOTAL MANAGED FUNDS

EUR billion




## PRE-PROVISION PROFIT (NET OPERATING INCOME)

EUR Million



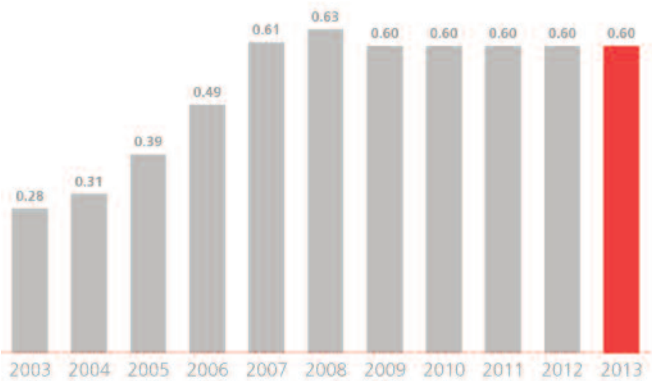
| 2008<br>EUR Mill. | 2007<br>EUR Mill. | 2006<br>EUR Mill. | 2005<br>EUR Mill. | 2004<br>EUR Mill. | 2003<br>EUR Mill. | CAGR(4)<br>(%) |
|---|---|---|---|---|---|---|
| 1,049,632 | 912,915 | 833,873 | 809,107 | 664,486 | 351,791 | 12.2 |
| 626,888 | 571,099 | 523,346 | 435,829 | 369,350 | 172,504 | 14.5 |
| 420,229 | 355,407 | 331,223 | 305,765 | 283,212 | 159,336 | 14.3 |
| 826,567 | 784,872 | 739,223 | 651,360 | 595,380 | 323,901 | 11.1 |
| 63,768 | 51,945 | 40,062 | 35,841 | 32,111 | 18,364 | 16.5 |
| 1,168,355 | 1,063,892 | 1,000,996 | 961,953 | 793,001 | 460,693 | 10.4 |

| | | | | | | |
|---|---|---|---|---|---|---|
| 20,019 | 14,443 | 12,480 | 10,659 | 7,562 | 7,958 | 12.5 |
| 32,624 | 26,441 | 22,333 | 19,076 | 13,999 | 13,128 | 11.7 |
| 17,807 | 14,417 | 11,218 | 8,765 | 6,431 | 5,721 | 13.3 |
| 10,849 | 10,970 | 8,995 | 7,661 | 4,387 | 4,101 | 6.4 |
| 8,876 | 9,060 | 7,596 | 6,220 | 3,606 | 2,611 | 5.3 |

| 2008<br>Euros | 2007<br>Euros | 2006<br>Euros | 2005<br>Euros | 2004<br>Euros | 2003<br>Euros | CAGR 4<br>(%) |
|---|---|---|---|---|---|---|
| 1.22 | 1.33 | 1.13 | 0.93 | 0.68 | 0.51 | (2.3) |
| 0.63 | 0.61 | 0.49 | 0.39 | 0.31 | 0.28 | 7.9 |
| 6.750 | 13.790 | 13.183 | 10.396 | 8.512 | 8.755 | (2.9) |
| 53,960 | 92,501 | 88,436 | 69,735 | 57,102 | 44,775 | 5.1 |

## ATTRIBUTABLE PROFIT TO THE GROUP
EUR Million


## REMUNERATION PER SHARE*
Euros




(*) Figures adjusted to capital increase in 2008

# GENERAL INFORMATION

## Banco Santander, S.A.

The parent group of Grupo Santander was established on 21 March 1857 and incorporated in its present form by a public deed executed in Santander, Spain, on 14 January 1875, recorded in the Mercantile Registry of the 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 8 June 1992 and entered into 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
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## General information

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**www.santander.com**

## Shareholders' Office

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## Relations with investors y analysts

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## Customer attention department

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28660 Boadilla del Monte
Madrid
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Telephone: 91 257 30 80
Fax: 91 254 10 38
atenclie@gruposantander.com

## Ombudsman

Mr José Luis Gómez-Dégano,
Apartado de Correos 14019
28080 Madrid
Spain

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**Photographs:**
Miguel Sánchez Moñita, Lucía M. Diz, Javier Vázquez, Ángel Baltanás, Íñigo Plaza, Cris Ryan.

**Production:**
MRM Worldwide

**Printing:**
www.LITOFINTER.com

**Legal deposit:**
M-6944-2014

Santander

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Access our social network profiles via the corporate website.

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a bank for your ideas

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