Annual Report 2017

#Connected

Santander

In 2017 we obtained excellent results the right way: through profitable growth

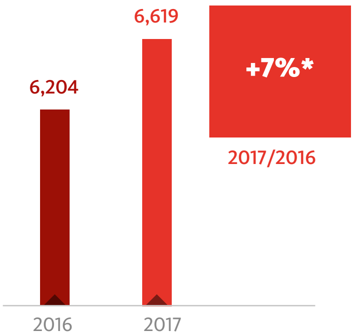
Ana Botín,
Group executive chairman of Banco Santander

> “Our success in 2017 shows that our way of doing business, and our focus on building loyalty, is creating a virtuous circle that delivers growth, profitability and strength”

> “We are one of the most profitable and efficient banks in the world, allowing us to lend more to customers, increase the per share dividend and organically generate capital”

ATTRIBUTABLE PROFIT

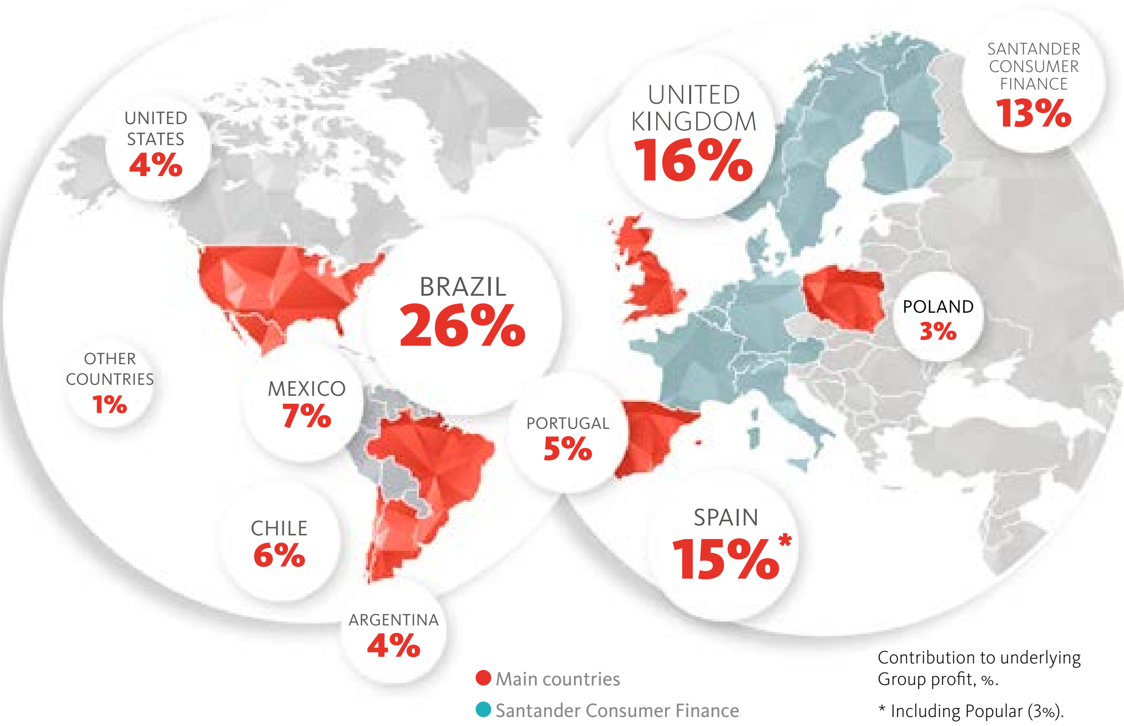
(Millions of euros)



* +7.4% in constant euros

Return on tangible equity (underlying)	**11.8%**	Fully loaded CET1 capital ratio	**10.84%**
Efficiency (cost-to-income)	**47.4%**	NPL ratio	**4.08%**

Balanced geographic diversification is key to our stable and predictable growth



Contribution to underlying Group profit, %.

* Including Popular (3%).

and a strong balance sheet, while helping people and businesses prosper

> “Our leading positions in 10 core markets, with a total population of a billion people, provide us stability and new opportunities”

> “Our scale, our diversification and the predictability of our business give us strong foundations on which to innovate”

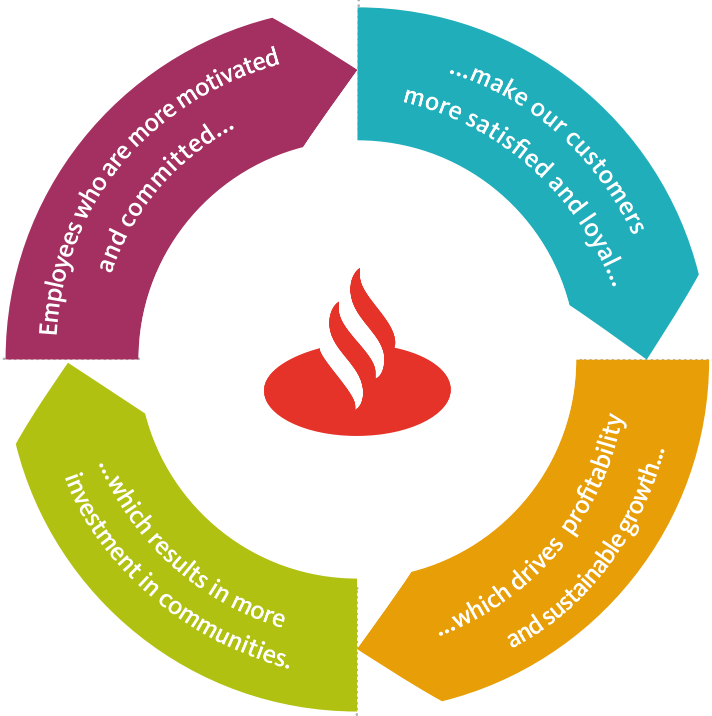
81%
employees believe that their colleagues behave in ways that are more simple, personal and fair

77%
of employees are engaged

17.3 (+13%)
million loyal customers

25.4 (+21%)
million digital customers

People
202,251



Customers
133
million

Communities
2.1
million people helped in 2017

Shareholders
4.0
million

44,862
scholarships granted in 2017

1,295
agreements with universities and academic institutions in 21 countries

16.6%
total shareholder return

+11%
cash dividend per share growth

Figures excluding Banco Popular, except number of employees and data on shareholders.

Simple | Personal | Fair

> "Our purpose is to help people and businesses prosper"

Our contribution to society

Santander contributes to the economic and social progress of the communities in which it is present

People

€12,047 million Personnel expenses[1]	**€98 million** invested in employee training, with an average of 39.6 hours of training per employee	**97%** of employees have permanent contracts

Customers

€848,914 million Loans outstanding (net)	**8/10** Lending grew in eight out of the Group's ten core markets, particularly household and business lending	**›250,000** microentrepreneurs supported in Brazil and other countries

Shareholders

€3,540 million[2] Total shareholder remuneration	**€88,410 million** stock market value at year-end 2017, largest in the euro zone	**€0.22** dividend per share, +7%[3]

Communities

€183 million Social investment	**€54 million** allocated to programmes and projects to support communities	**€129 million** allocated to universities

Suppliers

€7,770 million Payments to suppliers	**9,104** suppliers in the Bank's network	**95%** 95% of the Group's suppliers are local

Tax contribution

€7,972 million Taxes paid	**€4,137 million** corporate income tax	**€3,835 million** social security payments and other payroll taxes made by the Group, non-recoverable VAT and other taxes

1. From Group audited accounts.
2. Subject to the approval of the fourth dividend against the 2017 results by the board of directors and the shareholders' meeting.
3. Adjusted for the July 2017 capital increase.

A responsible bank that helps address major global challenges: financial inclusion, job creation and sustainable growth

The best company to work for

Santander is one of the three best banks to work for in the majority of its core markets. In 2017 it launched a new performance management model which places importance on the corporate culture and behaviours (40%) as well as on business objectives (60%).

See more on pages 40-41 of this report

Transparency

For Santander, transparency goes beyond meeting legal or regulatory disclosure requirements. It means maintaining an open and fluid dialogue with all its stakeholders. This dialogue and the stable, lasting relationships it engenders allows us to be more responsive to relevant issues that can arise and to our stakeholders' expectations.

See more on page 48-51 of this report

Committed to higher education

Santander invests more in supporting higher education than any other private company in the world (according to the Varkey Foundation in cooperation with Unesco). The main areas of focus are access to education, job skills, fostering university student entrepreneurs and the modernization of universities.

See more on page 49 of this report

EUROMONEY
AWARDS FOR EXCELLENCE
2017

A trusted partner for SMEs

SMEs are the main driver of job creation. Santander has a comprehensive offering to help SMEs as they grow, which goes well beyond just a financial offering. In 2017 it was named by *Euromoney* magazine for the second consecutive year as the Best Bank in the World for SMEs.

See more on page 43 of this report

Inclusive, sustainable growth

Santander promotes financial inclusion in order to support social and economic progress in the countries where it operates. The Bank promotes microfinance programmes in countries such as Brazil, Mexico and Argentina.

See more on pages 50 of this report

MEMBER OF
Dow Jones Sustainability Indices
In Collaboration with RobecoSAM

Santander is one of the ten most highly ranked banks in the world in the Dow Jones Sustainability Index

Highlights in 2017

160
YEARS

Santander celebrates its 160th anniversary

Banco Santander celebrated its 160th anniversary on 15 May 2017. The Bank was founded in the city of Santander, Cantabria (in the north of Spain) to finance the growing trade between the port of Santander and the Americas.

Increased target for profitability

During the *Group Strategy Update* held in New York in October, Santander raised its target for return on tangible equity (RoTE) for 2018 from 11.0% to 11.5%. The increase reflected the improved economic outlook in some of the Group's core countries.

+0.5 pp
increase in RoTE target

Banco Santander to sponsor of the UEFA Champions League

The Bank announced in November that it will be the official sponsor of the UEFA *Champions League* for three seasons starting in 2018. The *Champions League* is the world's most prestigious football club competition, with mass audiences in Santander's core markets in Europe and the Americas. The Champions League final is watched live by more than 160 million people.

UEFA
CHAMPIONS LEAGUE

Creation of Santander X, a unique ecosystem for universities and entrepreneurs

Banco Santander and 40 universities launched in October Santander X, which aims to be the largest platform in the world for promoting university entrepreneurship. This is a network in which universities and entrepreneurs from all over the world will be able to collaborate, share ideas and knowledge, and attract investment.

See more on pages 24-25 of this report

60
universities engaged

Openbank becomes the first fully digital Spanish bank

The new Openbank uses an IT infrastructure hosted in the cloud. This enables it to offer a fully digital proposition with innovative features and meet the highest security standards.

See more on pages 32-33 of this report

Openbank
Grupo Santander

FULLY
digital bank

Santander Río integrates the Citibank N.A.'s retail business in Argentina

Santander Río in April integrated the retail business acquired from Citibank N.A.'s Argentine unit into its network. As a result, it now has 482 branches, over 3.34 million individual customers, 288,000 SMEs and 1,300 corporates

482
branches

3.6
million customers

Santander acquires business from Deutsche Bank in Poland

The Santander Group reached an agreement to acquire the commercial and private banking business of Deutsche Bank in Poland. This transaction reinforces Bank Zachodni WBK (the local subsidiary of the Santander Group) as the third bank in Poland. The acquisition is expected to generate a 15% return on investment in 2021 and be accretive to Santander's earnings per share.

11.7%
combined market share in lending

superdigital

Santander Brazil launches Superdigital, a digital payment platform

In April, Santander Brazil launched Superdigital, an online and mobile platform that enables users to make and receive payments with no need for a bank account. By the end of the year, Superdigital had over 1 million users.

See more on pages 16-17 of this report

OVER 1
million users

Santander Group Awards in 2017

The Banker

- *Global Bank of the Year*
- *Bank of the Year in Latin America*
- *Bank of the Year in Brazil, Spain, Chile and Portugal*

Euromoney

- *Best Bank in the World for SMEs*
- *Best Bank in Latin America*
- *Best Bank in Brazil, Poland, Chile, Puerto Rico and Portugal*

Santander acquires Banco Popular, strengthening its leadership in Spain and Portugal

On 7 June 2017, Banco Santander acquired Banco Popular following its resolution by European and Spanish authorities. This transaction is underpinned by a good strategic and business fit for the Santander Group and will add value for customers and Banco Santander shareholders.

The acquisition provided financial stability to Banco Popular, enabling it to return to operational normality after a strong outflow of deposits in the preceding months, maintaining systemic stability and without drawing on public funds.

Strengthening of the franchise

Expected return on investment of
13-14%
in year three

Banco Santander + Banco Popular

Largest BANK in Spain
19% market share in lending

Portugal's leading private bank
~17% market share in lending

Key figures and milestones of this acquisition:

- **A capital increase** of Banco Santander of €7,072 million to support the transaction. The issue was eight times oversubscribed.
- **The sale of 51% of Banco Popular's property assets**, with a nominal value of €30,000 million.
- **The launch of a voluntary commercial action** aimed at retail customers affected by the resolution of Banco Popular, with an acceptance rate of 78%.
- **The appointments** of new members to the board of directors and its committees:
  Chairman of Banco Popular: Mr Rodrigo Echenique.
  Chief executive officer: Mr Rami Aboukhair.
- **The sale of Totalbank** of Miami, Florida, to Chile's Banco de Crédito e Inversiones for US$ 528 million.

Annual Report 2017

1

2

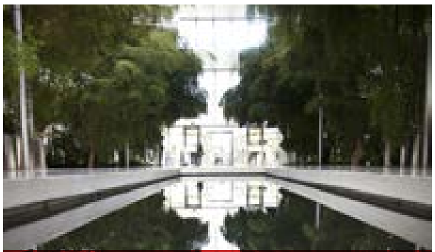
The online version of the 2017 Annual Report will be available as of the annual general meeting on March 23rd. You can access via smartphone or tablet by scanning the QR code.

http://www.santanderannualreport.com/2017/en/

Browse the document by clicking directly on the section in the table of contents. To return to the contents page, press home from any page.

3

4



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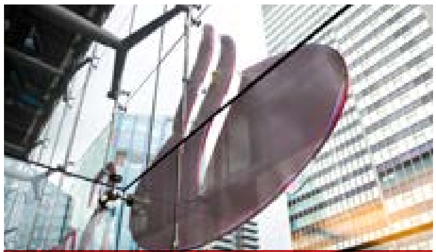


Message from Ana Botín

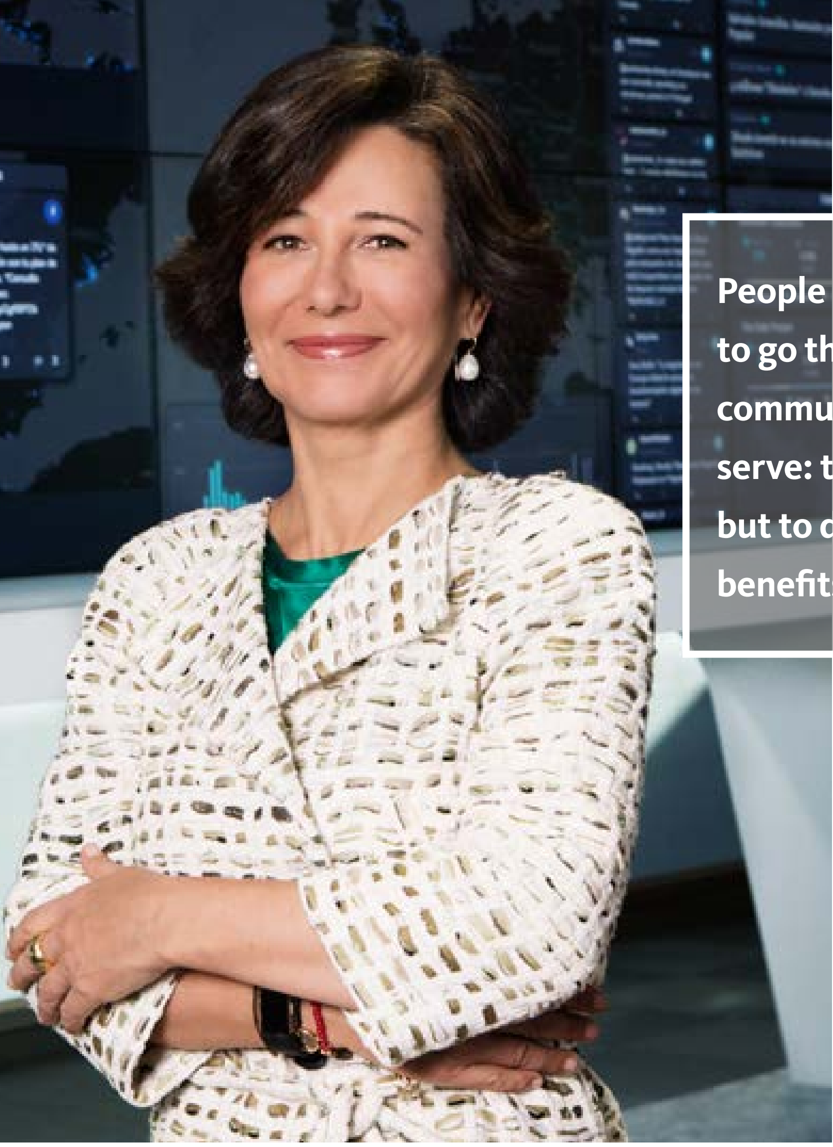
Simple, Personal and Fair – these three words are the bedrock of a responsible bank, and of a digital bank

We are living in an age of unprecedented change. An economic revolution, powered by digital technology, which is creating new challenges and opportunities at a pace we have never seen before. That change is having an impact on politics and society on every continent. And for Santander, it has an impact on how we do business.

To succeed in this revolution, **a business needs one thing more than anything else: loyalty**. Why? Because people have more choice and information than ever before. Consequently, the expectations people have of businesses are higher than ever before. People don't just expect to be treated personally, quickly and fairly – as an employee or a customer. They expect businesses to go the extra mile in the communities they serve: to make a profit, yes, but to do so in a way that benefits society overall.

Get this right and a business can prosper from the virtuous circle of loyalty. Research shows that employees are more likely to be motivated if they work for a company with a strong social purpose. Their motivation means better customer service, building customer loyalty. That loyalty delivers sustainable returns. And those returns build loyalty among shareholders, and enables the business to invest and do more in the communities it serves, fulfilling its purpose.

All of this is reflected in Santander's approach to business. **Our purpose is clear: to help people and businesses prosper**. Our aim is to be the best retail and commercial bank, by earning the lasting loyalty of our people, customers, shareholders and the communities we serve. How do we achieve this? By being Simple, Personal and Fair in all we do. These three words are the bedrock of a responsible



People expect businesses to go the extra mile in the communities they serve: to make a profit, but to do so in a way that benefits society overall

bank. They are also the hallmarks of a digital bank. Digital banking is simple. A digital bank uses data to personalise its service. And a digital bank – like any good business – treats those it serves, and those who work for it, fairly.

I am confident that we can deliver this aspiration by applying the wisdom and experience we have built up over generations to innovate and reinvent banking, while maintaining the strengths that have made us successful. We can do so because

- our growth, profitability and strength show **our strategy is working**
- our scale, diversification and predictability give us **strong foundations to innovate**
- our culture – our relentless focus on being **a responsible bank** – will strengthen people's loyalty in our brand.

Let me take each of those in turn.

Our strategy is working

Our success in 2017 shows that our way of doing business, and our focus on building loyalty, are creating a virtuous circle that delivers growth, profitability and strength. The Group again delivered very strong results for the year, ahead of plan on all our targets – growing underlying profit before taxes by 20% and earning the loyalty of a further 2 million customers. We have endeavoured to create value for our customers, by lending more to them (our loans book is up 2% compared to last year excluding Popular), and by improving our value proposition (customer funds are up 8%).

Here's the detail.

Growth: Last year, I said we would increase our number of loyal customers by a further 1.8 million to 17 million, and invest in technology to raise the number of digital customers to 25 million. We have achieved these targets, with loyal customer growth of 13% compared to last year to 17.3 million, and digital customer growth of 21% to 25.4 million. This had positive impacts on our revenues – in particular the net fees line grew by 14% to €11.6 billion.

Growth

Loyal Customers

17.3 million
(+13%)

Digital Customers

25.4 million
(+21%)

Customer revenues

€45,892 million (+11%)

> "We have strong foundations. We have scale. We are diversified. Our business is predictable"

Profitability

Cost to income ratio

47.4%
(-70 bps)

RoTE

10.4%
(+3 bps)

Strength

Attributable Profit

€6,619 million (+7%)

FL CET1

10.84%
(+29 bps)

Profitability: Santander is one of the most profitable banks in the world (10.4% RoTE) and, as I set out last year, we maintained a broadly stable cost to income ratio making Santander one of the most efficient banks in the world (47% cost to income ratio). This allows us to lend more to customers; increase dividends (11% cash dividend per share increase) and generate capital through organic growth (53 bps increase) all at the same time.

Strength: I said that in 2017 our aim was to increase our earnings and dividend per share; and that we would do this while continuing to grow our capital towards our target of reaching more than 11% Fully Loaded Common Equity Tier 1 by 2018. How have we done? We have grown our attributable profit per share by 1% compared to last year, and we have increased our FL CET1 by 29 basis points to 10.84%, on track to achieve our 2018 target.

As a result of our growth, profitability and strength, we were able to acquire Banco Popular when it ran into difficulties. We executed the transaction without government assistance, acting fairly with respect to Popular's teams and customers and in the best interests of our shareholders. I would like to congratulate our team who worked tirelessly to put in place the €7 billion capital increase to support the deal within weeks, and thank our shareholders for their confidence in us.

It was followed by the largest sale of real estate assets in Spanish history and a responsible approach to dealing with depositors, with the aim of ensuring their business remained within the Santander Group.

This has obviously been a highlight of the year, but it should not overshadow what has happened elsewhere. We will expand in Poland after reaching an agreement to buy part of Deutsche Bank's business. In the United Kingdom, as our business prepares for the challenge of Brexit, we have seen sustained strong performance. In Brazil, despite political and economic uncertainty we grew our revenues by 18% compared to last year, the strongest growth among all banks, while narrowing the gap in profitability compared to our peers. In the United States, 2017 was a pivotal year for Santander US with significant progress on regulatory and business issues: we passed Federal Reserve's qualitative capital stress test, made the first dividend payment to Group since 2011, and grew underlying profit by 5%.

Strong foundations to innovate

This performance matters as we implement our plans for digital growth, as behind these dry statistics lie some key points.

First, we have **scale** – and scale gives us insight. We don't simply have 133 million customers: we know those customers – and in the case of our 17 million loyal customers, we know them very well. In my mind, it's much better to have a deep understanding of many customers in 10 core markets, than it is to have a shallow understanding of the same number of customers in dozens of markets. In the digital age, that depth of insight combined with our scale is invaluable, and those relationships are priceless.

Second, we are **diversified**. Our business is mostly focused on retail banking, serving a diverse range of customers, and is balanced between developed economies and emerging economies and between Europe and the Americas, where growth is expected to be strong in 2018. The US will see its ninth year of economic expansion – the longest upward cycle since 1850 – which will help propel growth elsewhere. In the Eurozone, we expect to see strong growth of 2.3%. Looking at our major markets, Spain is forecast to see its fourth consecutive year of growth of around 3%; while the UK's economic growth, although expected to be subdued due to uncertainty caused by Brexit, is forecast to be 1.4%. Meanwhile the Brazilian economy, having returned to growth in 2017, is expected to grow by 3.2%, supported

> We aim to redefine banking in a way that serves the distinct needs of all our customers, through common, efficient and flexible global platforms

by historically low interest rates: business confidence is at the highest levels of the last years. And in Mexico, while the economy is still overcoming the uncertainty regarding the renegotiation of NAFTA and the impact of the September earthquake, it is expected to benefit from structural reforms.

Our leading position in 10 core markets, with an aggregate population of a billion people, gives us stability and presents us with new opportunities. In these markets, digital technology is making it easier to win new customers – especially the 160 million people in Latin America who are "unbanked." And thanks to our global network, I see great potential in developing relationships to serve our customers better along natural corridors of economic opportunity – such as between Brazil and Argentina, or the United States and Mexico.

Third, our business delivers **predictable results throughout the economic cycle**. This is because we are diversified, and thanks to our leading market shares in nine of our 10 markets, which allows us to sustain consistent and predictable results. Compared with our peers, for the last twenty years Santander has had the lowest volatility in earnings. This enables us to pay dividends, grow our business, invest in new technology, and as in last years to organically generate capital.

And this brings me to **our approach to innovation**. Our sector, like all sectors, faces the challenge of the digital revolution. We aim to redefine banking in a way that serves the distinct needs of all our customers, through common, efficient and flexible global platforms, which can support our local businesses. Our customers want services that are frictionless anytime, anyhow and anywhere. To provide that we need platforms that are resilient and flexible.

To achieve this, we describe our approach to innovation as reliable "supertankers" and agile "speedboats". The supertankers are our established businesses, carrying the bulk of our revenues and our growth. The speedboats are our new opportunities, with the flexibility to race ahead of our competitors. Each shares their experiences and all perform better as a result.

In 2017 we showed what this means in practice. In Spain, we relaunched Openbank with its own, new IT structure and new team. It now serves 1 million customers, offering a full range of services – from stocks to mortgages, but only has one branch and just 70 fulltime employees, some of whom have never worked for a bank before. In Brazil, SuperDigital – which allows customers to carry out transactions on their phones without the need for a bank account – is growing at around half a million customers a year.

Meanwhile, we've been investing and innovating in new payment systems. Santander is likely to be one of the first global banks to roll out in the next few months our distributed ledger technology to retail customers across Europe and the Americas, bringing real benefits by reducing the speed of international payments from 2-4 days to end of day/overnight. We have completed live pilots in the UK and Spain, with over 1,500 payments made for a value of €2 million. Leveraging this technology and other state of the art solutions, Santander Pay aims to become the definitive crossborder payment solution for our customers worldwide.

As the digital world of financial services continues to grow, much of today's regulation remains rooted in the analogue age. Many insurgent market entrants do not always face the same rigorous regulation as banks like Santander. Over time, the regulation of these businesses must and, I believe, will develop, guaranteeing a level playing field promoting innovation for banks as well as for new entrants. I am certain that reliable, responsible businesses with loyal customers, led by Santander, will emerge as the winners.

Shareholders

Cash Dividend per share

€0.19/ share
(+11%)

Tangible Net Asset Value per share

€4.15/ share
(+6% excluding exchange rate impact)

Attributable Profit per share

€0.40/ share
(+1%)

Total Shareholders' return 2017

16.6%
(vs. 12% European banks)

> Putting our purpose at the heart of our business is critical if we are to be a truly responsible bank. Our actions need to match our words

Responsible bank

- More than 250,000 microentrepreneurs supported
- Financial inclusion programmes to more than 300,000 people
- €129 million invested in education in 2017

A responsible bank

This brings me to the theme of responsibility. There are many hallmarks of a responsible bank, but here I would like to single out a few: a strong team that lives by clear values and behaviours; good governance; and a strong sense of purpose that drives the business.

Let me start with the team. To thrive in today's world, we obviously need to attract and retain the best talent. But we also need to attract a diverse team (women now make up 36% of our board), so that we are better able to understand and serve our customers. If we are to build this team, we need offer people great opportunities. But today, people want more than that. As I mentioned above, people want to work for a company that lives by its values, has a strong sense of purpose, and gives them the chance to make transformational change that benefits millions of people.

Building this team will enable us to implement change at pace – which requires us to work with agility and focus. This year, we've shown how we can work better, together, across all markets where we operate. Example of this active collaboration are the four speedboats launched, which are global businesses with key executives from various countries.

But there is more to do. A strategic target for us this year is to focus on developing our businesses by fostering greater collaboration. Each of our businesses has local management and is locally responsive, but I want to see them extract full value from being part of a group, so we continue to create the best possible products for our customers. And, wherever our businesses operate, we want to ensure that everything they do is Simple, Personal and Fair.

To turn these three words into reality, we are embedding our common culture in the day to day of all our teams, encouraging them to live by eight key behaviours. Starting in 2017, under our newly created performance management system, *MyContribution,* 40% of variable remuneration is linked to how well employees live our behaviours. This applies to our leadership as well. Across all markets, we have undertaken a series of initiatives (such as *KISS – Keep It Simple Santander* in the UK) to change processes so they are Simple, Personal and Fair. Alongside this, we have also made changes to our governance, to ensure that we have easy to understand policies and procedures, and clear lines of accountability so everyone knows who is responsible for what; transparent processes, so we, our regulators and, where appropriate, the public can see how decisions are made; and clear metrics, so we can assess our performance.

I also want to take the opportunity again to thank Matías Rodríguez Inciarte and Isabel Tocino Biscarolasaga for their great contribution in our Board. Matías, in particular, has been a key senior executive, a board member for more than three decades and an important part of Santander's history. And I would like to welcome Ramiro Mato García-Ansorena, who I am certain will add much value thanks to his broad financial and international banking experience.

Above all, we need to be sure that we are managing risks in a prudent, responsible way. This year, for instance, we upgraded all of our credit risk models across the group to reinforce the sustainability of our business, and we have increased our investment in Cyber Security to stay at the forefront of technological advances in the field. We have also dramatically reduced our exposure to real estate in Spain, which will reach nonmaterial levels by the end of 2018.

More than that, though, I want to ensure that we are fulfilling our purpose – to help people and businesses prosper. Putting that purpose at the heart of our business is critical if we are to be a truly responsible bank. Our actions need to match our words. For example, I was immensely proud of how our teams in Puerto Rico and Mexico responded to the crises caused by both Hurricane Maria and the earthquake, donating time and money to help those in need. Our scale and strength gives us the ability not just to help in these circumstances, but to support inclusive and sustainable growth wherever we operate. In doing so, we need to tackle three major challenges.

The **first challenge**: Two billon people still have no access to the financial system. But once they have a mobile phone and can get online, they can gain access to a bank. They don't need to travel to deposit money or take out a loan or get insurance. The bank is there in their hands. This is empowering millions of

The challenge we face is nothing less than the reinvention of banking. Our results, our targets, and above all our approach, show that Santander is rising to that challenge – and winning

people especially women. Between 2011 and 2014, 700 million people became account holders at banks or other financial institutions for the first time, reducing the number of "unbanked" adults by 20 percent. As I mentioned above, our services and products are already bringing the unbanked into the financial system, enabling them to share the benefits of growth. In 2017, we supported more than 250,000 entrepreneurs with microcredits, mainly in Brazil, and our financial inclusion programmes have reached more than 300,000 people. Our aim is to up the pace, and do even more.

The **second challenge**: 600 million jobs need to be created over the next 15 years to match the growth in the global workforce. Many of these jobs will be created by small businesses, which are the engine of economic growth. And those jobs will largely go to people with skills needed in the digital age. To help these businesses grow, we will use technology to provide a personalised service, giving them online advice and helping them to export to foreign markets. We've created a global online network so we can put a small business in Warsaw or Oporto in touch with potential customers in São Paulo or Mexico City.

And these new businesses need to be sustainable businesses – which is the **third challenge**: the need for sustainable growth. Banks need to help businesses act in a socially responsible way. That means a number of things, such as supporting businesses as they cut carbon emissions and make the transition to the green economy; financing innovation in green technology; encouraging businesses to operate in a way that supports local communities, respect human rights and encourages inclusive growth. Thanks to Santander's footprint and scale, we are in a good position to support businesses that do this.

By supporting inclusive and sustainable growth in this way, we shall do even more to help people and businesses prosper. And our efforts will be supported by the unique multinational network of 1,300 universities that Santander has created over several decades. Santander is the largest corporate contributor to education in the world, investing 129 million euros in 2017 alone. Our task now is to work with this network – the research, innovation and skill of these universities – to create a formidable partnership to tackle these global challenges.

Looking ahead

As I look to the future, there will be many challenges to address: the supervisory and regulatory regime, especially in Europe and in the UK; emerging risks related to the normalization of interest rates, exchange rate headwinds from a strong euro; and continuing geopolitical volatility. However, my team and I look ahead with confidence. Strong growth, digital innovation, meeting the global challenges – all this is why I believe Santander's best days lie ahead. As the world changes, so will we.

We will provide more details on how we are transforming ourselves to be prepared for future challenges at our Investor Day in October 2018. For this year, I would like to remind you of our strategic targets:

Growth: We aim to have 18.6 million loyal customers (an 8% increase) and 30 million digital customers (an 18% increase).

Profitability: We are targeting a RoTE of more than 11.5%.

Strength: We are aiming for FL CET1 above 11%.

And for our shareholders, we reiterate our targets of reaching double digit growth in earnings per share and growing our cash dividend per share in 2018.

So let me end where I began. We are living through an economic revolution. The challenge we face is nothing less than the reinvention of banking. Our results, our targets, and above all our approach, show that Santander is rising to that challenge – and winning.

Your continued support is key, and I would like to thank you for your trust.

Ana Botín
Executive Chairman

Main targets for 2018

18.6
million loyal customers (+8%)

30
million digital customers (+18%)

RoTE
more than
11.5%

Fully loaded
CET1 above
11%

EPS
Double digit growth

Cash DPS
Growth

Superdigital

Banking without a bank

Superdigital is a mobile platform for making deposits, withdrawals and payments even if you do not have a bank account. Santander Brazil launched Superdigital using its own tools and technology. Developed as a mobile-first solution, Superdigital is simple and easy-to-use. For many customers, it has become their main financial services channel. Superdigital will soon offer its customers microcredits as well.

Luiz Fortunato, centre, law student and Superdigital customer, with his friends in the Praça Pôr do Sol of Sao Paulo.

Financial services available to everyone

"I use Superdigital to buy directly online, without paying charges to any bank because I hardly use the services they offer me," explains Rafael De Menezes, a Brazilian university coordinator, aged 32. "The app is designed to be used by young people. It is very intuitive," he added.

"We needed to reach customers who consumed and thought differently. Superdigital is an incredible tool for this market because it is a live, democratic product. It is for everyone," explains Ezequiel Archipretre, CEO of Superdigital.

> "THE APP IS DESIGNED FOR YOUNG PEOPLE. IT IS VERY INTUITIVE"

Superdigital is a digital payment platform that is defined as simple and young. It was relaunched with an eye on the new generations. "When we discussed the product concept, we knew we had to do things differently," explains Renata Canin, Superdigital's head of marketing. To achieve this when they developed the app, they took into account the opinions of nine influencers with millions of followers in Brazil.

"Superdigital provides people with a totally different experience from the one on offer in the traditional financial market," explains Fernando Oliveira, the software development manager. One of the most interesting features is being able to chat among users, just like a messaging app. "In December alone, 600,000 messages were exchanged using Superdigital," notes Mr Oliveira.

Another Superdigital functionality is splitting expenses among groups ("vaquinhas"). What Rita Siqueira, a 22-year-old university student and call centre supervisor, likes most about Superdigital is how easy it is to buy bus tickets in São Paulo. "It's very simple. Superdigital saves me a lot of time," explains Ms Siqueira.

Rita Siqueira

But Superdigital targets not only young people. In Brazil, 32% of over-15s do not have a bank account. "We have agreements in place in less usual segments for the Bank, such as agribusiness and temporary employment agencies," explains Ezequiel Archipretre.

At the end of 2017, Superdigital had more than a million customers.Of these, 350,000 belong to segments classified as "of little interest" for the traditional financial services system.

"This is crucial for Santander Group as a whole," adds Sergio Rial, CEO of Santander Brazil. "It enables us to broaden our possibilities of banking the unbanked."

> "SUPERDIGITAL MAKES US INCLUSIVE IN BRAZILIAN SOCIETY"

"We are reaching different profiles and new types of customer. It makes us more inclusive in Brazilian society and is the perfect complement to our portfolio," concludes Mr Rial.

Message from José Antonio Álvarez

Grupo Santander carried out its business in 2017 in a more favourable environment, one of the most positive in recent years. The global economy and, in particular, the economies of the countries where the Bank operates, secured the upswing seen in the second half of 2016. The low interest rates in mature economies continued to be the most unfavourable factor for banking activity.

In this environment, Grupo Santander results again underscored the soundness of our business model. Underlying profit grew at double-digit rates at Group level and in most countries, the RoTE was one of the sector's highest and our capital ratios increased further.

I would like to thank our more than 200,000 professionals, as the results achieved in 2017 would not have been possible without the contribution of each one of them.

Our objective is to consolidate our position as the best retail and commercial bank for our employees, customers, shareholders and society in general. To this end, we must continue to strengthen the pillars of our corporate culture, being Simple, Personal and Fair in all we do. We are convinced this is the best way to lay the foundations for progress and improve not only the quality of the income statement, but also the company's value and the share price.

Grupo Santander results again underscored the soundness of our business model

The Group's performance in 2017

Our **priorities** were to:

1. **Continue our commercial transformation,** both in the traditional banks as well as via new units that work independently under a start-up model. Their objective is to create agile and innovative platforms, focused on creating synergies for the Group. In 2017 we invested around €1 billion in global and digitalisation projects, and we have similar plans for the coming years.

2. **Strengthen our position in the markets in which we operate**. As well as organic growth in most of our countries (mainly in developing markets), 2017 presented us with new acquisition opportunities. The most notable transaction was the purchase of Banco Popular, which enabled us to reinforce our leadership in Spain and Portugal, with the clear aim of generating shareholder value. We also improved our position in retail banking in Argentina, increased stake in Santander Consumer USA and reached an agreement to acquire the retail and commercial business of Deutsche Bank in Poland.

3. **Exit non-core businesses in order to improve the Bank's profitability**. Of note were the sales of 51% of Banco Popular's real estate business to Blackstone and TotalBank in the United States.

We posted an **attributable profit** of €6,619 million, 7% more than in 2016. These results were hit by some **non-recurring impacts** amounting to a net negative €897 million, mainly to do with amortisation of goodwill and ongoing optimisation plans.

Profit before extraordinary results was 14% higher at €7,516 million. Nine of the core units increased their earnings, seven of them at double-digit rates.

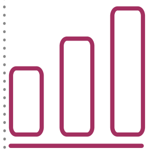
Gross income rose 10% to a record €48,392 million, driven by **double-digit growth in net interest income and fee income** which together generated 95% of revenues. This enabled us to grow consistently and recurrently.

Attributable profit

€6,619
million
+7%

Gross income

€48,392
million
+10%



- Record gross income
- Double-digit growth in net interest income and fee income

Loyal customers **+13%**

Digital customers **+21%**

Operating expenses stable in real terms and on a like-for-like basis

Cost of credit improvement and proactive risk management

The number of digital **customers** grew 21% and loyal clients 13%. Their increase was important for securing quality growth in the income statement.

Operating expenses remained stable in real terms and on a like-for-like basis, despite higher regulatory costs and investments in transformation. **The focus on operational excellence and digitalisation has enabled us to continue to be the reference in efficiency terms,** while our units in seven of our core countries are among the top three in customer satisfaction.

The 4% decline in **loan-loss provisions** and the continued improvement in the cost of credit (to 1.07%) reflect a proactive risk management that has enabled us to keep on enhancing the quality of the portfolio and reduce the NPL ratio to 4.08%.

We are conscious of the importance of strengthening the **risk culture** of all the Group's employees, bolstering, among others, processes in cyber security, prevention of money laundering and operational and reputational risk.

The balance sheet:

- **Lending,** which rose 12%, was balanced between individual customers, consumer credit, SMEs and corporates. Customer **funds,** increased 17%. Both loans and funds were driven by strong growth in developing countries and by the integration of Banco Popular. Excluding Popular, growth would have been 2% and 8%, respectively. All figures are stated at constant exchange rates.
- The Bank's **liquidity** position is very comfortable, as is that of all its units. The liquidity ratios easily meet the minimum requirements.
- We have generated **capital** quarter after quarter. In fully loaded terms, we reached a CET1 ratio of 10.84%, while comfortably meeting the legal requirements.

We ended 2017 with an **underlying RoTE** of 11.8%, one of the highest among international banks, and an **underlying RoRWA** of 1.5%, which we expect to keep on improving in 2018, as we take measures to more efficiently manage risk weighted assets and consumption of capital.

The market positively assessed our strategy and its impact on business. **The total shareholder return** (TSR) was 16.6% in 2017.

Performance of the units in 2017

There are two aspects of business that I consider particularly important.

The first is the **excellent geographic diversification** of our results between mature and developing markets, which gives us stability, recurrence and growth greater than that of our competitors.

The second is that we see a **consistent improvement in countries' profits as well as in their main metrics:** customers, cost of credit, efficiency and profitability.

Spain excluding Popular

We combined the acquisition of Banco Popular and the first steps of its integration with the execution of our strategy in Santander and a very positive business performance.

> We ended 2017 with an underlying RoTE of 11.8%, one of the highest among international banks, and an underlying RoRWA of 1.5%, which we expect to keep on improving in 2018

The *1|2|3* account helped us to add close to 600,000 loyal customers (+42%) in 2017 and the number of digital customers rose 15%, spurred by the launch of *Digilosofía*. The new means of payment strategy led to record sales of cards and we are the mobile payments leader in Spain. This growth produced market share gains in the main products.

Of note in results were the increase in fee income, lower operating expenses and the decline in loan-loss provisions, due to the better credit quality, all of which offset the pressure on net interest income and boosted profits.

Popular

Banco Popular's incorporation produced a loss of €37 million, due to extraordinary charges made for integration costs. Excluding these, underlying attributable profit was €263 million.

We began to integrate Banco Popular, a process that is expected to be completed in the next two years. We have been very careful to ensure this process is done in the most reasonable way in order to attain the efficiency levels promised to the market, but also looking after those affected and treating them appropriately.

A commercial action was also taken for customers of Santander and Popular who were shareholders of Banco Popular. This was successfully completed, with 78% acceptance of the loyalty bonds subscription offer.

Lastly, I would like to point out that we see a recovery of business momentum, reflected in growth in deposits and a slower decline in loans, which were stable in the fourth quarter.

United Kingdom

Business was carried out in an environment of lower growth and uncertainty over Brexit. Customer loyalty remains our priority, aided by *1|2|3 World*, the commercial transformation and operational excellence.

Activity evolved very positively. The current account balances of individuals, mortgages and corporate loans and deposits all increased. The results in the upper part of the income statement were robust, although specific provisions and amortisation of intangibles dented profit.

Santander Consumer Finance

SCF is Europe's consumer finance leader. The unit continued to advance in its strategy of striking brand agreements with car manufacturers and European distributors.

Profit grew for the eighth year running, spurred by a positive trend in revenues, larger volumes and high geographic diversification. The efficiency ratio and cost of credit were also at historically low levels. RoTE increased to 16%.

United States

Santander US passed the Federal Reserve's stress tests in 2017, both quantitative and qualitative. This will enable us to focus on improving the profitability of retail and commercial banking, reducing duplications in costs and optimising the structure of capital, as Santander Holding USA begins to normalise its policy of paying dividends to the Group.

Underlying profit rose 5%. The final profit was hit by impacts stemming from the hurricanes, increased stake in Santander Consumer USA and the tax reform.

Spain exc. Popular
Profit
€1,180 (+46%)
million

Popular
Profit
-€37
million

United Kingdom
Profit
€1,498 (-3%*)
million

Santander Consumer Finance
Profit
€1,168 (+4%*)
million

United States
Profit
€332 (-7%*)
million

* Excluding fx impact

> **Banco Santander's solid position in 10 core markets puts us in a privileged position to seize the opportunities that arise**

Portugal	Profit €440 (+10%) million
Brasil	Profit €2,544 (+34%*) million
Mexico	Profit €710 (+16%*) million
Chile	Profit €586 (+12%*) million
Argentina	Profit €359 (+14%*) million
Poland	Profit €300 (-3%*) million
Global Corporate Banking	Profit €1,821 (+1%*) million

* Excluding fx impact

Portugal
The acquisitions of Banif and Popular bolstered Santander Totta's position as the largest private sector bank in Portugal, gaining market share in new lending to companies as well as in mortgages and positioning it as the country's most profitable bank.

In addition, the good performance of the *1|2|3 World* programme facilitated organic growth in loyal and digital customers, increased volumes and boosted profit by 10%.

Brazil
2017 was an excellent year for our franchise in Brazil. We gained market share, and profit evolution reflected the profitable, sustainable and customer-focused business model, coupled with solid organic growth.

Profit was 34% higher, growth that was well above the sector, underpinned by a significant increase in net interest income and fee income, the fruit of the commercial strategy and greater customer loyalty. These growth rates, together with a lower cost of credit, pushed up RoTE to 17%, higher than in 2016.

The strength of our franchise, combined with better macroeconomic prospects, make us optimistic about recurring results in the future.

Mexico
We are strengthening the distribution model and investing in systems and infrastructure that focus on multichannel innovation, digitalisation and the launch of new business initiatives.

Attributable profit rose 16%. Of note was the 13% increase in net interest income. The RoTE reached more than 19%.

Chile
We continued to consolidate our commercial transformation, launching *digital onboarding,* the first fully digital system, and opening more *WorkCafé* branches. Penetration of high income, SME and large company segments remained a priority, and we began to recover growth in the mass consumer market.

Profit was 12% higher, thanks to a moderate rise in gross income, control of operating expenses and a lower cost of credit.

Argentina
Our bank has a leading position in a country with a high growth potential of the banking system. A greater financial stability environment should enable us to capture this growth and translate it into profits.

Attributable profit was 14% higher than in 2016, driven by gross income growth.

Poland
At the end of 2017 we announced the agreement to acquire Deutsche Bank's commercial and private banking business in Poland, which will strengthen our position (market share of 12% in loans and 11% in deposits). Our aim is to continue to lead in digital channels and innovation.

Profit was in line with 2016 when it benefited from capital gains. Excluding this impact, profit was 8% higher thanks to growth in gross income, control of costs and lower provisions.

The units in **Uruguay** and **Peru** increased their profits 19% and 7%, respectively. Uruguay's were driven by net interest income and fee income. Peru maintained activity, despite the economic downturn, and the cost of credit dropped.

Global Segments
Global Corporate Banking, our wholesale banking business, gained market share in high value-added businesses, under a strategy that places particular importance on efficient use of capital. Santander is securing its leadership

and market position in Spain, Portugal and Latin America. Also noteworthy was the significant growth in our cash management platform for multinationals and a continuous improvement in the services for retail clients. GCB is establishing itself as one of the most profitable units in RoRWA terms.

Lastly, we created the **Wealth Management Division,** which will integrate the private banking businesses and asset management. The creation of this division means focusing efforts on a segment that is efficient in terms of capital consumption and which boosts fee income.

2018 Objectives

The **estimates for 2018** point to GDP growth of around 2% in both mature economies as well as in Latin America.

Banco Santander's solid position in its 10 core markets puts us in a privileged position to seize the opportunities that arise. Our focus in mature markets will be on improving profitability, adapting the business models in order to increase customer satisfaction and gain market share. In developing countries, we will try to use the good conditions to gain market share and improve, even more, our operational efficiency.

We attained our goals in 2017 and begin 2018 in a good position to reach those for this year announced at the Group Strategy Update.

In order to achieve these objectives, we have set the following goals and management priorities:

- **Improve the quality of the income statement** in an environment with significant pressure on spreads.
- **Gain market share on a sustained basis,** as our growth opportunities are in those markets in which we already operate.
- **Continue the commercial and digital transformation** without affecting the efficiency ratio. Offset the investment plan with measures to optimise costs.
- **Improve the main risk metrics.** Manage the higher loan-loss provisions derived from greater lending and the impact of the new accounting regulation on recognition of provisions (IFRS9).

I would like to end by thanking our more than four million shareholders for their confidence in Banco Santander. We are working to give them personalised attention, listening to their concerns and informing the market continuously and transparently on our daily activities.

Our priority is to increase the profitability of their investment in a sustainable way and to this end we are dedicating our best efforts.

José Antonio Álvarez
Chief executive officer

2018 financial objectives announced at the Group Strategy Update

RoTE	> 11.5%
Earnings per share	Double-digit growth
Cash dividend per share	Increase
Fee income	Average growth 2015-2018 10%
Efficiency ratio	45%-47%
Cost of credit	Average cost 2015-2018 1.2%
Fully-loaded CET1	> 11%

Santander X

Opening doors to university entrepreneurs

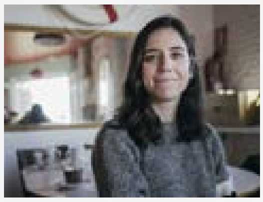
Santander X is an innovative platform that is bringing together all the programmes to support university entrepreneurs that Banco Santander has been carrying out for more than 20 years through Santander Universities. Santander X aims to be a meeting place entrepreneurs. It will be the largest global ecosystem for university entrepreneurship, a shared space for international collaboration among universities, businesses and entrepreneurs who want to make their projects a reality and open up to the world.

Jader Stefanello and Fernando Ferreira, students at the Universidade Federal de Santa Maria in Brasil and winners of the Empreenda Santander 2K17 award for their Lunix Project, which deploys sensors for intelligent management of urban lighting networks.

Connection is the key

José Cárdenas had an idea. After talking with various specialists, the Chilean medical student came up with the idea of creating a device for performing health checks on pregnant women remotely, so that patients would not have to visit a clinic. Although Mr Cárdenas had a clear idea of how to develop the device, it would have to be produced on a large scale to reach the market. In other words, he would need to set up a company.

Patricia Aymá lives in Spain, thousands of kilometres away from Mr Cárdenas but she has several things in common with him. As a student of Biotechnology and Environmental Engineering in Barcelona, during her investigation work, she discovered the potential of bacteria for creating bioplastics.



Patricia Aymá

"Producing bioplastics is expensive. So, we designed an alternative method, using bacteria that produce bioplastics from waste, in a simple and robust manner," explains Ms Aymá. When she saw that the technology could be developed on a large scale, the opportunity appeared, but so did the problem.

"I had a science background, so the most difficult part for me was setting up a company. I had no idea," confesses Ms Aymá. So she signed up to the Santander Explorer programme, while Mr Cárdenas joined Brain Chile: two initiatives by Banco Santander to encourage university entrepreneurship.

"WE CREATED A CONNECTED, OPEN, GLOBAL ECOSYSTEM FOR BUILDING A BETTER FUTURE"

For more than two decades, Santander has been supporting training and development for university students and entrepreneurs with initiatives such as these, and now it has taken a further step forward by creating Santander X.

"With Santander X we want to go one step further by building, together with our more than 1,000 partner universities, the world's largest ecosystem for university entrepreneurship," states Javier Roglá, global director of Santander Universities and Universia. "We created a connected, open, global ecosystem for building a better future for everyone," he adds.

WITH SANTANDER'S SUPPORT, THE IDEAS THAT JOSÉ CÁRDENAS AND PATRICIA AYMÁ CAME UP WITH HAVE BECOME REALITY

Connection is key: Santander X will connect university entrepreneurs and universities worldwide to share knowledge, experience, and best practices. So far, more than 60 universities have signed up for the project and many more are expected.

With Santander's support, the ideas that José Cárdenas and Patricia Aymá came up with have become reality. Mr Cárdenas founded HubbyMed and Ms Aymá created Venvirotech. HubbyMed is set to launch the device in early 2018 and Venvirotech is currently developing its business and strategic plan.

Powered by Santander

Corporate governance

A responsible bank has clear, robust governance, in which accountabilities are well-defined; risks and opportunities are prudently managed; and long-term strategy is designed to safeguard the interests of all stakeholders and society at large.

Balanced board composition

- Of 14 directors, 11 are non-executive and three are executive. 36% are women.
- More than half of the directors are independent.
- The board is diverse in terms of expertise, gender and international experience.

Respect for shareholders' rights

- The principle of one share, one vote, one dividend.
- The Bylaws do not include anti-takeover clauses.
- Encouragement of informed participation at shareholders' meetings.

Maximum transparency in remuneration

- This is essential for generating shareholder and investor confidence.
- Remuneration policy for executive directors and senior management is aligned with our Simple, Personal and Fair culture.

At the forefront of best practices and long-term vision

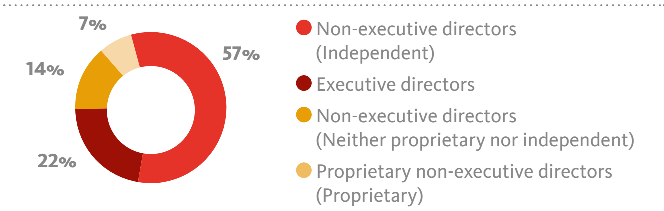
- A strong lead director to foster proactive communications with stakeholders.
- Effective corporate and internal governance system for the supervision and oversight of the Group and its subsidiaries.

Carlos Fernández González

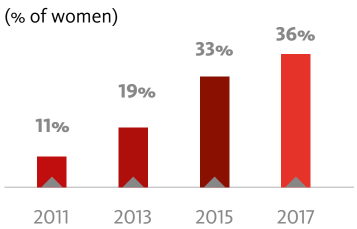
José Antonio Álvarez and Bruce Carnegie-Brown

Belén Romana García and Juan Miguel Villar Mir

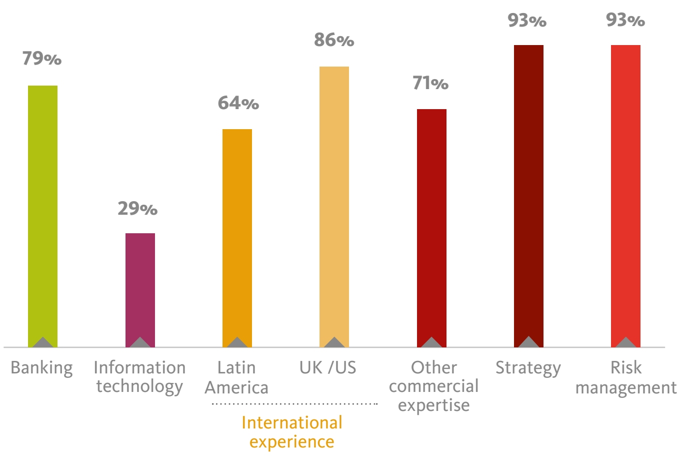
COMPOSITION OF THE BOARD



BOARD DIVERSITY



RELEVANT EXPERTISE OF BOARD MEMBERS (% OF MEMBERS)



Board of Directors

The board of directors is the Group's highest decision-making body, except for matters reserved for the Annual General Meeting of shareholders. The main assets of Santander's highly-qualified board are the experience, knowledge, dedication and diversity of its members.

In line with the Bank's aim and purpose, and as part of its general oversight function, the board takes the lead on decisions regarding the Group's main policies, long-term strategy and corporate culture, the definition of the Group's structure and on fostering the most appropriate corporate social responsibility policies. The board also promotes a prudent risk culture by establishing a solid framework for management, taking into account the regulatory and competitive environment and the Group's long-term interests, and ensuring that the "three lines of defence" model is respected.

The board of directors is also responsible for ensuring that the Group complies with the relevant legislation, respects best practices in the sectors and countries in which it operates, and observes the principles of social responsibility to which it has voluntarily adhered.

All board members are recognised for their professional capacity, integrity and independence. Together, their skills and experience provide the outlook and understanding required to define Santander's long-term strategy.

The annual self-assessment carried out by the board of directors and its committees ensures continuous improvement in the quality and efficiency of the board's operation and composition.

The board defines the Bank's long-term strategy, taking into account the interests of all its stakeholders

The three lines of defence

1ST	Business and support units
2ND	Risk management and compliance
3RD	Internal audit

Meetings of the board of directors held in 2017

15

Meetings of the board committees

96

Sol Daurella Comadrán

Javier Botín-Sanz de Sautuola and Rodrigo Echenique

Changes in the composition of the board and its committees

- In June 2017, Ms Homaira Akbari and Ms Esther Giménez-Salinas were appointed members of the audit committee and the risk, regulation and compliance oversight committee, respectively, replacing Mr Juan Miguel Villar Mir.
- In November, Mr Ramiro Mato García-Ansorena was designated independent director when Ms Isabel Tocino left the board on her appointment as non-executive (independent) vice chairman of Santander Spain. Mr Mato was the chief executive of BNP Paribas in Spain and Portugal for 20 years.
- Mr Matías Rodríguez Inciarte left the board in November and was appointed non-executive chairman of Santander Universities.
- In November, Mr Carlos Fernández was appointed to the remuneration committee and ceased to hold office as a member of the risk, regulation and compliance oversight committee.
- In December, Ms Belén Romana was appointed as a member of the innovation and technology committee.

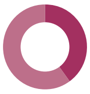
Remuneration policy

The Group's remuneration policy is based on the following principles:

1. Remuneration must be aligned with shareholders' interests.
2. Fixed remuneration must account for a significant part of total remuneration.
3. The variable component must reward performance based on the achievement of agreed targets, reflecting the employee's role and responsibilities, in a framework of prudent risk management.
4. Similarly, appropriate corporate benefits to support employees and their families must be provided.
5. The total remuneration package and its structure must be competitive in order to help attract and retain employees.
6. When decisions on remuneration are taken, conflicts of interest must always be avoided.
7. There must be no discrimination in remuneration decisions.
8. The remuneration structure and amount in each country must comply with local practices and regulations.

To reinforce its culture, in 2017 the Group made a fundamental change in the way it appraises employees and sets their variable remuneration:

60% what we do (business objectives)



40% how we do things (SPF behaviours)

Board remuneration as a percentage of attributable profit

0.42%

For more information on corporate governance see pages 72 to 109 of Banco Santander's 2017 Annual Report.

Jaime Pérez Renovales, Homaira Akbari and Esther Giménez-Salinas i Colomer

Ramiro Mato García-Ansorena (left), Guillermo de la Dehesa Romero and Ignacio Benjumea Cabeza de Vaca

Internal governance

Santander is structured around subsidiaries, of which the parent is Banco Santander, S.A. and which are autonomous in capital and liquidity. Its system of internal governance consists of a governance model and corporate frameworks, which are approved by Banco Santander and are adopted by the subsidiaries while taking their local needs into account.

The main features of the governance model are:

- Presence of Group representatives on the subsidiaries' respective boards of directors.
- Reporting lines of the local CEOs / *country heads* to the Group CEO.
- Interaction between the Group and the subsidiaries' oversight, management and business functions, including the Group's participation in the appointment, target-setting and assessment of results of the subsidiaries' key positions.

Meanwhile, the corporate frameworks establish the common principles in matters that have a significant impact on the Group's risk profile. These include risks, compliance, technology, cybersecurity, audit, financial accounting and control, financial management, strategy, human resources, communication, sustainability and branding.

International advisory board

The international advisory board, comprising eight non-executive members, provides the Group with strategic advice, focusing particularly on innovation, digital transformation, cybersecurity and new technologies. It also offers its views on the trends it sees in capital markets, corporate governance, brand and reputation, regulation and compliance, and in global financial services with a focus on customers.

Chairman
Mr Larry Summers
Former US Treasury Secretary and President Emeritus of Harvard University

Members

Ms Sheila Bair
Former Chair of the Federal Deposit Insurance Corporation and President of Washington College

Mr George Kurtz
CEO and co-founder of CrowdStrike

Ms Marjorie Scardino
Former CEO of Pearson and director of Twitter

Mr Francisco D'Souza
CEO of Cognizant and director of General Electric

Ms Blythe Masters
CEO of Digital Asset Holdings

Mr Mike Rhodin
Senior Vice President of IBM Watson

Mr James Whitehurst
CEO of Red Hat

Secretary
Mr Jaime Pérez Renovales

Board of directors of Banco Santander

Ms Ana Botín-Sanz de Sautuola y O'Shea
Group executive chairman and executive director

Mr José Antonio Álvarez Álvarez
Chief executive officer and executive director

Mr Bruce Carnegie-Brown
Vice chairman and lead non-executive director (Independent)

Ms Homaira Akbari
Non-executive director (Independent)

Mr Carlos Fernández González
Non-executive director (Independent)

Mr Ignacio Benjumea Cabeza de Vaca
Non-executive director

Mr Juan Miguel Villar Mir
Non-executive director (Independent)

● Executive committee
▲ Audit committee
● Appointments committee
■ Remuneration committee

● Risk, regulation and compliance oversight committee
▲ Innovation and technology committee

Mr Rodrigo Echenique Gordillo
Vice chairman and executive director
● ▲

Mr Guillermo de la Dehesa Romero
Vice chairman and non-executive director
● ● ■ ● ▲

Ms Belén Romana García
Non-executive director
(Independent)
▲ ● ▲

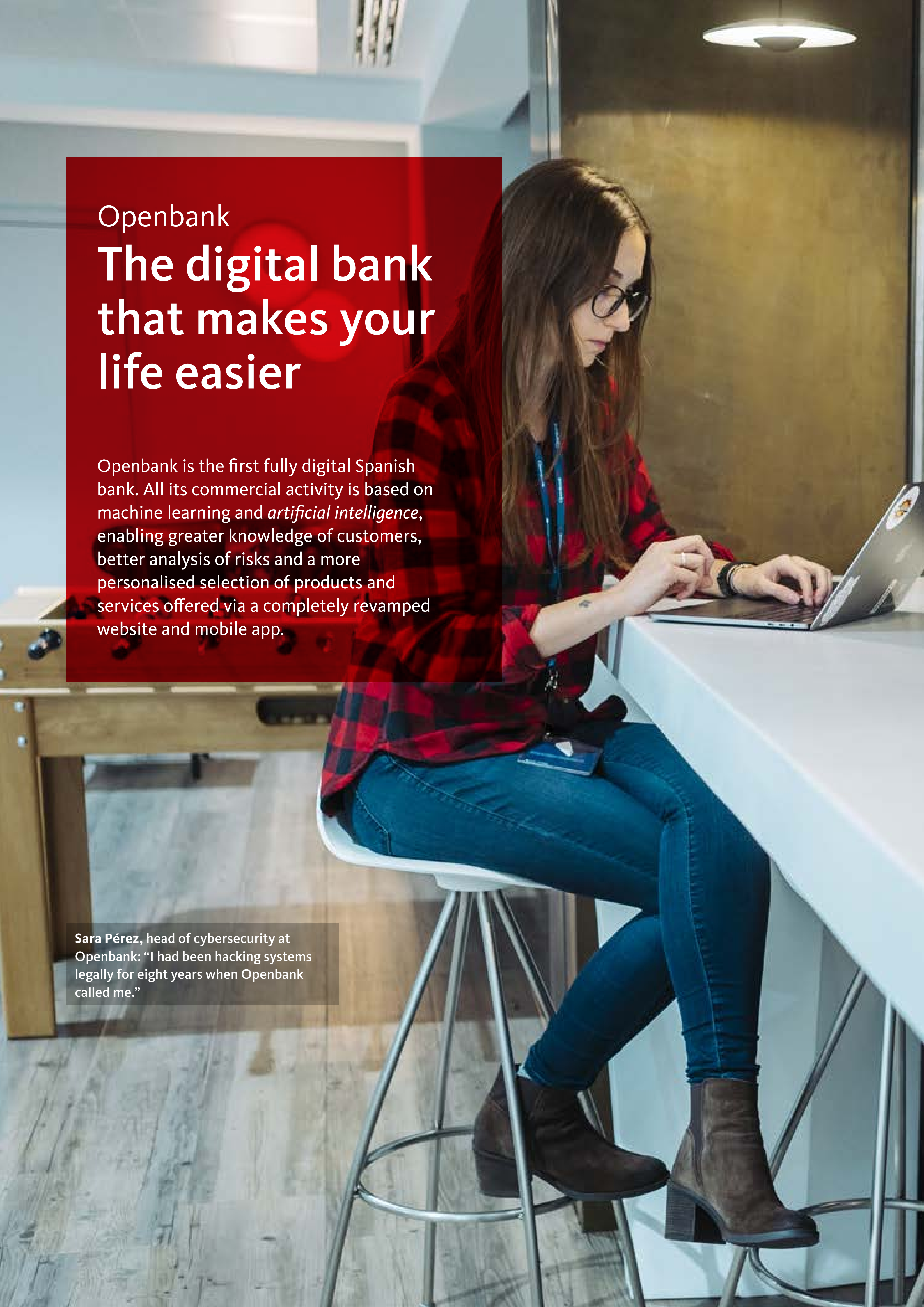
Mr Ramiro Mato García-Ansorena
Non-executive director
(Independent)
● ▲ ●

Ms Sol Daurella Comadrán
Non-executive director
(Independent)
● ■

Ms Esther Giménez-Salinas i Colomer
Non-executive director
(Independent)
● ▲

Mr Javier Botín-Sanz de Sautuola y O'Shea
Non-executive director
(Proprietary)

Mr Jaime Pérez Renovales
General secretary and secretary of the board



Openbank

The digital bank that makes your life easier

Openbank is the first fully digital Spanish bank. All its commercial activity is based on machine learning and *artificial intelligence*, enabling greater knowledge of customers, better analysis of risks and a more personalised selection of products and services offered via a completely revamped website and mobile app.

Sara Pérez, head of cybersecurity at Openbank: “I had been hacking systems legally for eight years when Openbank called me.”

“Openbank gives me what I’m looking for”

If you ask Miguel Montáñez about his daily routine, he responds with three words: “Work, work, work”. “I have a very demanding work life,” he acknowledges. “I can work several 12-hour days in a row, working under a lot of pressure and travelling a lot,” he explains. “I spend more than 100 days a year outside Spain,” he adds.

María José Talavera has a similar situation. Her schedule is very hectic. “I can only ever go to two types of office,” says Ms Talavera: “to that of my customers or to mine. Never to a bank branch.”


David Stocks

María José Talavera and Miguel Montáñez are customers of Openbank, as is David Stocks, a US citizen living in Spain. “I don’t like banks,” confesses Mr Stocks bluntly. “But Openbank gives me what I’m looking for, it helps me with what I need. It doesn’t bother me.”

Openbank was relaunched in 2017 with the aim of becoming one of the world’s leading digital banks. “Being a digital bank isn't just about having a cute app,” notes Ezequiel Szafir, CEO of Openbank. “Being a digital bank means having the right technology and talent.”

“Many companies talk of digital transformation, but few of them really do anything about it,” explains Javier Ros, Cloud Technical Architecture Manager of Openbank, who formerly worked for Amazon. “If you want to keep pace with your customers, you need to work completely in the cloud. Openbank is genuinely committed to changing digital banking,” says Mr Ros.

The case of Sara Pérez, Openbank’s Head of Cybersecurity, is similar. “I had been hacking systems legally for eight years when Openbank called me,” she recalls. “I was very much attracted to working on this project's cybersecurity,” she affirms. Cybersecurity is Openbank’s top priority, together with the customer, of course. “Machine learning and artificial intelligence enable us to offer our customers personalised products,” explains Daniel Villatoro, Head of Data Science.

“BEING A DIGITAL BANK ISN'T JUST ABOUT HAVING A CUTE APP”

“We are the only bank that takes risk decisions based on artificial intelligence,” says Mr Szafir. “For example, in an ordinary bank, around 70 per cent of customers have credit cards. We grant a higher percentage of our customers cards because our intelligent algorithm takes into account many more variables.”

“WHENEVER I NEED ANYTHING IT'S WITHIN MY REACH”

To improve customer satisfaction, Openbank has developed a new website and a new app, the main points of contact between the customer and the bank. The aim is for the customer service to be personalised and to fully meet the customers’ needs. “I have an adviser at my disposal, with a name and a face,” explains Miguel Montáñez. “It’s not a virtual entity. And whenever I need anything it's within my reach, via my mobile phone,” he adds.

Montáñez highlights Openbank’s investments platform as the apps strong point. “I can view my investments, in a simple manner, at any time and anywhere,” he explains.

This has allowed him to manage his portfolio independently, with great results.

“We have the technology that Santander Group as a whole will need over the next five years,” confirms Szafir. “Openbank is already what every bank will have to be in the near future. We are ready.”

Openbank
Grupo Santander

1

A MODEL FOR SUSTAINABLE, PREDICTABLE GROWTH

A Santander branch in Barcelona

Our model and the results it generates show that Santander is on the right track

The Santander vision

We are committed to generating growth in a sustainable, predictable and responsible manner.

Our purpose

To help **people** and businesses prosper

Our aim

To be the **best retail and commercial bank,** earning the lasting loyalty of our people, customers, shareholders and communities

A bank that is...

Simple | Personal | Fair

Our strengths

1

We have SCALE and the potential to grow organically

- We are the leader in market share in five of our core markets. We are also in the top three in seven of those markets in terms of customer satisfaction.
- We have 133 million customers in markets with a total population of more than one billion.
- We have more than 17 million loyal customers and 25 million digital customers. This implies huge potential for organic growth through increased loyalty and digitalisation.

Our critical mass gives us efficiency, sources of growth and new business opportunities

POSITION OF BANCO SANTANDER IN MARKET SHARE IN LOANS

#1	SPAIN, ARGENTINA[1], PORTUGAL[1], CHILE, SCF
#3	BRAZIL[1], MEXICO, POLAND
#5	UK[2], US[3]

1. Only including private sector banks.
2. Mortgages, consumer and commercial loans.
3. Santander Bank market share in the States in which the Group operates.

to continue growing

2

PREDICTABLE GROWTH: diversification by country and business, which contributes higher profits in a more stable manner

- Our diversification by country and business allows us to maximise results throughout the cycle and it is the key to our positive performance.
- Geographically, we have a balanced distribution between mature markets (which provide stability), and developing markets (which fuel growth in revenue).
- By business, there is a good revenue mix between products for individuals, consumer finance, SMEs, companies and other products.

Our unique business model allows us to deliver better results with less volatility and higher growth

Distribution of underlying profit

and to be successful in the long term

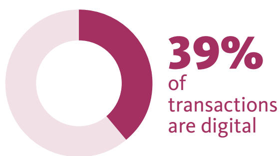
3

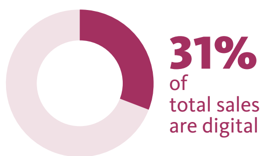
Focus on INNOVATION to increase customer loyalty and operational excellence

- Our technological transformation contributes to increasing the number of loyal and digital customers.
- The digitalisation of our commercial business allows us to offer our customers products and services that are more simple, personalised and modern. This increases customer satisfaction and loyalty.
- We have launched a wide array of initiatives at the bank, focusing on four main areas: *blockchain*, data, payments and services.

Our digital transformation is paying off: we have more digital customers and more digital transactions and sales

Percentage of transactions and sales in digital channels





Creating value

We aim to be our customers' bank of choice. Through innovation, we are transforming our business to become a more profitable and sustainable bank.

We are meeting our targets earlier than expected...

	Strategic priorities	Key metrics
People	Be the **best bank** to work for and have a strong internal culture	**Number of core markets where the Bank is among the three leading banks to work for (according to the *local* rankings)**
Customers[1]	Earn the **lasting loyalty** of our individual and corporate customers: improve our franchise	Loyal individual customers (millions) Loyal corporate customers (thousands) Growth in customer loans (%)[6]
	Operational excellence and digital transformation	Number of countries where the Bank is among the top 3 of its competitors in customer satisfaction Number of digital customers (millions) Growth in fee income (%)[6]
Shareholders	**Capital strength** and risk management	Fully loaded CET1 capital ratio (%) Cost of credit (%)
	Improve **profitability**	Cost-to-income ratio (%) Growth in earnings per share (%) RoTE (return on tangible equity, %)[5] Cash dividend as a percentage of attributable profit
Communities	Santander Universities	Number of grants (thousands)
	Support people in the **local communities** where the Bank operates	Number of people helped by the Bank's social investment programmes (millions)

1. Excluding Popular.
2. 2015-2018 average.
3. Except in the United States, where it will be close to our competitors.
4. Total amount 2016-2018.
5. 2016 and 2017 are calculated using underlying profit. RoTE on attributable profit was 10.4% in both years.
6. Constant euros.

...with a clear strategy and a strong culture

2016	2017	Targets 2018	Further info
4	5	Most countries	Pages 40-41
13.9	15.8	17	Pages 42-45
1,356	1,494	1,646	Pages 42-45
2%	2%	> com-petitors	Page 58
8	7	All[3]	Page 45
20.9	25.4	30	Pages 42
8.1%	10.6%	c. 10%[2]	Page 59
10.55%	10.84%	>11%	Page 59
1.18%	1.07%	1.2%[2]	Page 59
48.1%	47.4%	45-47%	Page 59
1.0%	1.0%	double digit	Page 60
11.1%	11.8%	>11.5%	Page 59
40%	40%	30-40%	Pages 46-47
37	45	130[4]	Page 49
1.7	2.1	5[4]	Pages 48-51

Simple | Personal | Fair

Just as important as what we do is how we do it: Simple, Personal and Fair. This culture is based on our corporate behaviours.

- I show respect
- I truly listen
- I talk straight
- I keep promises
- I actively encourage cooperation
- I bring passion
- I support people
- I embrace change

The Santander brand

In 2017 we defined a strategy to evolve towards a brand which Is more customer-focused, modern and digital, sustainable and committed to communities. Our brand positioning revolves around the idea that prosperity is created day by day. The evolution of global sport sponsorship responds to this strategy: we are entering a new phase in the UEFA Champions League.

The flame, which has been part of our logo since 1986, reflects our commitment to progress and is inspired by fire and what its discovery meant to human progress.

Santander

Risk culture: *risk pro*

Santander has a solid risk culture, called *risk pro*, which defines the way in which we understand and manage risks in our day-to-day activities. It is based on making all employees responsible for the risks they generate and on other principles that understood and assimilated into the way of working throughout the Group.

risk pro

All the Santander team engaged in risk

>94%
of employees recognise and are responsible for the risks in their daily work

People

An engaged, motivated team

To better help people and businesses prosper, our transformation begins with our employees. We aim to be one of the best banks to work for to be able to attract and retain the best global talent.

A Santander branch in Spain

Our people management strategy focuses on six key areas:

Talent management

Identify the best professionals worldwide and help them to grow both personally and professionally, respecting and fostering diversity.

Knowledge and development

Offer continuous training and development to enhance our employees' skills and capabilities in a changing digital environment.

Remuneration and benefits

Set clear targets and reward not only results but how they were attained.

Employee experience

Foster teams' engagement and motivation with measures that encourage listening, a more efficient and collaborative way of working which enhances the work-life balance, recognition and a healthy environment.

Systems

Use the benefits of digitalisation to manage people better.

Culture

Ensure that the entire Group shares a common culture based on the corporate behaviours and focused on the purpose and aim, and on doing things in a Simple, Personal and Fair way.

OUR TEAM

55% women

202,251 employees

45% men

45% with university degrees

38 years average age

10 years average length of service

Initiatives carried out by Human Resources in 2017

Talent

- ***MyContribution:*** A new corporate performance management model that strengthens the culture as a driver of transformation. To continue creating that culture, we are introducing a new way to assess our employees' performance and decide their variable remuneration:

60% What we do (Business objectives)

40% How we do things (SPF behaviours)

- **Succession planning for leaders:** The Group made progress in succession planning for key roles.

- **Talent Assessment Committees:** With the participation of senior management, over 2,500 executives have been analysed.

- **Diversity and inclusion:** The Santander Group recognises and supports all types of diversity: gender, race, age, disability, professional and life experience, religion, values and beliefs, sexual orientation and personality. A global executive Diversity and Inclusion task force was created in 2017, together with a global network of diversity experts.

- The Bank is developing a new strategy to position itself as an ***employer of choice*** for employees and external candidates, with a particular focus on digital talent.

Knowledge and development

- A new strategy for knowledge and overall development to stimulate continuous learning by all employees, with the slogan ***Never stop learning***.

- The ***Global Knowledge Campus*** has been launched; it is a new training space in which to share knowledge and best practices, which will help the Group's employees to contribute to cultural change and improve their performance.

- ***Leading by example*** is now under way. This is a training programme that helps leaders to identify the role that they should play to implement the Simple, Personal and Fair culture and carry out the transformation.

  In this regard, the United States has launched two programmes to accelerate the cultural transformation in its leaders: ***Managing the Santander Way and Accelerated Development Program.***

Global engagement survey

84% participation

77% of employees are engaged, above the averages of peers and the sector's best performers

81% of employees believe that their colleagues behave in a more Simple, Personal and Fair way

92% of employees know what they have to do to build a bank that is more Simple, Personal and Fair

Important progress made in SPF* behaviours and new ways of working

International mobility

- ***Global job posting***: corporate platform offering all staff the chance to learn about and apply for vacant positions in other countries, companies or divisions. Since its launch in 2014, over **3,000 jobs have been posted**.

- ***Mundo Santander***: A corporate development programme in which, for three months, the Bank's professionals work on a project in another country, promoting the exchange of best practices and broadening their global vision. Since its launch, **1,726 employees in 30 countries** have taken part.

- The first two training modules of the ***Talent in Motion* (TiM)** programme, aimed at fast-track development of talented young people, have been held. This promotes mobility and provides participants with the opportunity to broaden their vision of the Group and to gain international experience.

* Simple, Personal and Fair

Employee experience

- ***We are Santander* Week**: The 10th edition of this global initiative, which conveys the Santander culture to employees and to promote their pride in belonging, was held in June. This year it focused on the corporate behaviours.

- A culture of recognition is being promoted through initiatives such as ***StarmeUp***, the first global recognition network to promote collaboration and to recognise those individuals who practise the corporate behaviours.

- The Group continued to implement its global health and well-being programme, ***BeHealthy***, an example of its commitment to the health of its employees and to helping them to acquire healthy habits.

- Under the ***New Ways to Work*** programme, Argentina and the corporate centre in Spain remodeled work spaces, eliminating offices and creating open areas for teamwork, using new technologies to facilitate teamwork and collaboration. *Flexiworking* continued to improve work-life balance. Other initiatives in *New Ways to Work* include *Keep It Simple Santander (KISS)* for branches and call centres in the UK and the ***Inconsistencias*** programme in Chile to identify processes to be improved.

Customers

We work for the prosperity of our 133 million customers

Our goal is to have more customers, who are increasingly more loyal and digital. We want to be the bank of choice for our customers.

Loyal customers

17.3 million

Digital customers

25.4 million

Innovative, simple, personalised solutions

1|2|3 World and other engagement strategies

Our value proposition for individual customers

With this relationship model, customers earn interest on their account balances and money back on spending, among other advantages.

- In Spain in 2017, the 1|2|3 model was extended to new segments, such as the fully digital 1|2|3 Smart Account, aimed at the 18-31 age group. A new credit card was also launched, offering 1, 2 or 3 euros for each goal scored by the football teams in Spain's top two divisions, LaLiga Santander and LaLiga 1|2|3.
- In the United Kingdom, the 1|2|3 strategy has 5.4 million customers, an increase of 275,000 from December 2016.
- In Mexico, Santander Plus, the local version of 1|2|3, celebrated its first anniversary. Since its launch, the Santander Plus programme has attracted over 3.0 million customers, 52% of whom are new.
- In Portugal, activity continues to be strongly supported by 1|2|3 World, with very positive trends in the numbers of accounts, credit cards and protection insurance policies.
- Poland launched its of As I Want it Account, which enables customers to decide what they need and how to pay for the products and services offered.

1|2|3 customers

2.6 million (Spain)

5.4 million (United Kingdom)

Santander Plus customers

3.0 million (Mexico)

Santander Wealth Management

Asset management and private banking

Santander created a new global division bringing together its private banking and asset management businesses, to build the best specialist wealth management unit in Europe and the Americas.

- Following the repurchase of Santander Asset Management's business in 2017, and the integration with Private Banking, the new division will enable us to generate significant synergies and exploit the competitive advantage of our presence and positioning in Europe and the Americas, allowing us to drive the growth of the asset management business in our core countries.
- Our customers, who are always at the core of our strategy, will benefit from the strength of the new division and from an approach based on personalised service, boosted by a global value proposition, leveraging the connectivity between the franchises and the development of new digital capabilities.
- Lastly, to create the most powerful and winning value proposition for our customers in Europe and the Americas.

Santander PRIVATE BANKING

Santander ASSET MANAGEMENT

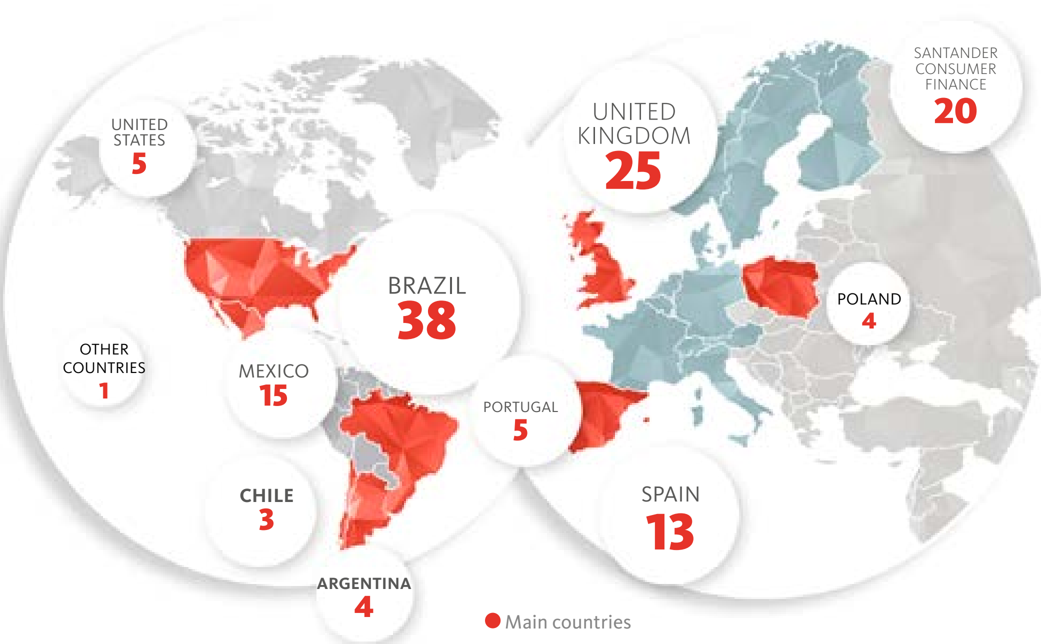
Assets managed by Santander Wealth Management

€333,000 million

Specialised service for clients in

14 countries

BREAKDOWN OF GROUP CUSTOMERS (MILLIONS)*



Santander SMEs

A global solution making us partners in SMEs' growth

SMEs are the main driver of job creation. We aim to help companies grow in the new digital economy and become more international by leveraging the Group's innovation capabilities and geographic diversification. This means both offering traditional bank products and services and innovating to meet the financial needs of companies that have new business models and help entrepreneurs make their plans reality.

- Santander's strategy with SMEs is a global initiative adapted, in the local environment, to the characteristics of each market in which we are present. This model, which operates throughout the Group, provides a strong financial offering and other solutions to spur internationalisation, training, employment and digitalisation of SMEs, so that we can become their bank of choice.
- Santander is committed to the long-term growth of SMEs. Its aim with this strategy is to benefit 45,000 SMEs in Latin America and a total of 90,000 SMEs worldwide.

EUROMONEY AWARDS FOR EXCELLENCE 2017

Euromoney named Santander the Best Bank in the World for small and medium-sized enterprises, for the second consecutive year

* *Excluding Popular.*

New digital solutions

Local banks are pushing forward with their digital transformation while the Group invests in infrastructure and creates agile, global platforms. All teams work in collaboration. As a result, we can offer our customers better products, services and channels.

Openbank

The fully digital bank

- The Santander Group launched the new Openbank, Spain's first fully digital bank. It offers its customers a complete portfolio of products and services through a totally redesigned website and mobile app.
- Openbank has the experience, the expertise and the support of the Santander Group. It is one of the first banks in the world to have its software, application programming interfaces (API) and all its customer activity hosted in the cloud. All with the maximum security and replicated at various European sites. Openbank's technology model is based on machine learning.

Superdigital Brazil

A digital mobile-first payment solution

- Santander Brazil launched Superdigital, an independent digital payment platform, built and developed in Brazil. With proprietary tools and technology, this mobile-first solution allows customers to open a new payment account in a matter of minutes. They can also pay, deposit and withdraw money with no need to have a bank account.
- Superdigital enables the Santander Group to broaden its possibilities of helping individuals to join the banking system for the first time, through either Superdigital or Banco Santander, irrespective of their customers' socio-economic profile.

Financial inclusion

More than
1,000,000
Superdigital customers

Of these, more than
350,000
belonged to sectors with low rates of access to banking services

Santander Cash Nexus

An agile cash management platform

- A services platform that allows customers to manage their treasuries, combining the Bank's global services offer with a wide range of local services in each country.
- Customers may digitalise, in a simple and competitive way, liquidity management, the collection and payment of transactions, and direct debits, and centralise the information through electronic channels.

Machine learning

Global platform to know our customers better

- Our global machine learning platform is producing very positive results in various countries.
- It enables us to know our customers better, offer them a personalised proposition, and assess the related operational and credit risks faster and better.
- Actual results: up to 60% less customer attrition and a 30% increase in loyalty.
- Continuous learning thanks to the one billion transactions that the Bank manages in its core markets each year.

Four focuses of digital innovation

- Blockchain
- Data
- Payments
- APIs and services

DIGITAL INITIATIVES

UNITED KINGDOM
Santander UK launches a new digital account opening process. Santander Investment Hub, an online platform for customers to manage their portfolios without advisory services, is being enhanced.

SPAIN
Fresh progress in the digital transformation, with the new *app* and the launch of *Digilosofía*, which has enabled the Bank to multiply by seven the weekly acquisition of digital customers. Spain consolidates its leadership in mobile payments through *Apple Pay* and *Samsung Pay*.

BRAZIL
Santander ONE, a new online bank for individual customers. *Consignado*, fully digital, signed up to by mobile phone. *WebCasas*, a digital platform for taking out property loans.

MEXICO
In mobile payments, *Súper Wallet* is a tool that enables customers to manage all their cards in one place. *Select Me* is launched to support women by providing solutions to make their daily lives easier and to assist in their professional development.

CHILE
Launch of the country's first full digital *On Boarding*process.

Operational excellence

Maximise the bank's efficiency and customer service quality.

Throughout the Group, initiatives are under way to transform and enhance the customer experience.

MEXICO
Automatic service by bots. Santander has implemented three automated reply systems for customers using robots: on the website, Facebook and Twitter. It is the only bank with this triple automated system in Mexico.

POLAND
Bank Zachodni WBK introduced a biometric voice solution aimed at large companies, together with electronic guarantees incorporating an electronic signature option.

PORTUGAL
The Bank made progress with its mobile app, increasing its sales though digital channels. At year-end, the digital channels accounted for 28% of the Bank's total sales of products.

UK
Santander UK expanded the information content on its fund platform (Investment Hub) to help customers understand and meet their needs in relation to investments, as well as online mortgage loans and increased its mobile banking capacity (*Android Pay*).

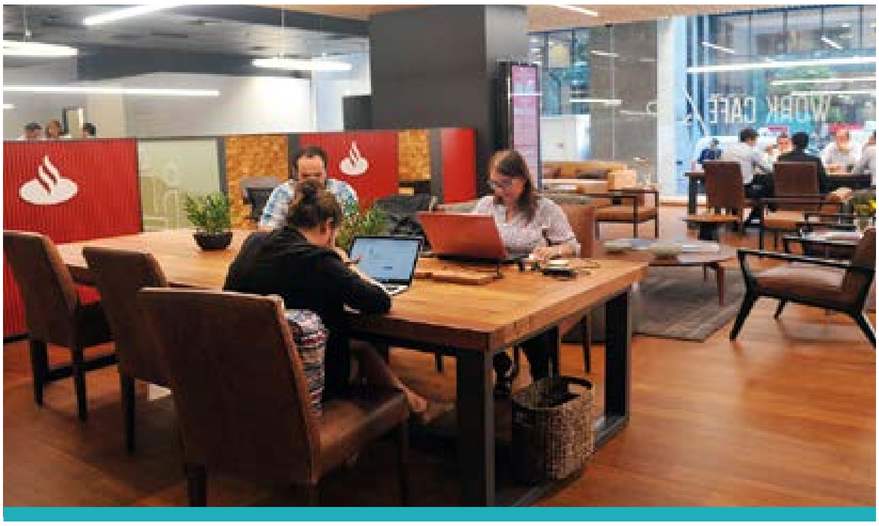
BRAZIL
A new, more efficient, model centred on operational excellence was implemented, with an end-to-end vision of the process experienced by customers using products and services.

New, redesigned branches are transforming customer experience

With initiatives such as WorkCafé in Chile, Smart Red in Spain and the digital branch in Argentina, our new branches are transforming customer experience in nearly 1,000 locations.

The new branches:

- Are **20%** more productive
- Generate **96%** customer satisfaction
- Increase brand visibility and engagement with communities



WorkCafé in Chile

CUSTOMER SATISFACTION

Santander is ranked in the top three banks in seven countries that account for more than 77% of our customers

	ARGENTINA	BRAZIL	CHILE	SPAIN	MEXICO	POLAND	PORTUGAL	UK	US	GROUP
RANKING	1	2	3	3	3	4	3	3	9	
% satisfied customers	87.1%	77.9%	91.6%	85.5%	96.4%	95.9%	91.4%	96.0%	81.8%	88.02%

* *Corporate* benchmark of active individual customers' experience and satisfaction. Data at 2017 year-end.

Shareholders

We provide sustainable growth and predictable profits for our shareholders

In 2017, the Bank made significant progress in its strategic priorities and met its business and financial targets while remaining one of the most profitable and efficient banks in the world. Our shareholders' trust is key to achieving sustainable growth over the long term.

Shareholder remuneration

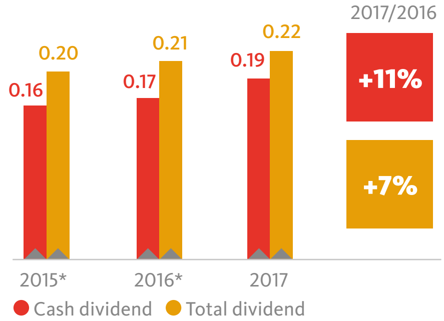
Shareholder remuneration increased in 2017, maintaining the payment of the four dividends

- Total remuneration from 2017 profit: €0.22 per share, with an increase of 7% in the total dividend per share and 11% in the cash dividend, compared to 2016.*
- 16.6% total shareholder return in 2017, compared with 11.3% on the IBEX 35, 12% on the Stoxx Banks Index and 24.8% on the MSCI World Banks Index.
- The total Santander shareholder return is higher than the average of European banks.

Three of the four dividends have already been paid: two in cash of €0.06 per share and one via the scrip dividend of €0.04 per share. The fourth and final dividend is scheduled for May 2018 following approval at the annual general meeting.

SHAREHOLDER REMUNERATION

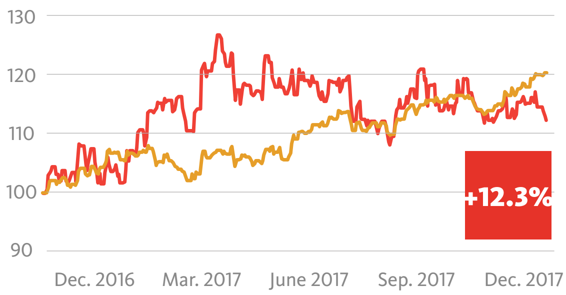
Euros per share



The Santander share in 2017

COMPARATIVE SHARE PRICE PERFORMANCE

(Dec. 2016 - Dec. 2017)



- Markets performed well in 2017 in an environment of greater optimism due to positive macroeconomic data.
- The Santander share price ended 2017 at €5.48, an increase of 12.3% during the year. The main Spanish index, the IBEX 35 rose 7.4% and the European bank index 8.1%.

Banco Santander was the largest bank in the eurozone by stock market value at year-end, with capitalisation of €88,410 million.

Shareholder base

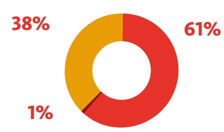
- In the year, the following capital transactions were carried out:
  - July 2017: a capital increase of €7,072 million to support the acquisition of Banco Popular (the issue was eight times oversubscribed). A total of 1,458,232,745 new shares were issued.
  - November 2017: 95,580,136 shares issued as part of the *Santander Scrip Dividend* programme.

16,136 million shares at 31 December 2017

DISTRIBUTION OF THE SHAREHOLDER BASE

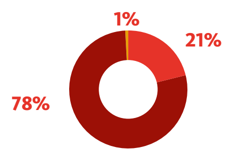
By type of shareholder

- Institutional investors
- Board
- Retail shareholders

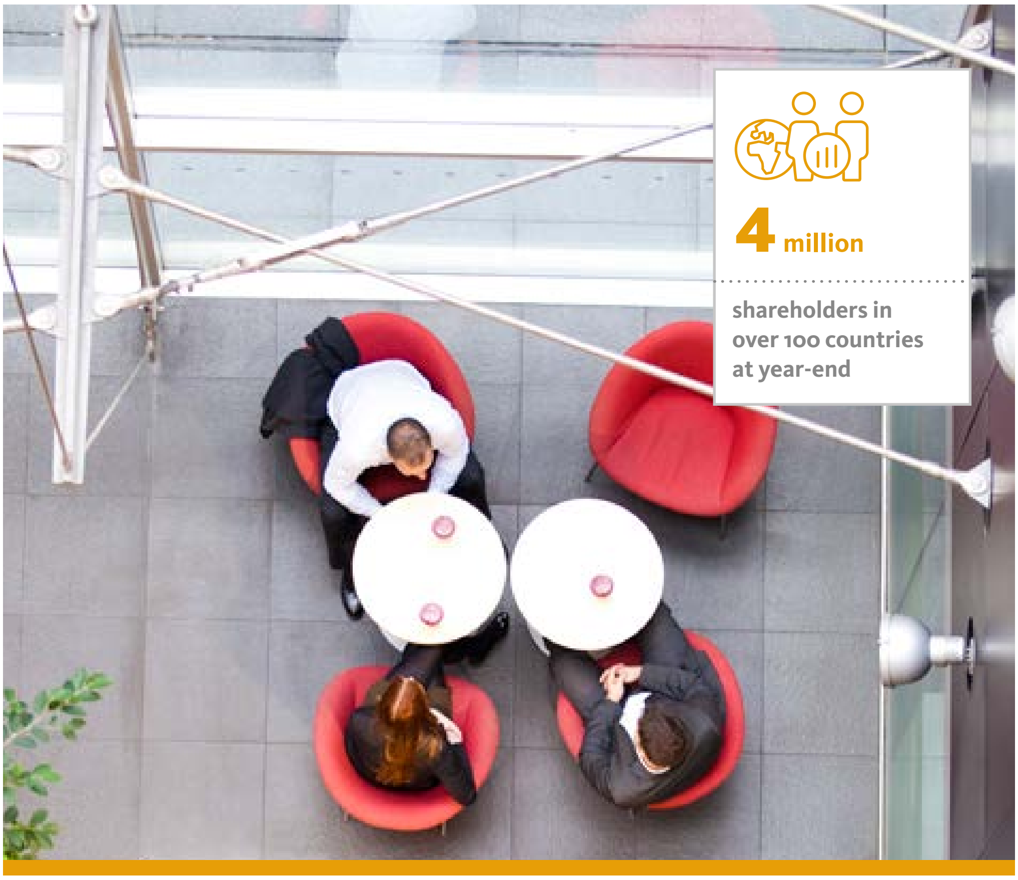


By geographic distribution

- Americas
- Europe
- Rest of the world



*Figures are adjusted to reflect the July 2017 capital increase.



4 million

shareholders in over 100 countries at year-end

Meeting our commitments

RoTE (Underlying)

11.8% Increase

Dividend per share

€0.22 Increase

Earnings per share

€0.40 Increase

Fully loaded CET1 RATIO

10.84% +40 bps in organic generation

* Data at 2017 year-end vs target set for the year.

Commitment to shareholders

The activity of the Shareholder and Investor Relations area in 2017 was aligned with the following priorities:

Maintain continuous, fluid communication with retail shareholders, institutional investors, analysts and rating agencies

- In October, for the second consecutive year, the *Group Strategy Update* was held to update the market on the fulfilment of the commitments made at the 2015 *Investor Day*. Over 250 investors and analysts attended.
- 175 roadshows, 19 conferences and 1,560 meetings with fixed income and equity investors.
- Meetings with almost 12,517 retail shareholders at 241 corporate events.

Enhance personalised service to shareholders and seek their opinions

- 178,353 enquiries answered (by email and telephone).
- Over 300,000 shareholders consulted in quality studies and surveys.
- Shareholders offered possibility of rating their degree of interest in the communications received by email. 70% of the replies scored the information as quite interesting or very interesting.

260 analysts and investors at the *Group Strategy Update*

241 events for shareholders

>1,000 communications sent to shareholders

64% record participation at the AGM

Facilitate the participation of shareholders

- Record participation in the general shareholders' meeting. 64% of the Bank's share capital (over 800,000 shareholders) voted in person or by proxy on the board of directors' proposals.
- Santander was the first European bank to receive the Aenor certification of its annual general meeting as a sustainable event.

Drive the digital transformation

- New corporate website for shareholders and investors; launch of *WhatsApp* as a new channel for serving shareholders and new functionalities in the specific app for them.

Offer exclusive products and benefits

Through the yosoyaccionista.santander.com website.

Communities

Our commitment is sustainable and responsible

We carry out our business responsibly, by contributing to the economic and social progress of the communities in which we are present. We manage our environmental impact and we foster stable relationships with our main stakeholders.

Companies have a responsibility to create value by taking into account the positive and negative effects of their decisions on their environment. Acting responsibly is more important now than ever before. Society is facing major challenges, both social (achieving inclusive growth for everyone) and environmental (addressing climate change). Businesses must play a central role in meeting these challenges.

Banco Santander's view is that acting responsibly is the best way for its activity to be profitable and sustainable in the long term, and to help people, businesses and communities prosper.

Santander helps communities prosper through its social investments as well as its ordinary banking activities.

Support for higher education is part of the Group's identity. Access to education, employability, driving university entrepreneurship and modernising universities are its main areas of action.

It also carried out numerous local community support programmes, in many of which participation by the Group's professionals was encouraged as a way of promoting solidarity, motivation and pride in belonging. These programmes included:

- **Local initiatives to support pre-school education**, particularly in Latin America where the Bank co-operates in projects that support each country's education programmes. *Projeto Escola* (in Brazil) and *Becalos* (in Mexico) are two examples.
- **Financial education programmes that convey to children the importance of saving**, prepare young people for an independent life and help families to take basic financial decisions.
- **Programmes to combat social exclusion and tackle poverty**, vulnerability and marginalisation, such as the social projects in Spain and Discovery Grants in the UK.

Strategic targets

To help five million people between 2016 and 2018

5 million

People helped in 2017

2.1 million

Community investment

Santander Universities and Universia

Banco Santander, which is unique among banks for its firm support of higher education, invests more in supporting education than any other private company in the world, according to the first global study published by the Varkey Foundation in cooperation with Unesco.

Support for university progress

- **Grants and social impact:** over 290,000 grants have been awarded since 2005 under various grant programmes in 21 countries promoting excellence, international mobility, equity and university access, research and initial contact with the labour market. Because education is synonymous with progress and with fairer and more competitive societies.

- **Digitalisation and modernisation of universities:** Santander Universities' digital strategy aims to encourage the modernisation of universities and to foster and boost their programmes and initiatives in social networks. This strategy includes the development of software to enhance services and meet the new demands of the university community in digital environments; such as AppCrue in Spain, which registered 51,426 downloads at 11 universities in 2017, and offers a wide range of services, such as consulting academic grades, timetables, accesses and library catalogues.

Fostering entrepreneurship with Santander X

Santander Universities devotes over €13 million a year to programmes that support and promote the university entrepreneurial spirit. This key priority is what drives the Santander X project which, in partnership with universities, aims to become the world's largest ecosystem for entrepreneurs.

See more on page 24-25 of this report

Furthermore, the new global entrepreneurship community, Santander X, based on a digital platform which is currently being developed and is evolving, already has its first 8,000 followers in its related social networks, such as JointheX. The various channels of Universia and Santander Universities had 3,041,796 followers worldwide at year-end 2017.

- **Employability:** Training, achievement and excellence should be the basis of personal and professional progress, the instruments that help young people to be more employable and competitive in professional environments that are increasingly variable, digital and dynamic. This is why Santander Universities and Universia carry out initiatives that help young people join the labour market, develop their skills, know where to find new job opportunities and develop their talents. This also includes the promotion of equity and inclusion through the opportunities offered by the Universia Foundation.

Santander UNIVERSIDADES

universia

Total scholarships and grants awarded

44,862

39,069 university grants and scholarships

5,793 grants for e-learning

Agreements with universities and other academic institutions in 21 countries through Santander Universities and Universia

1,295

Further information is available in the sustainability section of our corporate website, the 2017 sustainability report and the thematic reports available at www.santander.com.

We support and promote financial inclusion

Contributing to the social and economic progress of the countries in which we operate.

Santander supports and promotes financial inclusion as a way of contributing to the well-being of the countries in which it operates. To this end, the Bank promotes major microfinance programmes in countries such as Brazil, Mexico and Argentina. These programmes help the most underprivileged groups to access credit in order to improve their social and financial inclusion and the quality of their lives and environment. In its relationships with the university community, the Bank develops specific products and services so that students may access a wide range of basic financial services.

Financial inclusion

€150 million
outstanding microfinance loans

micro-entrepreneurs supported
›250,000

“We want to serve 280,000 microenterprises over the next four years in order to increase financial inclusion in Mexico, by offering them a broad range of competitive financial products and services.”

Ana Botín,
at the presentation of “Tuiio” in Mexico City, October 2017.

***Tuiio*, a new financial inclusion initiative in Santander Mexico.** Launched in October 2017, *Tuiio* is a financial inclusion programme for people with low incomes which aims to have a measurable social impact through a broad and expanding range of interconnected products (from microcredits to microinsurance, remittances, payments and other services, etc.) supported by its own branches, agents, ATMs, point of sale terminals and use of electronic banking. The initiative includes a programme of training and financial education for its customers, with the aim of maximising their skills, developing their potential and optimising their use of resources.

Prospera in Brazil for microenterprises

PROSPERA Santander Microcrédito

Through the *Prospera* programme in Brazil, Santander encourages small businesses to grow and therefore helps the underprivileged and those with a lower standard of living to escape from poverty. Loans are mainly granted to informal microenterprises that have no access to credit.

- 70% of microcredits are granted to female breadwinners.
- They are granted to solidarity groups of three or four people.
- The average amount is EUR 300, with no need for additional guarantees.
- The average term is eight months.
- Active portfolio of over 170,000 customers.
- 30 branches and 300 employees serve 700 municipalities.

Firm commitment to the environment

Banco Santander is firmly commited to the environment and the fight against climate change, which is reflected in various lines of action, such as the analysis of social and environmental risks in funding transactions, the development of products and services with a positive environmental impact and the measurement of its internal environmental footprint.

The Bank continued to reduce its consumption, waste and emissions, **meeting its targets for reduction set in the 2016-2018 Efficiency Plan**. The rapid progress in meeting the energy reduction and emissions goals is a result of the immediate impact of more than 200 initiatives under the plan, advances in technology and greater environmental awareness.

The Bank continued to implement its policies for sensitive sectors such as energy, soft commodities and defense, and in 2017 approved a new policy on mining and metallurgy. An extract of these policies was published on the Bank's website, thus enhancing transparency.

In 2017 the Bank subscribed to the banking sector's main initiative for implementing the reporting recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) of the Financial Stability Board, under the auspices of the United Nations Environment Programme.

These recommendations will represent a major step forward in the reporting of risks and opportunities associated with climate change.

In 2017 the Bank approved its policy for the mining and metallurgy sector, which was added to the policies on energy, defence and soft commodities.

€300 million

New lines of financing signed with **multilateral institutions** for renewable and efficient energy projects in Spain and Poland

€136 million

The Bank issued its **first green bond in Poland** through a bilateral accord between Bank Zachodni WBK and the International Finance Corp. covering energy efficiency, renewable energy and water and waste management

Project finance to support renewable energies

As a contribution to the transition to a low-carbon economy, the Bank participated in 2017 in the financing of new renewable energy projects such as photovoltaic plants and windfarms with a installed capacity of 3,390 megawatts (MW).

3,390 MW

Total installed capacity of solar and wind generation supported by the Bank in 2017

Presence in sustainability indices

Banco Santander has been included in the Dow Jones Sustainability Index (DJSI) since 2000. In 2017, the Bank received a score of 89 out of 100, well above the average for the financial services sector. The Bank's place on the DJSI is a result of its commitment to sustainablility and transparency.

This score again places Santander as one of the world's leading banks and the leader in Spain for its sustainable management, among the top ten banks in the world on the Dow Jones Sustainability Index and the first among the 17 financial institutions in its benchmark peer group*.

Santander improved its scores on other renowned sustainability rating indices such as Sustainalitycs, MSCI, Oekom and Vigeo, and continues to form part of the FTSE4Good index, in which its results also improved.

MEMBER OF
Dow Jones Sustainability Indices
In Collaboration with RobecoSAM

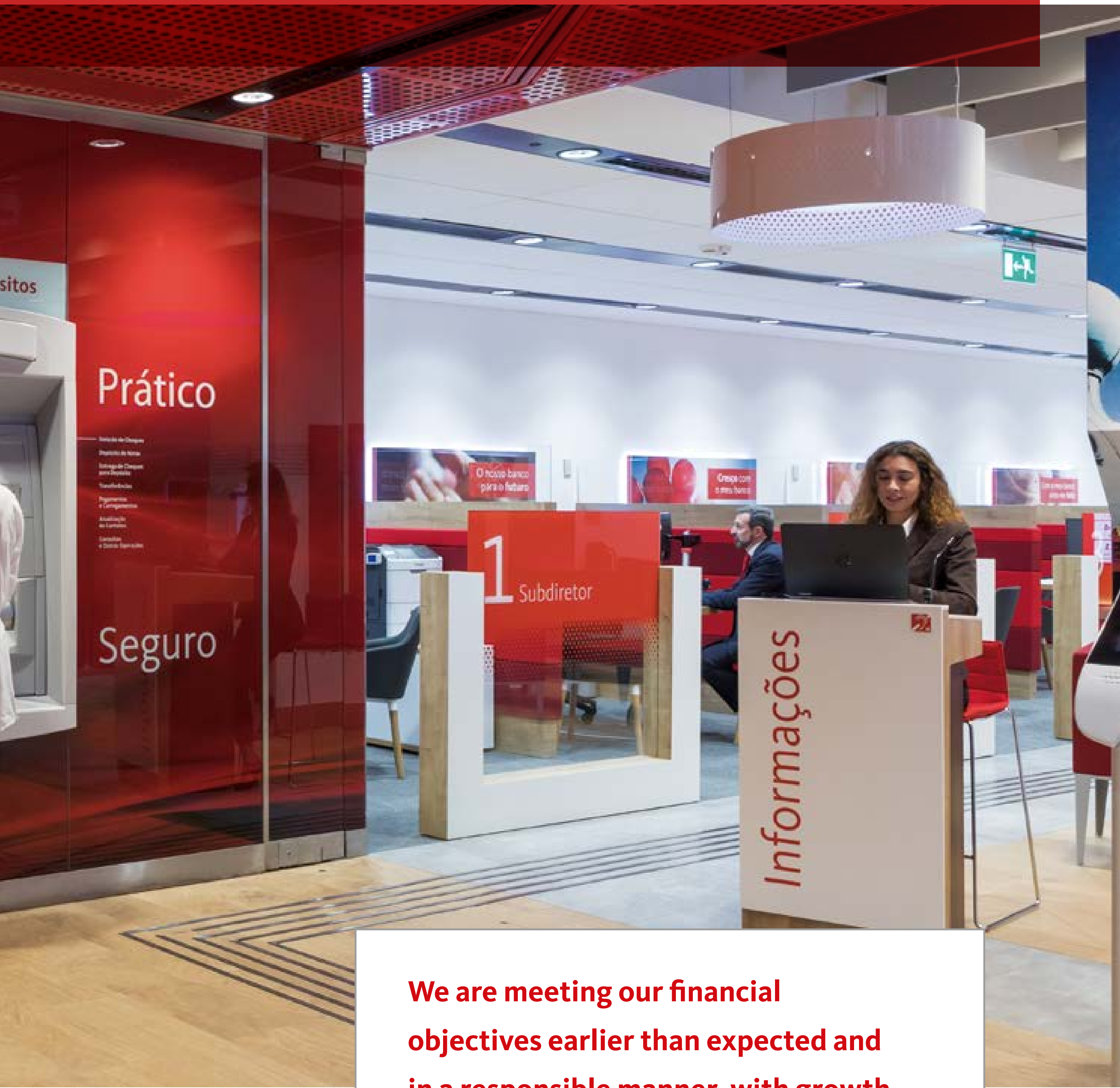
FTSE4Good

*The benchmark group comprises the following entities: Itaú, JP Morgan, Bank of America, HSBC, BNP Paribas, Standard Chartered, Citi, Société Générale, ING, Barclays, Wells Fargo, BBVA, Lloyds, UBS, Intesa San Paolo, Deutsche Bank and Unicredit.

2

THE GROUP'S RESULTS IN 2017

A Santander branch in Lisbon



We are meeting our financial objectives earlier than expected and in a responsible manner, with growth, profitability and a strong balance sheet

An improved global economy

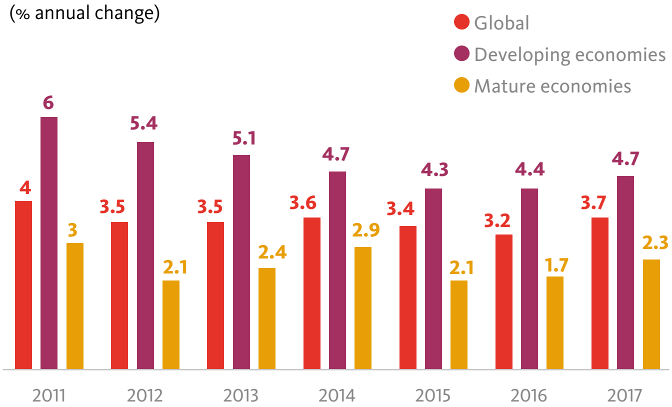
World economic growth rose in 2017 in an environment of improved global confidence which was reflected in international markets. In the regulatory field, the Basel III review was completed in 2017 and the debate on the impact of digital transformation on banking regulation and supervision advanced.

Advanced and emerging economies revitalised

In 2017, the world economy recorded higher growth than the previous year (3.7% vs 3.2%), in an environment of improved global confidence arising from the decline in political uncertainty, especially in Europe, favourable financial conditions and increased dynamism in international trade. Both advanced and emerging economies benefited from this renewed buoyancy.

GDP

(% annual change)



Source: IMF, *World Economic Outlook*, January 2018.

ECONOMIC PERFORMANCE BY COUNTRY

	% CHANGE IN GDP 2016	2017	
United States	1.5	2.3	Acceleration in economic growth in the eighth year of the longest upward cycle since 1850, with underlying inflation moderating to 1.5%. The unemployment rate fell to 4.1%, justifying the 75 bp increase in the Fed Funds interest rate to a range of 1.25%-1.5%. It is expected to continue with gradual increases.
United Kingdom	1.9	1.7	The economy held up well in the face of Brexit uncertainty, but with some slowing of growth. The unemployment rate remains at full employment levels and inflation, at around 3%, has exceeded the 2% target. The official rate was raised by 25 bp to 0.5% at year-end, reversing the cut that followed the referendum.
Eurozone	1.8	2.4	Notable economic revival in 2017, broadly based by component (domestic demand and exports) and by country. The unemployment rate declined to 8.8%, still above pre-crisis levels. Inflation remained low at 1.5%, with the result that the European Central bank (ECB) held its rates unchanged.
Spain	3.3	3.1	GDP growth exceeded 3% for the third consecutive year. The healthy creation of employment enabled the unemployment rate to fall to 16.6%. Growth was balanced, with no sign of inflationary pressure.
Portugal	1.5	2.6	Notable acceleration of growth in 2017, driven by domestic demand. Employment rose by over 3% and unemployment declined strongly to 8.5%. Inflation remained moderate. Private sector borrowing continued to fall and the budget deficit ended the year at 1.5% of GDP.
Poland	2.9	4.6	Strong growth in 2017 driven by private consumption and the external sector. Unemployment rate at historic lows (4.7%) and inflation at 2.5%. The central bank kept its official rate stable at 1.5%.
Brazil	-3.6	1.0	Gradual economic recovery during 2017, driven by consumption and investment. Inflation moderated to less than 3%. The central bank continued to reduce the *Selic* rate to 7% at year-end. The real depreciated slightly against the dollar (by 1.5%) and by almost 15% against the euro.
Mexico	2.3	2.1	The economy slowed due to lower growth in domestic demand. Inflation picked up to 6.8%, but is still expected to moderate in 2018. The central bank raised its official rate by 150 bp to 7.25%, while the peso appreciated by 5.2% against the dollar and fell 8.1% against the euro.
Chile	1.6	1.5	The economy began to recover from the middle of the year. Inflation ended the year at 2.3%, below the target of 3%, and the central bank cut the official rate by 100 bp to 2.5%. The peso rose by 8.1% against the dollar during the year and fell by 4.5% against the euro.
Argentina	-2.2	3.0	The economic recovery consolidated throughout the year, due to the strength of investment and private consumption. Inflation stabilised at around 2.0% a month and the central bank raised its official interest rate by 400 bp to 28.75%, enhancing its commitment to price stability.

For the first time in a decade, all the economies in which the Group has a presence grew

MSCI World Index

+20%
in 2017

Brent crude

$67
per barrel (+21%)

Yield on 10-year German bund

0.42%
(+22 bp on 2016)

Confidence in the financial markets

Financial markets were benign throughout the year. The absence of major upheavals increased investors' appetite for risk, which supported the rise in stock markets, increases in commodity prices and improved funding conditions in the corporate debt market.

In the United States, attention focused mainly on the ability of the new administration to implement its economic agenda. The S&P scaled new highs, supported by the strength of the economy and expectations of a more expansive fiscal stance.

The Federal Reserve raised interest rates on three occasions and in October began reducing its balance sheet; a process likely to take various years to complete. The market reacted well to these initial cautious steps. Long-term debt rates remained stable, below the levels they reached after Donald Trump's victory.

In the euro zone, political risk weighed heavily on the markets in early 2017, mainly due to fears of the far-right making further progress in France. This caused the risk premiums of public debt to rise, even in the traditionally stable countries. **However, political risk declined after Emmanuel Macron's victory in the French elections, which led to a normalisation of risk premiums.** The rating upgrades of Portugal and Italy caused risk premiums in these countries to decline further.

The ECB revealed it would not raise interest rates until the end of the bond buying programme, which will continue at least through September 2018. Nevertheless, unexpectedly strong growth and the reduction in political risk led to an appreciation of the euro against the dollar.

In the United Kingdom, sterling remained weak amid the slow progress of the Brexit negotiations. The Bank of England raised rates in November, the first increase in over a decade. This reversed the cut that followed the Brexit referendum.

The performance of Latin American currencies was uneven during the year. In the first half, they tended to appreciate, reflecting expectations of a recovery in the region's main economies. Recent months have seen reversals in the face of the uncertainty regarding the effects on these economies of the normalisation of the Federal Reserve's monetary policy.

The absence of major upheavals encouraged risk-taking in 2017; this sustained the rise in stock markets, higher commodity prices and improved corporate debt financing conditions

The Tenth Santander International Banking Conference, 8 November 2017, at the Santander Group headquarters in Boadilla del Monte, Spain

Regulatory milestones in 2017

The regulatory agenda in 2017 was marked:

- On an international scale, by completion of the Basel III agreement and launch of the fintech *debate*.
- The European Commission's proposed reforms to the capital requirements and resolution framework and measures to advance the integration of the European retail market.
- In many countries, by measures related to consumer and investor protection.

A stronger banking sector

The international banking sector continued to improve the health of its balance sheet by bolstering capital adequacy and liquidity, and reducing impaired assets. A more benign economic environment also allowed banks to improve their profit margins. These factors were translated into a generalised rise in financial share prices on the stock markets.

However, in developed countries and especially Europe, banks are still facing major challenges when it comes to increasing their profitability. Although monetary policy has begun to normalise in some areas, interest rates remain low, as do business volumes. In addition, competitive pressures continue to rise in most markets, both between banks and from new entrants and new ways of funding.

In emerging countries, with interest rates and margins above those in advanced countries, banks' profits remain consistently higher, even when the macroeconomic conditions are less favourable. This is due to the strong increase in financial inclusion. Thus, the proportion of the population with current accounts increased by 12 percentage points in only three years, although it still remains far below the ratios found in developed countries (51% vs 94%).

The vast majority of banks are now adapting to the digital revolution, which is changing the way they deal with customers while also improving quality and process efficiency, expanding the range of services on offer.

Banks are also facing diverging socio-demographic trends, with an ageing population across developed economies and a rise in the middle classes in emerging economies. These differences will require strategies tailored for each market.

Regulatory developments

In 2017, the Basel III review was completed after almost three years of negotiations. Discussions advanced on the impact of technology on the financial sector and its regulation and supervision. In Europe, progress continued in negotiations on revising capital and resolution frameworks.

Basel III revision completed

The Group of Central Bank Governors and Heads of Supervision (GHOS) approved the final framework for Basel III on 7 December. The revision seeks to reduce unjustified differences in the risk weighting of banking assets.

The final agreement will come into effect from 1 January 2022, but the capital floors to be established to limit the capital saved by the use of internal models will be implemented gradually until 2027.

In addition, the Basel Committee announced that the implementation of the new market risk framework (FRTB), initially planned for 2019, will be delayed to 1 January 2022.

The final framework makes a number of significant improvements on the proposals initially raised. According to an analysis conducted by the Basel Committee and the EBA, the final Basel III framework will have only a limited impact overall.

The completion of Basel III provides certainty on the regulatory requirements for the banking system and contributes to the credibility of the banks' asset valuation models.

The Basel Committee also published a consultative document opening a debate on the review of the capital treatment of sovereign debt and the additional information requirements regarding banks' exposure to this debt.

Santander believes regulation should:

- **Be agile and flexible, fostering innovation and digital transformation.**
- **Cover new realities: cybersecurity, the cloud, distributed ledger technology, and artificial intelligence, as well as the use and access to data.**
- **Ensure a level playing field: the same activity and the same risks should require the same regulation and supervision.**
- **Complete the European Banking Union with a European deposit guarantee fund and a fiscal backstop for crisis management.**

The fintech debate takes off

The Basel Committee released a set of recommendations in 2017 to control and supervise the activities of fintechs, focusing on the risks these companies pose for banks, as well as the opportunities that their developments may offer for the economy.

These recommendations add to those already issued by other international bodies, such as the International Monetary Fund and the Financial Stability Board (FSB), and European organisations such as the European Banking Authority.

The aim of the authorities is to understand and monitor developments in digital transformation to assess the effects they might have on banking business models, financial stability, consumer protection and risks such as cybersecurity and terrorism financing.

Cooperation between the authorities and an intense dialogue with the industry is essential if this analysis is to be carried out quickly and efficiently.

Sustainable economy

In June 2017, the Task Force on Climate-related Financial Disclosures of the Financial Stability Board (FSB) released its recommendations on how best to prepare financial information in such a way as to present most efficiently the risks relating to climate change. This task force has set up a working group, of which Banco Santander is a member, to facilitate the implementation of these recommendations.

Meanwhile, in January 2018, the European Commission's High-Level Expert Group on Sustainable Finance (HLEG) published its definitive recommendations on global strategy in the field of sustainable finance in the EU, integrating social, environmental and corporate governance aspects. Based on these, the European Commission will present an action plan in three main areas:

- Integrate sustainability factors into investment criteria.
- Create a common vocabulary and classification to let investors know what is green and sustainable.
- Encourage banks to play a role in financing the sustainable economy.

Banco Santander shares the aim of building a financial system that supports sustainable economic growth.

The Banking Union

In October 2017, the European Commission published a communication in a bid to further negotiations on completing the Banking Union. **The measures include the need to progress with the revision of the capital and resolution framework, the single European deposit guarantee fund, a backstop for the European resolution fund and the treatment of sovereign debt.**

Review of the capital and bank resolution frameworks in Europe

In November 2016, the European Commission published a proposal to reform the capital and bank resolution frameworks with several aims:

- Reducing risk in the banking sector.
- Introducing the new Basel III standards on market risk, leverage ratios and interest rate and counterparty risk.
- Integrating the loss absorbing capacity requirement (TLAC: *Total Loss Absorbing Capacity* (TLAC) requirement, set at international level by the FSB in the European framework.

In addition, it proposes reviewing other aspects of the current resolution framework, which was applied in practice for the first time with the resolution of Banco Popuiar.

In 2017 Santander grew its profit, increased shareholder return

"

Our recurring profitability enables us to lend more to our customers and increase dividends and generate capital

"

Ana Botín,
2017 Earnings presentation
Santander Group City, January 2018

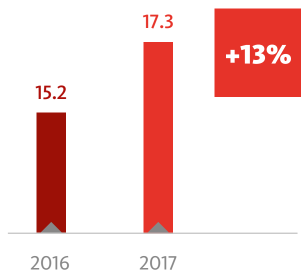
Growth

In 2017, Santander grew in all its main metrics and met its targets earlier than expected, with double-digit growth in revenue and in underlying profit before taxes

Santander's strategy focuses on customer loyalty in all its markets and on growth in digital customers. The continued improvement in the multichannel offering with new digital apps, innovative products and sound business strategies led to a significant increase in the number of loyal and digital customers in 2017.

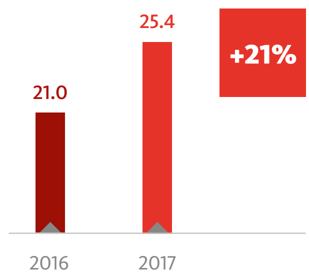
LOYAL CUSTOMERS

(Millions)



DIGITAL CUSTOMERS

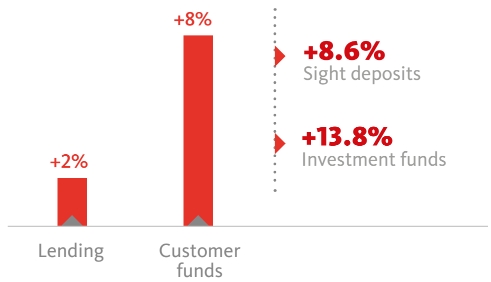
(Millions)



Santander grew responsibly, in line with its purpose: to help people and businesses prosper. The Group recorded growth in **lending** in the main segments in eight of the ten core units. In **customer funds**, the focus was on demand deposits and investment funds, which grew in eight of the ten core units. The 109% **loan-to-deposit ratio** (114% at year-end 2016) reflects the robust funding and liquidity structure.

ACTIVITY (EXCLUDING POPULAR)

(%)



Growth in constant euros

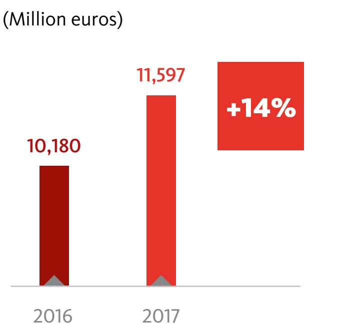
and strengthened its balance sheet, all in a responsible manner

Profitability

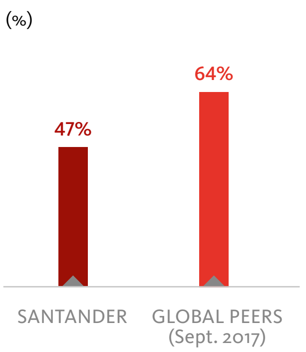
Santander is one of the most predictable, profitable and efficient banks in the world. This enables it to increase both customer lending and dividend payments while organically generating capital

Improved customer loyalty drove strong growth in fee income, while digitalisation and operational excellence helped revenue to grow faster than costs, leading to an improvement in the cost-to-income ratio to 47%. Santander is among the three leading banks for customer satisfaction in seven of its nine core countries.

FEE INCOME

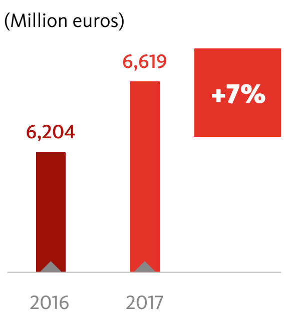


COST-TO-INCOME RATIO

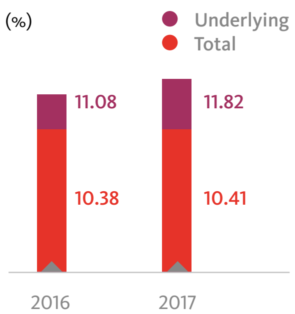


As a result of the growth in revenue, control of costs and the trend in provisions, underlying profit before taxes rose by 20% (in constant euros) and increased in eight of the Group's ten core units. Santander obtained one of the highest underlying RoTE rates among European banks. Santander's subsidiaries are among the leaders in terms of profitability in their respective markets.

ATTRIBUTABLE PROFIT



ROTE

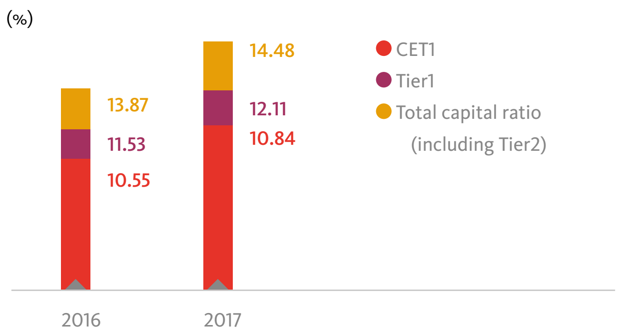


Strength

Santander strengthened its balance sheet thanks to a unique business model focused on ten core markets and ended 2017 with more capital and a lower NPL ratio (excluding Banco Popular)

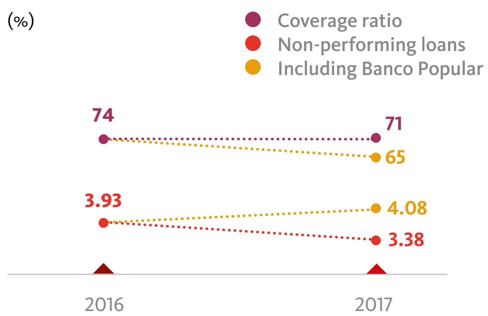
The organic generation of capital and the issuance of €7,072 million relating to the Banco Popular transaction **helped strengthen the Group**. The **fully loaded CET1** ratio reached 10.84%, 29 basis points more than at year-end 2016. The fully loaded **leverage** ratio is 5.0% and the **capital tangible book value** stands at €4.15.

CAPITAL RATIOS (FULLY LOADED)



Non-performing loans (excluding Banco Popular) fell 16% in 2017, a reflection of Santander's traditional prudence in risk management, while the coverage ratio rose to 71%. At 1.07%, the **cost of credit** (excluding Banco Popular) is already below the target maximum value established at the Investor Day. **Including Banco Popular**, the NPL ratio stands at 4.08%, after the sale of real estate assets to Blackstone.

NPL AND COVERAGE RATIOS



Santander Group key data

Including Banco Popular

BALANCE SHEET (million euros)	2017	2016	%2017/2016	2015
Total assets	1,444,305	1,339,125	7.9	1,340,260
Net customer loans	848,914	790,470	7.4	790,848
Customer deposits	777,730	691,112	12.5	683,142
Total customer funds	985,703	873,618	12.8	849,403
Equity	106,832	102,699	4.0	98,753

INCOME STATEMENT* (million euros)	2017	2016	%2017/2016	2015
Net interest income	34,296	31,089	10.3	32,189
Gross income	48,392	43,853	10.3	45,272
Net operating income	25,473	22,766	11.9	23,702
Underlying profit before taxes**	13,550	11,288	20.0	10,939
Underlying profit attributable to the Group**	7,516	6,621	13.5	6,566
Profit attributable to the Group	6,619	6,204	6.7	5,966

EPS***, PROFITABILITY AND EFFICIENCY (%)	2017	2016	%2017/2016	2015
Underlying attributable profit per share (euros)	0.463	0.429	7.8	0.438
Underlying EPS (euros)**	0,404	0,401	0.9	0.397
RoE	7.14	6.99		6.57
Underlying RoTE**	11.82	11.08		10.99
RoTE	10.41	10.38		9.99
RoA	0.58	0.56		0.54
Underlying RoRWA**	1.48	1.36		1.30
RoRWA	1.35	1.29		1.20
Cost-to-income ratio (including depreciation and amortisation)	47.4	48.1		47.6

SOLVENCY AND NPL RATIO (%)	2017	2016	%2017/2016	2015
Fully-loaded CET1	10.84	10.55		10.05
Phased-in CET1	12.26	12.53		12.55
NPL ratio	4.08	3.93		4.36
Coverage ratio	65.2	73.8		73.1

MARKET CAPITALISATION AND SHARES	2017	2016	%2017/2016	2015
Number of shares (millions)	16,136	14,582	10.7	14,434
Share price (euros)***	5,479	4.877	12.3	4.483
Market capitalisation (millions of euros)	88,410	72,314	22.3	65,792
Tangible book value (euros)***	4.15	4.15		4.00
Price / tangible book value***	1.32x	1.15x		1.12x
P/E ratio***	13.56x	12.18x		11.30x

OTHER DATA	2017	2016	%2017/2016	2015
Number of shareholders	4,029,630	3,928,950	2.6	3,573,277
Number of employees	202,251	188,492	7.3	193,863
Number of branches	13,697	12,235	11.9	13,030

(*) Variations w/o exchange rate: 2017/2016: NII: +10.2%; Gross income: +10.2%; Net operating income: +11.4%; Underlying attributable profit: +14.3%; Attributable profit: +7.4%

(**) Excluding net capital gains and provisions.

(***) Data adjusted to capital increase of July 2017.

For more information about the results of the Group and its main units see 110-194 of Banco Santander's 2017 Annual Report.

Results by countries and businesses

Spain*

Banco Santander became the leading bank in Spain following the acquisition of Banco Popular. Santander Spain's loyalty-centred strategy is producing good results while the Bank is making progress in its digital transformation.

+42%	+15%
loyal customers	digital customers

A Santander branch in Spain

Strategic priorities

- **Seamlessly integrate Banco Popular**
- **Profitable, loyalty-based growth**
- **Bank of choice for corporates**
- **Digital transformation to improve the customer experience**

2017 Highlights

- Since the acquisition of Banco Popular in June, the priority for Santander Spain has been to carry out an exemplary integration, without losing a single customer and maintaining the same excellence in service.
- Income from fees grew in double digits. Leadership in Global Corporate Markets, private and personal banking were maintained, while market share grew in SMEs and large companies corporate.
- The commercial strategy is focused on increasing **customer loyalty** and improving the **customer experience.**
- **The 1|2|3 strategy** was a key factor in increasing individual customer loyalty by 54%. Progress was made in completing the value proposition with the Smart 1|2|3 *account* for *millennials* and the *Zero account*, a fully digital, zero-fee account.
- With the **new positioning in corporates**, aimed at making Santander their bank of choice, loyalty rose by 6%. There was notable growth in value-added products, such as international business (up 16%).
- In **wholesale banking**, Santander consolidated its leadership in the main *rankings*, such as those for fixed income and syndicated lending.
- Sales of cards reached a record 1.4 million in the year while new lending through cards increased by more than 50%.
- Household lending growth outperformed the market, particularly mortgages, with new lending increasing by 33% during the year.
- The **digital transformation** progressed with the launch of ***Digilosofía,*** Santander's new digital philosophy. Santander is the leading bank for mobile payments in Spain, with 60% of the market. The digital ecosystem was renewed with a new website and app for individual and corporate customers, together with other launches such as *App Renting Bansacar*, *Confirming Santander* and *Mi Comercio* (My Business).
- Santander **helped people and businesses prosper** by providing over 12,000 grants and support to more than 1,200 entrepreneurs.
- Santander Spain was certified as a ***Top Employer***, demonstrating its commitment to the *Simple Personal and Fair* (SPF) culture and to the Organisation.
- Santander Spain received *The Banker's award* as **Bank of the Year** in Spain and **Best Private Bank**.

*Figures excluding Banco Popular.

Key data

People

22,916 (-0,4%)

Customers (millions)

12,675 (-1.2%)

Loans[1 2]

148,585 (-1,6%)

Attributable profit[1]

1,180 (+46,4%)

Contribution to Group profit[3]

15%

1. Millions of euros.
2. Gross lending, changes without repos.
3. Including Popular.

Santander Consumer Finance

SCF is the consumer finance leader in Europe. It specialises in auto finance and in loans for durable goods, personal finance and credit cards.

It is present in 15 European countries: Germany, Austria, Belgium, Denmark, Spain, Finland, France, Netherlands, Italy, Norway, Poland, Portugal, United Kingdom, Sweden and Switzerland.

>130K	>100
agreements with associated points of sale	agreements with 16 car and motorcycle manufacturers

Santander Consumer Finance head office in Austria

Strategic priorities

- **Support the transformation of manufacturers and dealers**
- **Develop innovative products and digitalise the customer cycle processes**
- **Implement open *e-commerce* platforms in the businesses and sign new agreements with distributors**
- **Develop channels, business intelligence and digital value-added propositions**

2017 Highlights

- **Ordinary profit of €1,254 million**, 15% more than the previous year. Attributable profit of €1,168 million, including a charge of €85 million in Germany.
- **The agreements with Banque PSA Finance**, finalised in prior quarters, advanced and includes joint ventures in 11 countries.
- **Increased income**, due mainly to net interest income (up 5%).
- Advances were made in digitalisation of channels and procurement and lending procedures.
- **The cost-to-income ratio** stands at 44%, an improvement of 0.6 percentage point.
- **The NPL ratio** fell to 2.5%, while coverage is 101%.
- **By geographies**, the main contributors to underlying profit were Germany (€364 million), the Nordic countries (€318 million) and Spain (€241 million).
- **New production** rose in the main countries, especially in the automotive sector (+11%) and the consumer business, notably cards (+9%).

Key data

People
15,131 (+1.4%)

Customers (millions)
19.9 (+11%)

Loans[1 2]
92,431 (+6.2%)

Attributable profit[1]
1,168 (+4.4%)

Contribution to Group profit

13%

1. Millions of euros, with changes in constant currencies. 2. Gross lending, changes without repos.

Poland

Bank Zachodni WBK consolidates its position as the third bank in the country following the agreement to acquire the retail and private banking activities of Deutsche Bank in Poland.

+3% loyal customers	+6% digital customers

2017 Highlights

- The Bank presented its new brand promise and claim: "Bank As You Want It". The new Account As I Want It, allowing users to adapt banking services to their needs flexibly, was launched and at year-end had 335,000 customers.
- Nearly 3.4 million customers have access to mobile and online banking services through BZWBK24. The proportion of credit facilities sold through remote channels (mobile, internet or contact centre) rose to 38%.

Bank Zachodni WBK branch in Poland

- The Bank issued nearly **120,000** smart cards: electronic student cards with a payment function.
- Bank Zachodni WBK introduced a biometric voice solution aimed at large companies, together with electronic guarantees incorporating a qualified electronic signature option and biometric facial recognition for individuals.
- Euromoney awarded Bank Zachodni WBK the prizes for **Best Bank in Poland** and **Best Bank in Poland for SMEs**.

Key data

People
11,572 (-3.6%)

Customers (millions)
4.4 (+1%)

Loans[1 2]
22,974 (+5.1%)

Attributable profit[1]
300 (-2.8%)

Contribution to Group profit
3%

1. Millions of euros, with changes in constant currencies.
2. Gross lending, changes without repos.

Portugal*

Santander Totta is Portugal's most profitable bank, with market shares of around 15.5% in loans and 13.2% in deposits (November 2017).

+8% loyal customers	+11% digital customers

2017 Highlights

- With the acquisition of Banco Popular, Santander Totta became the country's largest private bank, in terms of domestic assets and lending.
- Market share in new lending to companies was 17% and in new mortgage lending above 20%.
- The Bank made progress with its mobile app, increasing its sales through innovative products in digital channels. At year-end, digital channels accounted for 28% of the Bank's total sales of products.
- In 2017, Santander Totta was recognised as **Best Bank in Portugal** by *Euromoney* and *Global Finance* and as **Bank of the Year** by *The Banker*.

Santander Totta branch in Portugal

*Figures excluding Banco Popular.

Key data

People
5,895 (-6.5%)

Customers (millions)
4.7 (+18%)

Loans[1 2]
31,296 (+7.8%)

Attributable profit[1]
440 (+10.2%)

Contribution to Group profit[3]
5%

1. Millions of euros.
2. Gross lending, changes without repos.
3. Including Popular.

United Kingdom

Santander is one of the leading banks in the country, with an innovative value offering for retail customers and small businesses. In 2017, it remained focused on improving customer loyalty and customer experience through digitalisation and simpler products.

+5% loyal customers

+10% digital customers

Santander branch in the United Kingdom

Strategic priorities

- **Increase customer loyalty and market share**
- **Provide operational and digital excellence**
- **Achieve profitability growth and a strong balance sheet**
- **Support communities through expertise, knowledge and innovation**

2017 Highlights

- Santander UK's principal businesses recorded good results, with **growth in net interest income, an improved cost-to-income ratio and high credit quality.**
- Santander UK is continuing with its 1|2|3 World strategy, which has transformed its business and accounts for 5.4 million customers, up 275,000 on December 2016.
- Digital customers continued growing to 5 million, while users of mobile apps reached 1.9 million.
- Santander UK continued to develop its digital offering by expanding the information on the fund platform Investment Hub, which helps its 220,000 registered users to better understand and meet their investment needs.
- Santander UK launched in June a programme that allows customers to apply for a mortgage online or via videoconference with a financial advisor. The bank also expanded the features of its mobile offering through Android Pay.
- Outstanding residential mortgages grew by GBP 600 million this year, reflecting the price adjustments required in a competitive market, with an emphasis on customer service and retention.
- Santander UK rolled out the NeoCRM customer relationship management tool, used by 14,000 branch and call centre employees, which provides better customer knowledge enabling improved communication with customers.
- Despite inflationary pressure, operational efficiency continued to benefit from the growth of the business and improvements in digital channels, leading to a cost-to-income ratio of 50%.

Key data

People
25,971 (+1.1%)

Customers (millions)
25.4 (+0%)

Loans[1,2]
235,783 (+0.8%)

Attributable profit[1]
1,498 (-2.7%)

Contribution to Group profit
16%

1. Millions of euros, with changes in constant currencies. 2. Gross lending, changes without repos.

Brazil

Santander is Brazil's third largest private bank and largest foreign bank. In 2017 it met its profitability target thanks to its customer-centred business model, the commitment of its 47,000 employees and a strategy focused on profitable growth.

A Santander branch in Brazil

+14% loyal customers	**+34%** digital customers

Strategic priorities

- **Income growth**
- **Gain market share in acquiring, consumer and SMEs**
- **Digital transformation**
- **Risk management and recoveries**

2017 Highlights

- **Balance sheet growth, credit quality and appropriate control of costs drove a significant increase in Santander Brazil's net profit.** Deposits grew by 37% during the year and lending by 7%. The cost-to-income ratio improved by 3.9 percentage points to 35.6%, while the NPL ratio declined from 5.90% to 5.29%.

- Solutions to optimise the customer experience: **Superdigital**, the mobile platform that provides transaction services without a bank account, reached more than a million customers and brought innovations such as transfers by chat and online shopping. The ***Santander Way*** app, which simplifies credit card transaction, continues to garner high ratings from users, with 4.8 stars in the Apple Store and 4.6 in Google Play.

- New products and services: ***Santander One***, the new digital financial advice channel focused on investment, registered over 8 million views. ***Consignado Digital,*** which enables customers to manage their payroll deposit, helped increase market share in this segment by 214 basis points to 12.9%. ***Santander Corretora*** also has a new app that enables customers to ask questions, receive recommendations. and invest more quickly and easily.

- Santander Brazil also created ***Santander Auto***, a fully digital insurer resulting from a joint venture with HDI Seguros.

- New operations model: with the aim of improving customer satisfaction, a new, more efficient model, centred on operational excellence, was implemented, with an end-to-end vision of the process experienced by customers when using products and services.

- Strengthening of businesses: A 70% stake in Ipanema Credit Management, a company that manages impaired loan portfolios, was acquired. It will contribute more experience and expertise in loan recoveries. In ECM (Equity Capital Markets), Santander Brazil was the country's leading operator, according to Dealogic.

- Most prestigious awards received in 2017: Santander Brazil was named **Bank of the Year** in Brazil for the first time by *The Banker* and **Best Bank in Brazil** by *Euromoney.* In addition, for the second consecutive year it was named as one the best companies to work for by *Great Place to Work.*

Key data

People
47,135 (+0.9%)

Customers (millions)
38.1 (+11%)

Loans[1 2]
74,341 (+7.2%)

Attributable profit[1]
2,544 (+33.7%)

Contribution to Group profit

26%

1. Millions of euros, with changes in constant currencies. 2. Gross lending, changes without repos.

Mexico

Santander is the second largest bank in Mexico in terms of mortgages and loans to companies, and the third largest in credit cards.

+24% loyal customers	**+52%** digital customers

A Santander branch in Mexico

Strategic priorities

- **Increase direct deposits by payroll and strengthen the *Santander Plus* offer to encourage loyalty**
- **Consolidate positioning in SMEs and strengthen leadership in mortgages**
- **Operational and technological transformation through digital platforms and customer management**
- **Improve customer service in all channels throughout the Bank**

2017 Highlights

- Santander Mexico advanced with its 15,000 million-peso, three-year investment plan, focused on strategic initiatives such as the modernisation of channels, systems and infrastructure.
- Since its launch, the ***Santander Plus*** programme has attracted over 3.0 million customers, of whom 52% are new.
- The Bank increased its digital customer base by over 52% compared to 2016, reaching 1.9 million active customers.
- **Launches:**
  - ***Santander Connect***, a new remote banking model, personalised and fully digital, in which customers interact with their relationship managers by video call.
  - ***Spotlight***, Santander Mexico's digital factory, has 120 people dedicated to the development of digital solutions based on flexible, collaborative workstreams.
  - ***Tuiio*** aims to foster mass market financial inclusion with a measurable social impact by means of a broad competitive offering with its own operations, infrastructure and brands.
  - ***Campus Pay,*** a pioneering application for Mexico that boosts the use of bank services by university students and enables them to make payments in their educational establishments using their smartphones.
  - ***The Santander Me*** programme is designed to help women in their empowerment.
  - **Service by *bots***. Santander has implemented three automated reply systems for customers using robots: on the website, Facebook and Twitter. It is the only bank with this triple automated system in Mexico.
- *Euromoney* recognised Santander Mexico as **Best Investment Bank in Mexico** and *International Finance Magazine* (IFM) named it **Most Socially Responsible Bank in Mexico**, for the second consecutive year.

Key data

People
18,557 (+5.4%)

Customers (millions)
15.1 (+12%)

Loans[1,2]
26,962 (+4.6%)

Attributable profit[1]
710 (+16.5%)

Contribution to Group profit


7%

1. Millions of euros, with changes in constant currencies. 2. Gross lending, changes without repos.

Chile

Santander is the country's leading private sector bank in terms of assets and customers.

+3% loyal customers	**+5%** digital customers

2017 Highlights

- In 2017, Santander Chile introduced *On-boarding Digital*, the first fully digital platform for non-customers to become customers. *Touch-ID* (fingerprint) enables customers to buy banking products in seconds on their mobile phones. These initiatives have enabled the Bank to recruit a million digital customers, of whom 450,000 have downloaded the app and 300,000 are active customers, the highest figures of any local bank.
- **Launch of *Santander Life***, the new generation of products for individual customers sold in a fully digital format, which enables them to accumulate *Méritos Life* (exchangeable points). The better the customer's payment behaviour, the more benefits they obtain.
- **The WorkCafé model was consolidated**, with over 20 new sites. *WorkCafé* has been recognised, not only for its attractive format, but also for its commercial process, based on advanced digital technology.
- Santander Chile was named **Best Bank in Chile** by *The Banker, Euromoney* and *Latin Finance.* In addition, it is considered the second best large company to work for in Chile, according to *Great Place To Work.*

WorkCafé in Chile

Key data

People

11,675 (-2.7%)

Customers (millions)

3.5 (-3,3%)

Loans[1,2]

38,249 (+2.7%)

Attributable profit[1]

586 (+11.7%)

Contribution to Group profit

6%

1. Millions of euros, with changes in constant currencies.
2. Gross lending, changes without repos.

Argentina

Santander Río is Argentina's leading private bank in business market share, following the integration of the retail business acquired from Citibank N.A.'s unit in Argentina and through organic growth.

+20% loyal customers	**+30%** digital customers

2017 Highlights

- **Santander Río integrated 500,000 individual customers and a network of 70 branches** following the acquisition of the retail business of Citibank N.A.'s Argentine unit.
- **Market share** stands at **10% in lending and 11% in deposits.**
- Alliance with American Airlines and its frequent flyer *AAdvantage*®, which will allow Santander Río customers to accumulate air miles when they use their cards to make purchases.
- The branch transformation plan continues, with 276 already converted and two digital branches.
- Launch of UVA inflation-linked mortgage loans.
- **Santander Río** achieved fourth place in the ***Great Place to Work*** ranking. In addition, it was named Best Digital Bank and Best Mobile Bank in Latin America by *Global Finance* magazine and Best Bank in Argentina by *LatinFinance* magazine.

Santander Rio branch in Argentina

Key data

People

9,277 (+17%)

Customers (millions)

3.6 (+23%)

Loans[1,2]

7,608 (+44%)

Attributable profit[1]

359 (+14%)

Contribution to Group profit

4%

1. Millions of euros, with changes in constant currencies.
2. Gross lending, changes without repos.

United States

Santander's US franchise consists of a retail and commercial bank in the Northeast, a nationwide vehicle financing business based in Dallas, an international private banking business in Miami providing services to non-US residents, a broker-dealer in New York and a retail bank in Puerto Rico.

+8% loyal customers	**+5%** digital customers

Santander branch in the United States

Strategic priorities

- **Improve customer experience and loyalty**
- **Provide auto financing to all customer segments**
- **Improve profitability**
- **Continue to comply with regulatory expectations**

2017 Highlights

- **Santander US** achieved two key regulatory milestones in 2017, passing the Federal Reserve's capital stress test and closing its 2014 Written Agreement with the Federal Reserve. As a result, Santander US has now returned to a normal capital approval cycle and paid dividends to the Group for the first time since 2011. Underlying profit rose by 5% in 2017.

- **Santander Bank** has 670 branches in the Northeast of the United States. The net interest margin improved substantially during the year, reaching the same level as its peers. The Bank continued to improve customer experience, expanding its digital range and its commitment to communities. Santander Bank announced a $11 billion five-year plan to invest in the communities it serves.

- **Global Corporate Banking (GCB) and Retail and Commercial Banking** continued to demonstrate the value of Santander US to the Group. The US-Mexico and US-UK collaboration projects are well underway, with a considerable number of transactions signed and an ample portfolio of new ones in the pipeline. US-Mexico collaboration increased cross-border income by 64% in the 2015-2017 period, while US-UK collaboration increased it by around 30% over the same period.

- **Santander Consumer USA**, one of the leading automotive financial institutions in the US, continued to optimise its customer mix, and consolidated its strategic relationship with Chrysler Capital, maintaining its leadership position in the ABS market and strengthening its risk management, compliance and consumer practice programmes.

- **Banco Santander International** in Miami achieved double-digit growth in profits in 2017, boosted by the inflow of new customers.

- **Banco Santander Puerto Rico** was named Best Bank in Puerto Rico by Euromoney magazine for a fourth consecutive year. It quickly reopened its branches after the destruction wrought by hurricane Maria, and it continues to support the recovery efforts.

Key data

People
17,560 (+0.3%)

Customers (millions)
5.0 (-3%)

Loans[1 2]
75,389 (-4.3%)

Attributable profit[1]
332 (-6.7%)

Contribution to Group profit
4%

1. Millions of euros, with changes in constant currencies. 2. Gross lending, changes without repos.

Santander Global Corporate Banking (SGCB)

SGCB is a global division that supports corporate and institutional clients, offering tailored services and value-added wholesale products suited to their complexity and sophistication. SGCB's main aim is to be the best bank for its clients in Latin American and Europe, with solid business hubs in the US and Asia.

Santander Global Corporate Banking (SGCB)

Strategic priorities

- **Capture international business flows between the countries in which the Group is present**
- **Offer value-added products for specialised customers of the retail and commercial banking network**
- **Evolve towards a low capital consumption business**
- **Deepen customer relationships within the franchise**

2017 Highlights

- SGCB's strengths are based on Santander's strong, extensive local network, with the best franchise in Latin America and the Iberian peninsula in debt capital markets, project finance, equity capital markets and Export Credit Agency (ECA) financing.
- The *cash management* business grew faster than the market in 2017, with very significant mandates through the ***Santander Cash Nexus*** solution. The number of transactions and the active customer base both doubled, both in SGCB and in retail and commercial banking.
- ***Export and agency finance:*** leadership positions in the ECA global business rankings (No. 1 in Dealogic global league tables, excluding aircraft and shipping). The focus continues to be on origination, in both established and new emerging markets.
- ***Trade and working capital solutions:*** significant growth in *supply chain finance* products, both *receivables* and international *reverse factoring* solutions, especially in Latin America.
- **Debt capital markets:** Santander maintains its leadership in Latin America, with an increase in origination and execution of cross-border transactions in dollars, sterling, euros and local currencies. Notable participation in the main debt issues in Europe and the Americas.
- **Syndicated corporate loans:** the Bank took part in the main transactions in the year in its core markets.
- Santander maintains its leadership position in **structured finance** in Latin America, Spain and the UK.
- In **market activity**, strong income growth in Spain, the UK and Asia. Increased contribution in book management, notably in the UK, Spain, Portugal and Mexico.
- ***Corporate finance***: SGCB had a historic year in share placement, taking part in the main transactions in both continental Europe and Latin America.

Key data

Loans[1,2]

87,015 (-5%)

Attributable profit[1]

1,821 (+1%)

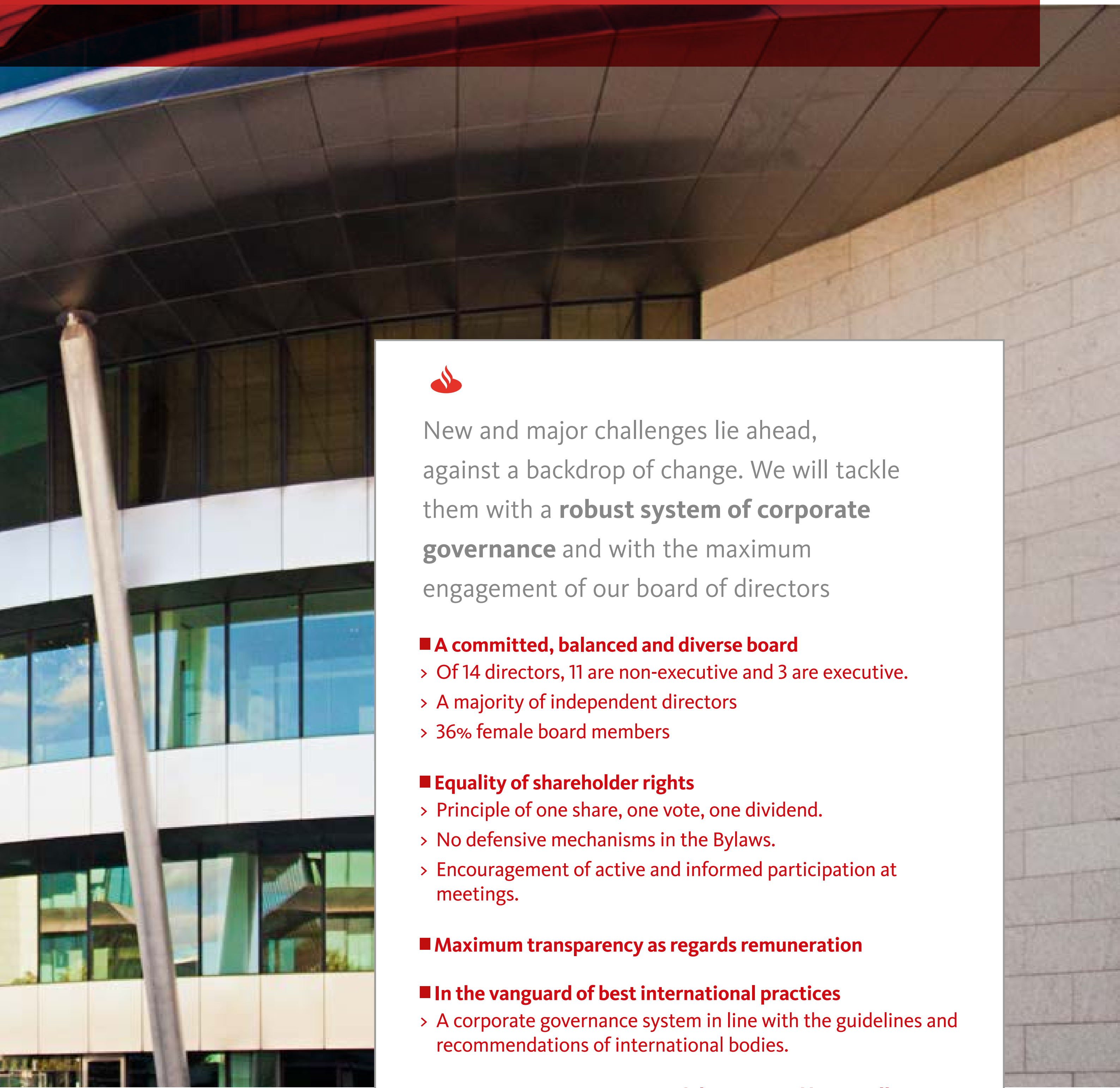
Contribution to Group profit

20%

1. Millones of euros, with changes in constant currencies. 2. Gross lending, changes without repos.
3. This global unit's results are included in countries' profit figures.

3

CORPORATE GOVERNANCE REPORT



New and major challenges lie ahead, against a backdrop of change. We will tackle them with a **robust system of corporate governance** and with the maximum engagement of our board of directors

■ A committed, balanced and diverse board

- Of 14 directors, 11 are non-executive and 3 are executive.
- A majority of independent directors
- 36% female board members

■ Equality of shareholder rights

- Principle of one share, one vote, one dividend.
- No defensive mechanisms in the Bylaws.
- Encouragement of active and informed participation at meetings.

■ Maximum transparency as regards remuneration

■ In the vanguard of best international practices

- A corporate governance system in line with the guidelines and recommendations of international bodies.

■ A corporate governance model recognised by socially responsible investment indices

- Santander has been listed on the Dow Jones Sustainability Index and FTSE4Good since 2000 and 2002, respectively.

“Directors’ background and dedication, in addition to their judgement, are a huge asset enabling the board and executive team to turn technology challenges into opportunities”

Ms Ana Botín, executive chairman of Banco Santander
General shareholders' meeting
7 April 2017

EXECUTIVE SUMMARY

Changes in the composition of the Board and its Committees

In 2017 the composition of the board has changed in order to reinforce its competences and diversity:

- On 26 June 2017, the Bank's board of directors, at the proposal of the appointments committee, agreed to appoint Ms Homaira Akbari and Ms. Esther Giménez-Salinas i Colomer as members of the audit committee and the risk supervision, regulation and compliance committee, respectively, replacing Mr. Juan Miguel Villar Mir, who resigned from both committees on the same date.
- On 28 November 2017, at the proposal of the appointments committee and after having obtained the necessary regulatory clearance, the board of directors agreed to appoint Mr Ramiro Mato García-Ansorena as independent director, filling the vacancy left by Ms Isabel Tocino Biscarolasaga following her resignation on that same date. The board also appointed, at the proposal of the appointments committee, Mr Ramiro Mato García-Ansorena as member of the executive committee, the audit committee and the risk supervision, regulation and compliance committee.

  Mr Mato holds a degree in Economics from the Universidad Complutense and in Management Development Programme of the Harvard Business School. He has spent all his extensive professional career in banking, in which he started to work in the year 1980. Having held a number of positions in the public group Argentaria, some of them in the Latin America market, in 1993 he joined BNP Paribas, being its top representative in Spain and Portugal and director in different companies of the BNP Group, in Bolsas y Mercados Españoles, S.A. and in the Spanish Banking Association.

  Mr Mato’s appointment will be put forward for approval at the next general shareholders’ meeting.
- In addition, in the meeting of the board of directors held on 28 November 2017, Mr Matías Rodriguez Inciarte tendered his resignation as director, resigning also as vice chairman of the board of directors and as member of the executive committee and the innovation and technology committee, and also as member and chairman of the Executive Risk Committee, which is now chaired by the CEO, Mr Jose Antonio Alvárez.
- In the same meeting of 28 November 2017, the board of directors, at the proposal of the appointments committee, agreed to appoint Mr Carlos Fernández González as member of the remuneration committee, who withdrew as a member of the risk supervision, regulation and compliance committee on that date.
- In its meeting of 19 December 2017, the board of directors agreed, at the proposal of the appointments committee, to appoint Ms Belén Romana García as member of the innovation and technology committee, filling the vacancy left by Mr Matías Rodríguez.
- In its meeting of 13 February 2018, the board of directors agreed, at the proposal of the appointments committee, to submit to the general shareholders’ meeting to be held on 22 or 23 March 2018, in first or second call, respectively, the appointment of Mr. Álvaro Antonio Cardoso de Souza as independent director to fill the vacancy left following the resignation of Mr Matías Rodríguez Inciarte.
- Lastly, in the meeting of 13 February 2018, the board of directors also agreed to submit to the aforementioned General shareholders' meeting of 2018, the amendment of article 41 of the Bylaws to reduce the minimum and maximum thresholds of composition of the board of directors, which are currently fixed between 14 and 22 members, at a minimum of 12 and a maximum of 17, size more aligned with the recommendations of the Good Governance Code.

Following the above changes, the board of directors and its committees are now more diverse in terms of knowledge and professional experience for the efficient performance of their respective duties.

Activities of the board

- The board held 15 meetings in 2017. In addition to the report made by the executive chairman at each annual meeting, the chief executive officer submitted management reports on the Group.
- As in previous years, the board held one specific meeting on the Group’s global strategy in the long term, with which he is fully committed as a way to achieve a profitable and sustainable business in the long term.
- The board received reports from and was directly accessible by the heads of internal control functions, namely risks (CRO), compliance (CCO) and internal audit (CAE). This ensures the necessary independence of such functions and facilitates the board’s oversight work on the three lines of defence.
- Digital transformation, Big Data and new information technologies, in addition to risks related to cyber-security and technology threats, have increased its importance amongst the topics dealt by the board and are fully integrated in the board’s agenda.
- The board actively takes part in defining and overseeing the corporate culture and values, particularly in the corporate social responsibility policy. On 13 February 2018, the board amend its rules and regulations in order to, among others, regulate a dedicated responsible banking, sustainability and culture committee for the purpose of advising the board on the formulation and review of corporate culture and values, and on relations with stakeholders, especially employees, customers and consumers in countries where the Group operates.

- Social demand for greater transparency in business activities, beyond the financial sector, is fully internalised in board decision-making and in the non-financial information reported in the long-term strategy and in the non-financial information disclosed, with special focus on the analysis of socio-environmental risks.

Dividend policy

- Banco Santander has traditionally paid its shareholders, against year earnings, three interim dividends and a final dividend in the months of August, November, February and May, respectively. Total remuneration charged to 2017 earnings is expected to total 0.22 euros per share via a scrip dividend and three cash dividends, which amounts to an increase of 5% in total dividend per share and 9% in cash compared to 2016.
- To date, two interim dividends of 0.06 euros per share have been paid out against 2017 earnings, in August 2017 and February 2018, and another of 0.04 euros per share in November 2017 through the Santander Scrip Dividend scheme, with a subscription percent of 84.61%. If approved by the general shareholders' meeting in 2018, a final cash dividend of 0.06 euros per share will be paid out in May.
- In coming years, dividends are expected to perform in line with the increase in results, bringing the cash pay-out to between 30% and 40% of recurring profit.

Bylaw-stipulated emoluments

- Bylaw-stipulated emoluments earned by the board amounted to 4.7 million euros in 2017, which is 22% lower than the maximum amount approved by shareholders at the general meeting held on 7 April 2017.

Remuneration of executive directors

- At the general shareholders' meeting of 7 April 2017, shareholders also approved the maximum ratio of 200% between variable and fixed pay items for 2017 for a maximum of 1,000 members of the identified staff, including executive directors.
- In addition, the same shareholders' meeting also took the binding decision to approve the director remuneration policy of Banco Santander, S.A. for 2017, 2018 and 2019 and, on a consultative basis, voted the annual report on director remuneration.
- Investors and analysts held a positive view of, amongst other changes, streamlining the different variable items of remuneration, improving the adjustment for ex-ante risk in relation to variable remuneration and increasing the weighting of long-term pay items and multiyear performance measures, thus making the ratio of long and short-term objectives more effective as part of the directors remuneration policy.

Appointments at subsidiariess

- On 2017 the appointments committee endorsed the appointment of directors and senior executives of the main subsidiaries of the Group, after assessing their skills, competencies and appropriateness for the role.

Internal governance framework at the Group

- In 2017, the Group continued to develop and update its Internal Governance Framework, which comprises a model that regulates parent-subsidiary relations and a set of corporate frameworks that develop this model. The corporate frameworks cover all the different functions and decision-making processes that the Board of Directors deems to be important. A series of new corporate frameworks were approved (for cyber-security and outsourcing and arrangements with third parties) while others were updated and improved where needed.
- Also, Internal Governance continues to make progress in its work of adapting the Group's governance structure to meet the expectations of the Board. This work continues to focus on:
  - overseeing the effective application of the parent-subsidiary model of governance;
  - ensuring the internal consistency and effectiveness of the Internal Governance system and of its different component elements (governance model, corporate frameworks, operating models, policies and procedures);
  - identifying areas where new rules and improvements need to be implemented;
  - ensuring the consistent development and application of policy documents and administering the repository where those documents are kept; and
  - supervising the process of applying the Internal Governance system across the entire Group.

  These initiatives continue to be continuously improved through an ongoing action plan across three dimensions, namely simplification, embedding and ongoing communication.
- Lastly, with the aim of promoting continuous improvement of overall effectiveness of our Governance bodies, the creation of a Board Governance Office was announced in July 2017. This new unit plays a key role in ensuring that appropriate support mechanisms are in place to enable the Board and Board / Executive Committees to discharge their roles with maximum efficiency. It also provides additional assurance that consistency of Governance is being applied through our Governance bodies.

Financial information periodically published by the Bank

- The board has approved the individual and consolidated quarterly, half-yearly financial information, financial statements and management report for 2017, in addition to other documents such as the annual report, the sustainability report, the Pillar III disclosures report, the annual corporate governance report and the annual report on director remuneration. All these reports are published on the Group's corporate website (www.santander.com).

1. Introduction

Santander has an effective and robust corporate governance structure that enables us to confidently face the Group's challenges in an ever more complex environment.

During this year, we continued to move forward on the path of good governance, strengthening and improving our corporate governance structure and bringing it into line with our long-term strategy and with the highest international standards in order to increase the confidence of our shareholders, investors and other stakeholders, in an environment that is demanding ever more transparency.

The board of directors, fully engaged and committed to the Group's corporate culture and strategy, has the expertise, experience, knowledge, dedication and diversity needed to accomplish our objective of making Santander the best commercial and retail bank, helping people and businesses prosper and conveying the values in which we believe. A planned and professionally prepared refresh of the board ensures that we will always have the best talent for successfully meeting that challenge.

In line with the Bank's vision and mission, the board of directors, within its general supervisory framework, performs the non-delegable task of approving and overseeing the main policies and overall strategies, particularly the strategic plan, the Group's corporate governance and internal governance system, defining its organisational structure, the corporate culture and values, the corporate social responsibility policy and the structure of the Group of companies, ensuring these are in line with the business strategy and risk appetite and putting into place mechanisms to ensure that all Group entities know how they fit into these strategies and that their processes and mechanisms are consistent with those of the parent.

In particular, the board promotes a sound risk culture and ensures that it is aligned with the corporate governance and internal governance system, the strategic plan, the capital and financial plan and that it is taken into account in the remuneration policies. In the past year, the addition of Mr Ramiro Mato García-Ansorena has helped the board of directors of Banco Santander reinforce its knowledge and professional experience in the fields of finance and risk.

Lastly, the board of directors, has amended its rules and regulations in order to, among others, create a committee for responsible banking, sustainability and culture with the aim of providing the board with specific advice in overseeing business performance in line with these principles over the long term and in its relations with stakeholders.

Board of Directors. December 2017.

2. Ownership structure

Number of shares and significant interests

Number of shares

In 2017, the Bank carried out two capital increases:

1. The first one on 27 July 2017, was designed to ensure that there was no deterioration in the Group's capital ratio as a result of the acquisition of 100% of the share capital of Banco Popular Español, S.A. A total of 1,458,232,745 new shares were issued, representing 10% of the entity's share capital at year-end 2016. The total new shares subscribed plus the additional shares requested represented demand that is 8.2 times the number of shares offered in the capital increase

2. The second capital increase, as part of the Santander Scrip Dividend scheme, became effective on 6 November 2017. A total of 95,580,136 new shares were issued, equivalent to 0.7% of the Bank's share capital at year-end 2016.

On 31 December 2017, the Bank's share capital was represented by 16,136,153,582 shares. At that date, stock market capitalisation according to the listing price on the Electronic Spanish Stock Market Interconnection System was 88,410 million euros.

All shares carry the same voting and dividend rights.

Significant interests

At 31 December 2017, the only shareholders appearing on the Bank's register of shareholders with a stake of over 3% were State Street Bank and Trust Company (13.32%), The Bank of New York Mellon Corporation (8.83%), Chase Nominees Limited (7.41%), EC Nominees Limited (3.43%), Caceis Bank (3.13%), Clearstream Banking S.A. (3.10%) and BNP Paribas (3.03%).

Nevertheless, the Bank believes that those stakes are held in custody in the name of third parties and to the best of the Bank's knowledge none of those shareholders holds itself a stake of over 3% in the share capital or in the voting rights .

Bearing in mind the current number of members of the board of directors (14), the percentage of capital needed to exercise the right to appoint a director, in accordance with article 243 of the Spanish Limited Liability Companies Law (Ley de Sociedades de Capital) on proportional representation, is 7.14%.

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 executed in February 2006 by Mr Emilio Botín-Sanz de Sautuola y García de los Ríos, Ms Ana 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 Bank shares held by the signatories to the agreement or whose voting rights have been granted to them. This agreement was also reported to the Spanish National Securities Market Commission (CNMV) as a material fact and is described in the public records thereof.

On 3 August and 19 November 2012, Banco Santander notified the CNMV, through a material fact, 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 notified the CNMV, through a material fact, of an update to the signatories and the distribution of shares included in the syndication, as a result of a business reorganisation carried out by one of the parties to the agreement.

On 3 October 2014, Banco Santander notified the CNMV, through a material fact, of a new update to the signatories and the distribution of shares included in the syndication, as well as the change in the chairmanship of the syndicate, which is vested in the chairman of the board of trustees of the Botín Foundation (currently Mr Francisco Javier Botín-Sanz de Sautuola y O'Shea).

On 6 February and 29 May 2015, Banco Santander notified the CNMV, through respective material facts, of the updates to the signatories and the distribution of shares included in the syndication, all within the framework of the inheritance process as a result of the death of Mr Emilio Botín-Sanz de Sautuola y García de los Ríos.

Lastly, on 29 July 2015 Banco Santander notified the CNMV, through a material fact, of an update to the signatories and the distribution of shares included in the syndication as a result of extinguishing the usufruct over the shares of one of the parties to the agreement along with the voting rights arising therefrom, thereby consolidating the full price of the aforementioned shares in the Botín Foundation.

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

1. The threshold stipulated in Royal Decree 1362/2007, of 19 October, which implemented the Securities Market Law 24/1988, of 28 July, defining the concept of significant holding.
2. The website of the Spanish National Securities Market Commission (www.cnmv.es) contains a notice of significant holding published by Blackrock, Inc. on 9 August 2017, in which it notifies an indirect holding in the voting rights attributable to Bank shares of 5.940%, plus a further stake of 0.158% held through financial instruments. However, according to the Bank's shareholder register, Blackrock, Inc did not hold more than 3% of the voting rights on that date or on 31 December 2017.

Shares included in the syndication

At 31 December 2017, the syndication included a total of 79,072,050 shares of the Bank (0.49% of its share capital), broken down as follows:

Signatories to the shareholders' agreement	Number of shares
Ms Ana Botín-Sanz de Sautuola O'Shea	918,136
Mr Emilio Botín-Sanz de Sautuola O'Shea[1]	16,843,109
Mr Francisco Javier Botín-Sanz de Sautuola O'Shea[2]	17,922,803
Ms Paloma Botín-Sanz de Sautuola O'Shea[3]	8,394,905
Ms Carmen Botín-Sanz de Sautuola O'Shea	9,497,451
PUENTEPUMAR, S.L.	-
LATIMER INVERSIONES, S.L.	-
CRONJE, S.L., Unipersonal[4]	19,362,840
NUEVA AZIL, S.L.[5]	6,132,806
TOTAL	**79,072,050**

1. 7,800,332 shares held indirectly through Puente San Miguel, S.L.U.
2. 12,591,853 shares held indirectly through Agropecuaria El Castaño, S.L.U.
3. 7,187,903 shares held indirectly through Bright Sky 2012, S.L.
4. Controlled by Ms Ana Botín-Sanz de Sautuola O'Shea.
5. Controlled by Ms Carolina Botín-Sanz de Sautuola O'Shea.

Treasury shares

Treasury share policy

The sale and purchase of own shares, whether by the company or its subsidiaries or investees, must conform to the provisions of applicable law and the resolutions adopted at the general shareholders' meeting in this regard.

The Bank, by a resolution of the Board of Directors on 23 October 2014, approved the current treasury share policy[3] taking into ac count the criteria recommended by the CNMV.

Treasury share transactions have the following objectives:

a) To provide liquidity or a supply of securities, as applicable, in the market for the Bank's shares, giving depth to such market and minimising possible temporary imbalances between supply and demand.

b) To take advantage, in benefit of shareholders as a whole, of situations of weakness in the price of the shares in relation to prospects of changes in the medium term. Such transactions are subject to the following general guidelines:

- They may not entail a proposed intervention in the free formation of prices.
- Trading may not take place if the unit entrusted with such transaction is in possession of insider or relevant information.
- Where applicable, the execution of buy-back programmes and the acquisition of shares to cover obligations of the Bank or the Group shall be permitted.

Transactions with treasury shares are carried out by the investments and holdings department, which is isolated as a separate area from the rest of the Bank's activities and protected by the respective Chinese walls, preventing it from receiving any inside or relevant information. The head of such department is responsible for the management of treasury shares..

Key data

At 31 December 2017, the Bank and its subsidiaries and investees held a total of 3,913,340 treasury shares in the Bank, representing 0.024% of its share capital at that date (at year-end 2016, there were 1,476,897 treasury shares, representing 0.010% of the Bank's share capital at such date).

The following table sets out the monthly average percentages of treasury shares in 2017 and 2016.

MONTHLY AVERAGE PERCENTAGES OF TREASURY SHARES[1]

% of the Bank's social capital[2]

	2017	2016
January	0.05%	0.01%
February	0.02%	0.3%
March	0.01%	0.02%
April	0.01%	0.04%
May	0.02%	0.05%
June	0.03%	0.05%
July	0.07%	0.02%
August	0.10%	0.06%
September	0.09%	0.18%
October	0.08%	0.06%
November	0.07%	0.03%
December	0.05%	0.02%

1. Further information in this regard is included in Section A.8 of the annual corporate governance report.
2. Monthly average of daily positions of treasury shares.

Transactions with treasury shares performed by the consolidated companies in 2017 entailed the acquisition of 239,028,959 shares, equivalent to a par value of 119.5 million euros (cash amount of 1,309.4 million euros) and the sale of 236,592,516 shares, with a par value of 118.3 million euros (cash amount of 1,331.6 million euros).

The average purchase price of the Bank's shares in 2017 was 5.48 euros per share, and the average sale price of the Bank's shares was 5.63 euros per share.

The net gain for the Bank, net of tax, on transactions involving shares issued by the Bank amounted to 26,226,030 euros and was recognised in the Group's equity under Shareholders' Equity-Reserves.

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

Authorisation

The current authorisation for transactions with treasury shares arises from resolution Five adopted by the shareholders at the general shareholders' meeting held on 28 March 2014, item II) of which reads as follows:

"To expressly authorise the Bank and the subsidiaries belonging to the Group to acquire shares representing the Bank's share capital for any valuable consideration 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 the maximum percentage permitted by law while this authorisation remains in force, such shares being fully paid at a minimum price per share equal to the par value thereof and a maximum price of up to 3% higher than 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 any shares that must be delivered to the employees and directors of the company either directly or 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 capital authorised by the general shareholders' meeting held on 7 April 2017, under item eight on the agenda, amounted to 3,645,585,175 euros. The Bank's directors have until 7 April 2020 to carry out capital increases up to this limit. The shareholders gave the board (or, by delegation, the executive committee) the power to exclude pre-emptive rights, in full or in part, pursuant to the provisions of article 506 of the Spanish Limited Liability Companies Law, although this power is limited to capital increases carried out under this authorisation up to 1,458,234,070 euros.

At the date of this document, use of this authorisation has been made in the amount of 729,116,372.50 euros by virtue of the capital increase with pre-emptive subscription right adopted in July 2017 in connection with the acquisition of Banco Popular Español, S.A.

The decision of the general meeting of 27 March 2015 authorising the board to issue fixed-income securities convertible into and/or exchangeable for shares in the Bank for a combined maximum issue value (on one or more occasions) of 10,000 million euros, or equivalent value in another currency, remains in force. The general meeting also authorised the directors to fully or partially disapply the pre-emptive subscription right, subject to the same limits as for the aforementioned authorised capital. The Bank's directors will be entitled to issue instruments under this power through to 27 March 2020.

At the date of this document, two issues of preference shares contingently convertible into new ordinary shares of the Bank, with disapplication of shareholders' pre-emptive subscription right, for a total nominal amount of 1,750 million euros: one in April 2017 for a nominal amount of 750,000,000 euros and another in September 2017 for a nominal amount of 1,000,000,000 euros.

Moreover, the annual general meeting held on 7 April 2017 passed the following resolutions:

1. To effect a rights issue charged to reserves for the maximum amount that can be determined according to the terms of the agreement within the shareholder compensation scheme (Santander Scrip Dividend), whereby the Bank has offered shareholders the possibility of receiving, on the date on which the second interim dividend for 2017 is typically paid, shares under a scrip issue for an amount equal to that dividend payment.

   This capital increase became effective on 14 November 2017 through the issuance of 95,580,136 new shares, each of a par value of 0.50 euros each (equal to 47,790,068 euros), representing a total of 0.7% of the Bank's share capital at year-end 2016.

2. To render null and void, in the unused portion, the powers vested by general meeting of 18 March 2016, and vest powers in the board once again, pursuant to the terms of article 319 of the Regulations of the Mercantile Registry, authorising it to issue fixed-income securities on one or more occasions up to a maximum of 50,000 million euros, or equivalent value in another currency, doing so in any legally admissible manner, including bonds, covered bonds, promissory notes, debentures and preference shares, or other analogous debt instruments (including warrants, whether settled through physical delivery or netting). The Bank's directors will be entitled to exercise this power through to 7 April 2022, whereupon any part thereof not exercised will be cancelled.

   As of the date of this document, a total of 13,870,611,883.23 euros has been used under this authority.

3. To delegate to the board of directors, pursuant to the provisions of article 297.1.a) of the Spanish Limited Liability Companies Law, 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 an increase in capital through the issue of new shares agreed by the general meeting in the amount of 500 million euros. If the board does not exercise the powers delegated to it within the aforementioned period, these powers will be rendered null and void.

   This authorisation had not been used as of the date of this document.

3. Banco Santander's board of directors

Ms Ana Botín-Sanz de Sautuola y O'Shea

GROUP EXECUTIVE CHAIRMAN
Executive director

Nationality: Spanish
Born in 1960 in Santander, Spain.

Joined the board in 1989.

Degree in Economics from Bryn Mawr College (Pennsylvania, United States).

She joined Banco Santander after working at JP Morgan (New York, 1980-1988). In 1992 she was appointed senior executive vice president. Between 1992 and 1998 she led the expansion of Santander in Latin America. In 2002, she was appointed executive chairman of Banesto. Between 2010 and 2014 she was Chief Executive Officer of Santander UK. In 2014 she was appointed executive chairman of Santander.

Other positions of note: member of the board of directors of The Coca-Cola Company. She is also founder and president of the CyD Foundation (which supports higher education) and of the Empieza por Educar Foundation (the Spanish subsidiary of international NGO Teach for All) and she sits on the advisory board of the Massachussetts Institute of Technology (MIT).

Membership of board committees
Executive (chairman) and innovation and technology (chairman).

Mr José Antonio Álvarez Álvarez

CHIEF EXECUTIVE OFFICER
Executive director

Nationality: Spanish
Born in 1960 in León, Spain.

Joined the board in 2015.

Graduate in Economics and Business Administration. MBA from the University of Chicago.

Joined the Bank in 2002 and appointed senior executive vice president of the financial management and investor relations division in 2004 (Group chief financial officer).

Other positions of note: He is a member of the board of Banco Santander (Brasil), S.A. and SAM Investments Holdings Limited. He has also served as director of Santander Consumer Finance, S.A. and Santander Holdings USA, Inc. and he sits on the supervisory boards of Santander Consumer AG, Santander Consumer Holding GMBH and Bank of Zachodni WBK, S.A. He has also been board member of Bolsas y Mercados Españoles (BME).

Membership of board committees
Executive and innovation and technology.

Mr Bruce Carnegie-Brown

VICE CHAIRMAN
Non-executive director (independent) and lead independent director

Nationality: British.
Born in 1959 in Freetown, Sierra Leone.

Joined the board in 2015.

Master of Arts in English Language and Literature from the University of Oxford.

Other positions of note: He is currently the non-executive chairman of Moneysupermarket.com Group Plc and Lloyd's of London. He was formerly the non-executive chair of AON UK Ltd (2012-2015), founder and managing partner of the quoted private equity division of 3i Group Plc., and president and chief executive officer of Marsh Europe. He was also lead independent director at Close Brothers Group Plc (2006-2014) and Catlin Group Ltd (2010-2014). He previously worked at JPMorgan Chase for eighteen years and at Bank of America for four years.

Membership of board committees
Executive, appointments (chairman), remuneration (chairman), risk supervision, regulation and compliance (chairman) and innovation and technology.

Mr Rodrigo Echenique Gordillo

VICE CHAIRMAN
Executive director

Nationality: Spanish.
Born in 1946 in Madrid, Spain.

Joined the board in 1988.

Graduate in Law and Government Attorney.

Other positions of note: former chief executive officer of Banco Santander, S.A. (1988-1994). He has served on the board of directors of several industrial and financial companies, including Ebro Azúcares y Alcoholes, S.A. and Industrias Agrícolas, S.A., and he was chairman of the Advisory Board of Accenture, S.A. He also held the position of non-executive chairman of NH Hotels Group, S.A., Vocento, S.A., Vallehermoso, S.A. and Merlin Properties SOCIMI, S.A. He is currently a non-executive director of Inditex.

Membership of board committees
Executive and innovation and technology.

Mr Guillermo de la Dehesa Romero

VICE CHAIRMAN
Non-executive director

Nationality: Spanish.
Born in 1941 in Madrid, Spain.

Joined the board in 2002.

Government Economist and head of office of the Bank of Spain (on leave of absence).

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

Membership of board committees

Executive, appointments, remuneration, risk supervision, regulation and compliance and innovation and technology.

Ms Homaira Akbari

Non-executive director (independent)

Nationality: North-American and French.
Born in 1961 in Tehran, Iran.

Joined the board in 2016.

Doctorate in Experimental Particle Physics from Tufts University and MBA from Carnegie Mellon University.

She is Chief Executive Officer of AKnowledge Partners, LLC.

Other positions of note: currently non-executive director of Gemalto NV, Landstar System, Inc. and Veolia Environment S.A. Ms Akbari has also been president and CEO of Sky Bitz, Inc., managing director of True Position Inc., non-executive director of Covisint Corporation and US Pack Logistics LLC and she has held various posts at Microsoft Corporation and at Thales Group.

Membership of board committees

Audit and innovation and technology.

Mr Ignacio Benjumea Cabeza de Vaca

Non-executive director

Nationality: Spanish.
Born in 1952 in Madrid, Spain.

Joined the board in 2015.

Degree in Law from Deusto University, ICADE E-3, and Government Attorney.

He is vice chairman of the Financial Studies Foundation and a member of the board of trustees and the executive committee of the Banco Santander Foundation.

Other positions of note: senior executive vice president, general secretary and secretary to the board of Banco Santander, S.A., and board member, senior executive vice president, general secretary and secretary to the board of Banco Santander de Negocios and of Santander Investment. He was also technical general secretary of the Ministry of Employment and Social Security, general secretary of Banco de Crédito Industrial and director of Dragados, S.A., Bolsas y Mercados Españoles (BME) and of the Governing Body of the Madrid Stock Exchange.

Membership of board committees

Executive, appointments, remuneration, risk supervision, regulation and compliance and innovation and technology.

Mr Javier Botín-Sanz de Sautuola y O'Shea

Non-executive director

Nationality: Spanish.
Born in 1973 in Santander, Spain.

Joined the board in 2004.

Degree in Law.

Executive Chairman of JB Capital Markets, Sociedad de Valores, S.A.U.

Other positions of note: in addition to his work in the financial sector, he collaborates with several non-profit organisations. Since 2014 he has been chairman of the Botín Foundation and is a trustee of the Princess of Girona.

Ms Sol Daurella Comadrán

Non-executive director (independent)

Nationality: Spanish. Born in 1966 in Barcelona, Spain.

Joined the board in 2015.

Degree in Business and MBA from ESADE.

Executive chairman of Olive Partners, S.A. and holds several positions at companies belonging to the Cobega Group. She is also chairman of Coca Cola European Partners, Plc.

Other positions of note: Previously, she has served on the board of the Círculo de Economía and also as an independent non-executive director at Banco Sabadell, S.A., Ebro Foods, S.A. and Acciona, S.A. She has also been honorary counsel general of Iceland in Barcelona since 1992.

Membership of board committees

Appointments and remuneration.

Mr Carlos Fernández González

Non-executive director (independent)

Nationality: Mexican and Spanish. Born in 1966 in Mexico City, Mexico.

Joined the board in 2015.

Industrial engineer. He has undertaken graduate studies in business administration at the Instituto Panamericano de Alta Dirección de Empresas.

He is the chairman of the board of directors of Finaccess, S.A.P.I.

Other positions of note: Mr Fernández has also sat on the boards of Anheuser-Busch Companies, LLC and Televisa S.A. de C.V., among other companies. He is currently non-executive director of Inmobiliaria Colonial, S.A. and member of the supervisory board of AmRest Holdings, SE.

Membership of board committees

Audit, appointments and remuneration.

Ms Esther Giménez-Salinas i Colomer

Non-executive director (independent)

Nationality: Spanish. Born in 1949 in Barcelona, Spain.

Joined the board in 2012.

PhD in Law and degree in Psychology.

Professor Emeritus at Ramón Llull University, director of the Chair of Restorative Social Justice, director of Unibasq and Aqu (quality assurance agencies for the Basque and Catalan university systems) and of Gawa Capital Partners, S.L.

Other positions of note: She has been chancellor of the Ramon Llull University, member of the standing committee of Conference of Chancellors of Spanish Universities (CRUE), member of the General Council of the Judiciary, member of the Scientific Committee on Criminal Policy of the Council of Europe, director general of the Centre of Legal Studies and Specialised Training of the Department of Justice of the Government of Catalonia (Generalitat de Catalunya) and member of the advisory board of Endesa-Catalunya.

Membership of board committees

Risk supervision, regulation and compliance and innovation and technology.

Ms Belén Romana García

Non-executive director (independent)

Nationality: Spanish. Born in 1965 in Madrid, Spain.

Joined the board in 2015.

Graduate in Economics and Business Administration from Universidad Autónoma de Madrid and Government Economist.

Non-executive director of Aviva Plc, London and of Aviva Italia Holding SpA, and member of the advisory board of the Rafael del Pino Foundation.

Other positions of note: she was formerly executive vice president of Economic Policy and executive vice president of the Treasury of the Ministry of Economy of the Spanish Government, as well as director of the Bank of Spain and the Spanish National Securities Market Commission (CNMV). She also held the position of director of the Instituto de Crédito Oficial and of other entities on behalf of the Spanish Ministry of Economy. She was the executive chairman of Sociedad de Gestión de Activos Procedentes de la Reestructuración Bancaria, S.A. (SAREB).

Membership of board committees

Audit (chairman), risk supervision, regulation and compliance and innovation and technology.

The board has strengthened its knowledge and professional experience with the addition of Mr Ramiro Mato García-Ansorena as a new board member, thus concluding a rigorous selection process that involved a careful assessment of the capacities of board members (skills matrix) and a precise identification of the profiles best suited to helping the Group meet its strategic objectives, in accordance with the principles set out in the Bank’s director selection and succession policy. This process has been organised and overseen by the appointments committee.

Mr Juan Miguel Villar Mir

Non-executive director (independent)

Nationality: Spanish.
Born in 1931 in Madrid, Spain.

Joined the board in 2013.

Doctorate in Civil Engineering, graduate in Law and degree in Industrial Organisation.

He is the Chair of Villar Mir Group.

Other positions of note: formerly Minister of Finance and vice president of the government for Economic Affairs from 1975 to 1976. He has also served as chairman of the OHL Group, Electra de Viesgo, Altos Hornos de Vizcaya, Hidro Nitro Española, Empresa Nacional de Celulosa, Empresa Nacional Carbonífera del Sur, Cementos del Cinca, Cementos Portland Aragón, Puerto Sotogrande, the COTEC Foundation and of Colegio Nacional de Ingenieros de Caminos, Canales y Puertos. He is also currently Professor of Business Organisation at Universidad Politécnica de Madrid, a member of the Royal Academy of Engineering and of the Royal Academy of Moral and Political Sciences, an honorary member of the Royal Academy of Doctors and supernumerary of the Royal Academy of Economics and Finance.

Mr Ramiro Mato García-Ansorena

Non-executive director (independent)

Nationality: Spanish.
Born in 1952 in Madrid, Spain.

Joined the board in 2017.

Degree in Economics from the Complutense University of Madrid and the Management Development Programme of the Harvard Business School.

Other positions of note: He has held several positions in Banque BNP Paribas, including chairman of the BNP Paribas Group in Spain. Previously, he held several significant positions in Argentaria. He has been a member of the Spanish Banking Association (AEB) and of Bolsas y Mercados Españoles, S.A. (BME) and member of the Board of Trustees of the Fundación Española de Banca para Estudios Financieros (FEBEF).

Membership of board committees

Executive, audit, and risk supervision, regulation and compliance.

Mr Jaime Pérez Renovales

General secretary and secretary of the board

Nationality: Spanish.
Born in 1968 in Valladolid, Spain.

Joined the Group in 2003.

Graduate in Law and Business Administration at Universidad Pontificia de Comillas (ICADE E-3), and Government Attorney.

Other positions of note: He is non-executive chairman of Santusa Holding, S.L., Santander Holding International, S.A. and Servicios de Alarmas Controladas por Ordenadores, S.A.; he is also non-executive director of Portal Universia, S.A. In addition, he is member of the board of trustees of the Universia Foundation, of the Banco Santander Foundation, being also a member of its executive committee, and of Fundacion Generación 2015.

Previously, he was deputy director of legal services at the CNMV, director of the office of the second vice president of the Government for Economic Affairs and Minister of Economy, general secretary and secretary of the board of Banco Español de Crédito, S.A., general vice secretary and vice secretary of the board and head of legal advisory services of the Santander Group, deputy secretary of the Presidency of the Government and chairman of the committee for the Public Administration Reform.

Formerly chairman of the Agency of the Official State Gazette and director, amongst others, of Patrimonio Nacional, of the Sociedad Estatal de las Participaciones Industriales, Holding Olímpico, S.A., Autoestradas de Galicia, S.A. and Sociedad Estatal para la Introducción del Euro, S.A.

Secretary of board committees

Executive, audit, appointments, remuneration, risk supervision, regulation and compliance, innovation and technology.

Appointment, ratification and re-election of directors at the 2018 annual general shareholders' meeting

Pursuant to article 55 of the Bylaws[4] and article 27 of the Rules and Regulations of the Board4, directors are appointed to three-year terms, such that one-third of the board is renewed each year.

The following directors will be put forward for re-election at the 2018 annual general shareholders' meeting, scheduled for 22 or 23 March 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: Mr Carlos Fernández González, Ms Homaira Akbari, Ms Sol Daurella Comadrán, Mr Guillermo de la Dehesa and Mr Ignacio Benjumea Cabeza de Vaca, the first three as independent directors and the latter two as non-executive directors that are neither proprietary nor independent.

The appointment of Mr Ramiro Mato García-Ansorena as independent director will be submitted for ratification by the general meeting. Mr Mato was initially designated via co-option to fill the vacancy left by Ms Isabel Tocino Biscarolasaga. Also, the appointment of Mr. Álvaro Antonio Cardoso de Souza as independent director to fill the vacancy left following the resignation of Mr Matías Rodríguez Inciarte will be put forward.

Their professional profiles, together with a description of their work and activities, can be found in the preceding pages of this report and also on the Group's corporate website (www.santander.com) and in the motions for their re-election, appointment or ratification, to be laid before the general shareholders' meeting of 2018.

Each of the re-elections, the appointment and the ratification will be submitted separately for voting at the general meeting in accordance with article 21.2 of the Rules and Regulations for the General Shareholders' Meeting.

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

COMPOSITION AND STRUCTURE OF THE BOARD OF DIRECTORS[1]

Board of directors				Committees					
		Executive	Non-executive	1. Executive committee	2. Audit committee	3. Appointments committee	4. Remuneration committee	5. Risk supervision, regulation and compliance committee	6. Innovation and technology committee
Executive chairman	Ms Ana Botín-Sanz de Sautuola y O'Shea	■		E					E
Chief Executive Officer	Mr José Antonio Álvarez Álvarez	■		■					■
Vice chairmen	Mr Bruce Carnegie-Brown		I	■		E	E	E	■
	Mr Rodrigo Echenique Gordillo	■		■					■
	Mr Guillermo de la Dehesa Romero		E	■		■	■	■	■
Members	Ms Homaira Akbari		I		■				■
	Mr Ignacio Benjumea Cabeza de Vaca		E	■		■	■	■	■
	Mr Javier Botín-Sanz de Sautuola y O'Shea		E						
	Ms Sol Daurella Comadrán		I			■	■		
	Mr Carlos Fernández González		I		■	■	■		
	Ms Esther Giménez-Salinas i Colomer		I					■	■
	Mr Ramiro Mato García-Ansorena[5]		I	■	■			■	
	Ms Belén Romana García		I		E			■	■
	Mr Juan Miguel Villar Mir		I						
	Total								
General secretary and secretary of the board	Mr Jaime Pérez Renovales			■	■	■	■	■	■

1. However, 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.
2. Syndicated shares. See page 9.
3. Effective 13 January 2015.
4. Effective 12 February 2015.

Powers and duties

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

The Rules and Regulations of the Board (article 3) reserve thereto the power, which cannot be delegated, to approve general policies and strategies and oversee their application, including, in particular, strategic or business plans, management objectives and the annual budget, fiscal strategy and capital and liquidity strategy, investment and financing, dividend, treasury share, new product approval, activities and services of risk management and control (including fiscal), corporate governance and internal governance of the Bank and its Group, including definition of the organisational structure, the policy for outsourcing services or activities, corporate culture and values, including the corporate social responsibility policy, the regulatory compliance policy, the remuneration policies for employees of the Bank and its Group; and policies for reporting to and notifying shareholders, markets and public opinion.

Various matters, which likewise cannot be delegated, are also reserved for the board, including decisions regarding the acquisition and disposal 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 each director's remuneration and the approval of contracts governing the performance by the directors of duties other than those of director, including executive duties, as well as the remuneration to which they are entitled for the discharge thereof; the selection, appointment by co-option and ongoing assessment of directors; the selection, appointment and, if necessary, removal of the other members of senior management (senior executive vice presidents and equivalents, including employees in charge of internal control functions and those holding other key positions) and the monitoring of management activity and ongoing assessment thereof, as well as the determination of the basic terms and conditions of their contracts; authorisation to create or acquire interests in special purpose entities or in entities registered in countries or territories regarded as tax havens; the approval of investments or transactions of a strategic nature or with a particular tax risk; and the approval of certain related party transactions. With regard to certain powers that cannot be delegated, the executive committee may make any appropriate decisions, whenever justified by reasons of urgency, provided that the board is subsequently informed at the first meeting held to ratify such decisions.

Equity holding								
Direct	Indirect	Shares represented	Total	% of share capital	Date of first appointment	Date of last appointment	End date[1]	Date of last proposal of the appointments committee
918,136	19,362,840	-	20.280,976[2]	0.126%	04.02.1989	07.04.2017	First six months of 2020	21.02.2017
924,541	-	-	924,541	0.006%	25.11.2014[3]	07.04.2017	First six months of 2020	21.02.2017
22,263	-	-	22,263	0.000%	25.11.2014[4]	18.03.2016	First six months of 2019	11.02.2016
935,773	14,474	-	950,247	0.006%	07.10.1988	07.04.2017	First six months of 2020	21.02.2017
172	-	-	172	0.000%	24.06.2002	27.03.2015	First six months of 2018	20.02.2015
22,000	-	-	22,000	0.000%	27.09.2016	07.04.2017	First six months of 2020	21.02.2017
3,463,716	-	-	3,463,716	0.021%	30.06.2015[6]	18.03.2016	First six months of 2019	11.02.2016
5,272,830	12,649,973	119,466,183	137,388,986	0.851%	25.07.2004	18.03.2016	First six months of 2019	11.02.2016
142,094	456,970	-	599,064	0.004%	25.11.2014[7]	18.03.2016	First six months of 2019	11.02.2016
18,524,499	3	-	18,524,502	0.115%	25.11.2014[4]	27.03.2015	First six months of 2018	20.02.2015
6,014	-	-	6,014	0.000%	30.03.2012	07.04.2017	First six months of 2020	21.02.2017
0	-	-	0	0.000%	28.11.2017	28.11.2017	First six months of 2021	27.11.2017
166	-	-	166	0.000%	22.12.2015	07.04.2017	First six months of 2020	21.02.2017
1,328	-	-	1,328	0.000%	07.05.2013	27.03.2015	First six months of 2018	20.02.2015
30,233,532	**32,484,260**	**119,466,183**	**182,183,975**	**1.129%**				

5. Their appointment will be submitted for ratification at the general shareholders' meeting scheduled for 22 or 23 March 2018, on first or second call.
6. Effective 21 September 2015.
7. Effective 18 February 2015.

C Chairman
I Independent
E Non-executive neither proprietary nor independent

Both the Bylaws (article 40) and the aforementioned Rules and Regulations of the Board of Directors (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 additional social responsibility principles that it has voluntarily accepted. The board of directors and its representative bodies shall exercise their powers and, in general, carry out their duties in accordance with the interests of the company, understood to be the attainment of a long-term sustainable and profitable business that furthers its continuity and maximises the value of the company.

In addition, the Bank's board takes a very active interest in the Group's risk function. Of its 14 members, 9 are members of at least one of the two board committees that deal with risk: the executive committee and the risk supervision, regulation and compliance committee. Two executive directors are also members of the executive risk committee, which is the body not mandated by the Bylaws responsible for global risk management in the Group.

Changes made to the committee rules and regulations in the past year

At its meeting of 13 February 2018, the board of directors approved several changes to the Rules and Regulations of the Board aimed at strengthening the supervisory function of its committees, among other points, in line with the recommendations and best practices published in 2017 by different Spanish and international bodies.

Specifically, the Rules and Regulations of the Board were adapted to the following: (i) the 3/2017 Technical Guide of the Spanish National Securities Market Commission, on audit committees of public interest entities, of 27 June 2017, (ii) the guide to internal governance issued by the European Banking Authority and (iii) the joint guidelines issued by the European Banking Authority and the European Securities and Markets Authority on assessing the suitability of members of the board of directors and directors with key functions, the latter two published on 26 September 2017 and coming into force on 30 June 2018.

Further, a new responsible banking, sustainability and culture committee which is governed by article 21 of the Rules and Regulations of the Board will be set up.

This change in the rules and regulations of the board reflects the Group's commitment to complying with the highest corporate governance standards at all times, and is a further step in strengthening its internal governance system.

Size and composition of the board

Since the end of 2010, the size of the board has been downsized by 30%, from 20 to 14 members.

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

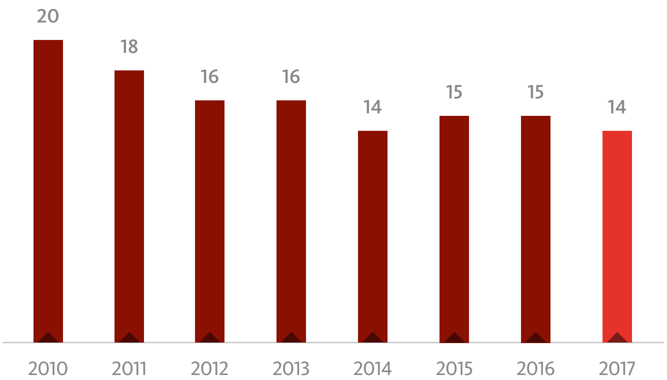
Pursuant to article 6.3 of the Rules and Regulations of the Board, the appointments committee has duly verified the status of each director. Its proposal was submitted to the board and approved thereby at its meeting on 13 February 2018.

Of the 14 members currently sitting on the board, three are executive and 11 are non-executive. Of the latter, eight are independent, one is proprietary and the other two, in the opinion of the board, are neither proprietary nor independent.

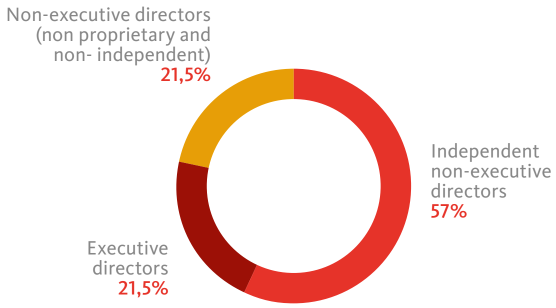
In its meeting of 13 February 2018, the board of directors agreed, at the proposal of the appointments committee, to submit to the general shareholders' meeting to be held on 22 or 23 March 2018, in first or second call, respectively, the appointment of Mr. Álvaro Antonio Cardoso de Souza as independent director to fill the vacancy left following the resignation of Mr Matías Rodríguez Inciarte. In case the aforementioned proposal is agreed, the board of directors shall be comprises of 15 members.

Lastly, in the meeting of 13 February 2018, the board of directors also agreed to submit to the aforementioned General shareholders' meeting of 2018, the amendment of article 41 of the Bylaws to reduce the minimum and maximum thresholds of composition of the board of directors , which are now fixed between 14 and 22 members, at a minimum of 12 and a maximum of 17, more aligned with the recommendations of the Good Governance Code.

SIZE OF THE BOARD



CURRENT COMPOSITION OF THE BOARD



Executive directors

Pursuant to the Rules and Regulations of the Board (article 6.2.a)), the following are executive directors: Ms Ana Botín-Sanz de Sautuola y O'Shea, Mr José Antonio Álvarez Álvarez and Mr Rodrigo Echenique Gordillo.

Independent non-executive directors

The Rules and Regulations of the Board (article 6.2.c)) include the legal definition of independent director established in article 529. duodecies.4 of the Spanish Limited Liability Companies Law.

Taking into account the circumstances in each case and following a report from the appointments committee, the board considers the following eight directors to be independent non-executive directors: Mr Bruce Carnegie-Brown (lead director), Ms Homaira Akbari, Ms Sol Daurella Comadrán, Mr Carlos Fernández González, Ms Esther Giménez-Salinas i Colomer, Mr Ramiro Mato García-Ansorena, Ms Belén Romana García and Mr Juan Miguel Villar Mir.

Given the current number of directors (14), independent non-executive directors account for 57% of the board.

This percentage exceeds the minimum threshold of one half of total directors set out in 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, in compliance with best practices in corporate governance.

Other non-executive directors

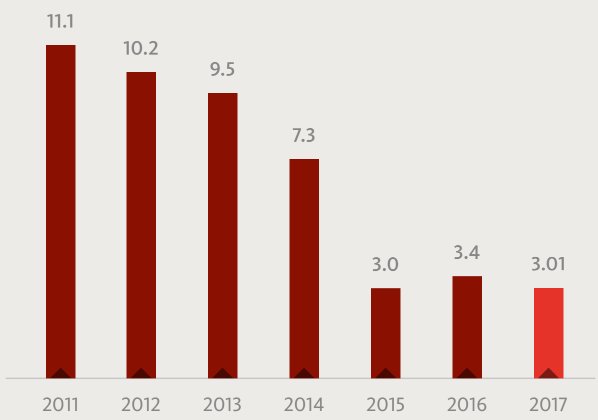
Mr Guillermo de la Dehesa Romero and Mr Ignacio Benjumea Cabeza de Vaca are non-executive directors that are neither proprietary nor independent. Neither can be classified as a proprietary director as they do not hold nor represent shareholdings equal to or greater than that which qualifies as significant under the law and have not been designated as such on account of their status as shareholders. Likewise, neither can be considered an independent director since, in the case of Mr de la Dehesa, he has held the position of director for more than 12 years and, in the case of Mr Benjumea, since three years have not yet elapsed since his resignation as a member of the Group's senior management.

The board of directors, following the proposal of the appointments committee, and after a review of practices in comparable markets and companies, resolved on 13 February 2018 to apply the legally established threshold for significant shareholdings (3% of share capital) to be considered as proprietary director. Since the shareholding represented by Mr. Javier Botín-Sanz de Sautuola y O'Shea (0.98%) is below the referred threshold, he has ceased to meet the requirements to be considered as proprietary director, whilst not satisfying the criteria to be regarded as an independent director under Art. 529 duodecies.4.i of the Spanish Companies Act. As a consequence, the board of directors, following the proposal of the said committee, resolved on that same date, to categorize him as other external director.

Therefore, following a report from the appointments committee, the board of directors has classified the three members of the Board as non-executive directors that are neither proprietary nor independent, in accordance with article 529.duodecies.4 of the Spanish Limited Liability Companies Law and article 6.2 of the Rules and Regulations of the Board.

YEARS OF SERVICE OF INDEPENDENT DIRECTORS

At the date of this document, the average length of service for independent non-executive directors in the position of board member is about three years.



Diversity on the board

As established in article 18.4.a) of the Rules and Regulations of the Board, the appointments committee is responsible for proposing and reviewing the director selection policies and succession plans and the internal procedures for determining who is to be proposed for the position of director.

The Bank has a policy of selecting directors that considers and favors diversity in the board of directors, contemplating issues such as experience and knowledge, geographical and gender diversity and that, in general, does not suffer from implicit biases that may imply any discrimination, from any point of view, including for reasons of age or disability. The Bank applies this policy in the selection of directors to cover vacancies that occur.

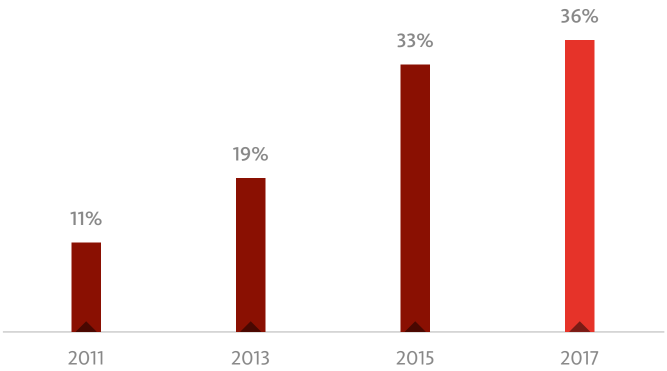
As regards gender diversity, both the appointments committee and the board of directors are aware of the importance of fostering equal opportunities between men and women and of the appropriateness of appointing to the board women who fulfil the requirements of ability, suitability and effective dedication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

The appointments committee, at a meeting held on 26 January 2016, agreed to raise the target level for the least represented gender on the board to 30% of total board members. This target has been met as the minority gender now accounts for 36% of seats.

At present, there are five women on the board of directors, one of whom is its executive chairman, namely Ms Ana Botín-Sanz de Sautuola y O'Shea, while the others are independent non-executive directors: Ms Homaira Akbari, Ms Sol Daurella Comadrán, Ms Esther Giménez-Salinas and Ms Belén Romana García.

The share of women on Banco Santander's board (36%) exceeds the target set by the appointments committee and is well above the average for large listed companies in Europe. According to a study conducted by the European Commission with data from July 2016, the percentage of female board members at large listed companies was 23.3% for all 28 countries in the European Union and 20.2% for Spain.

PERCENTAGE OF WOMEN ON THE BOARD



The table below shows the number and percentage of women on the board and on each of its committees.

	Number of members	Number of female directors	% of female directors
Board	14	5	35.7%
Executive committee	7	1	14.29%
Audit committee	4	2	50.0%
Appointments committee	5	1	20,.0%
Remuneration committee	5	1	20.0%
Risk supervision, regulation and compliance committee	6	2	33.3%
Innovation and technology committee	9	4	44.4%

Balanced structure of corporate governance

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

- The board and its committees oversee and control the activities of both the executive chairman and the chief executive officer.
- The vice chairman and lead independent director chairs the appointments, the remuneration and the risk supervision, regulation and compliance committees. The lead director also oversees the periodic process of assessing the chairman and coordinates the succession plan with the appointments committee.
- The audit committee is chaired by an independent director acting in her capacity as financial expert. All its members are independent directors.
- The powers delegated to the executive chairman and the chief executive officer exclude those that are exclusively reserved for the board itself and directly exercised in the performance of its general supervisory function.
- The executive chairman may not simultaneously hold the position of chief executive officer of the Bank.
- The corporate risk, compliance and internal audit functions, as independent units, periodically report to the board of directors and maintain direct access thereto when deemed necessary. The risk and compliance functions report to the risk supervision, regulation and compliance committee and answer requests for information received from this committee in the performance of its duties, while the internal audit function reports to the audit committee.

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

Succession planning for the main directors is a key element of the Bank's good governance, assuring an orderly leadership transition at all times. The process is regulated by article 29 of the Rules and Regulations of the Board, which also governs the succession plans for the Group's other directors and senior management. The board of directors has prepared a matrix of skills that it must possess, together with a succession plan aligned with those skills so as to ensure that when vacancies arise the incoming members reinforce and bolster those skills.

On the proposal of the appointments committee, the following were approved at board meetings held on 30 November 2016 and 24 January 2017, respectively: (i) the Group's succession policy; and (ii) the board member selection and succession policy.

Rules for interim replacement of the Group executive chairman

Article 44.2 of the Bylaws and article 10 of the Rules and Regulations of the Board set out interim replacement rules for the temporary performance (in cases of absence, inability to act or indisposition) of the duties of the executive chairman of the board of directors, in the expectation that in such cases she will be substituted by a vice chairman, according to the criterion of length of service on the board. However, if one of the vice chairmen is the lead director, he will be the first in the order of replacement. If there are no vice chairmen, the remaining directors will replace the executive chairman in the order established by the board, whereby the lead director should be the first in this order if such director does not hold the position of vice chairman.

Lead director

By resolution of the general shareholders' meeting of 28 March 2014, the figure of lead director, already established in the Rules and Regulations of the Board, has been included in the Bylaws, the responsibilities thereof being defined in article 49 bis of the Bylaws. Pursuant to article 49 bis of the Bylaws and article 14 of the Rules and Regulations of the Board of Directors, the lead director will have special powers to: (i) request that a meeting of the board of directors be called or that new items be added to the agenda for a meeting of the board that has already been called; (ii) coordinate and organise meetings of the non-executive directors and voice their concerns; and (iii) direct the regular assessment of the chairman of the board of directors and coordinate the succession plan; (iv) contact investors and shareholders to obtain their points of view for the purpose of gathering information on their concerns, in particular, with regard to the Bank's corporate governance; and (v) substitute the chairman in the event of absence under the terms envisaged in the Rules and Regulations of the Board of Directors.

At its meeting of 25 November 2014, the board of directors appointed Mr Bruce Carnegie-Brown as vice chairman and lead director.

The appointment of the lead director has been made for an indefinite period of time and with the abstention of the executive directors, as provided in the Bylaws.

COMPARISON OF NUMBER OF MEETINGS HELD*

	Santander	Average Spain	USA Average	UK Average
Board	15	10.8	8.2	7.8
Executive committee	47	9	2.5	-
Audit committee	12	8	12.8	8.2
Appointments committee	11	5.7	5.8	5.0
Remuneration committee	11	5.7	7.9	7.6
Risk supervision, regulation and compliance committee	12	16	10.9	8.0

* Source: Stuart Spencer Board Indices 2017 (Spain, United States and United Kingdom).

Secretary of the board

The Bylaws (article 45.2) and the Rules and Regulations of the Board (article 12) include among the duties of the secretary those of ensuring the formal and substantive legality of all action taken by the board, ensuring that the good governance recommendations applicable to the Bank are taken into consideration, and ensuring that governance procedures and rules are observed and regularly reviewed.

The secretary of the board is the general secretary of the Bank, and also acts as secretary for all board committees.

The Rules and Regulations of the Board (article 18.4.e)) provide that the appointments committee must report on proposals for the appointment or withdrawal of the secretary of the board prior to submission thereof to the board.

On 27 September 2016, the board of directors agreed to appoint Mr Óscar García Maceiras as vice-secretary to the board of directors, on the proposal of the appointments committee.

Proceedings of the board

The board of directors held 15 meetings during 2017.

The board holds its meetings in accordance with an annual calendar and agenda of business to discuss, without prejudice to any further items that may be added or any additional meetings that need to be held according to the business needs that may arise. Directors may also propose the inclusion of items on the agenda. The Rules and Regulations of the Board provide that the board shall hold not less than nine annual ordinary meetings, and at least quarterly.

The board shall meet whenever the chairman so decides, acting on her own initiative or at the request of not less than three directors (article 46.1 of the Bylaws). Additionally, the lead director is especially authorised to request that a meeting of the board of directors be

ROLES AND RESPONSIBILITIES

Group executive chairman

- The chairman of the board is the Bank's highest-ranking officer, responsible for managing the board and ensuring its effective operation (article 43.2 and 48.1 of the Bylaws and article 8.2 of the Rules and Regulations of the Board). In accordance with her position as such, the executive chairman is responsible, among others, for the following duties:
  - Ensure compliance with the Bylaws and that the resolutions of the general shareholders' meeting and of the board of directors are faithfully executed.
  - Carry out a high-level inspection of the Bank and all its services.
  - Meet with the chief executive officer and senior executive vice presidents to keep informed of the performance of the businesses.
- The board of directors has delegated to the executive chairman all its powers, except those that cannot be delegated by law, the Bylaws or the Rules and Regulations of the Board.
- The corporate strategic functions report to the executive chairman, directly involved in the long term strategy and corporate culture.

Chief Executive Officer

- The chief executive officer is entrusted with the day-to-day management of the business and the highest executive functions (article 49.1 of the Bylaws and article 11.1 of the Rules and Regulations of the Board).
- The board of directors has delegated to the chief executive officer all its powers, except those that cannot be delegated by law, the Bylaws or the Rules and Regulations of the Board.
- Corporate business and ordinary management support divisions and control functions all report to the chief executive officer, although they also have direct access to the board of directors as independent units.
- The country heads, who are the Group's first representatives in the countries in which the Group operates, also report to the chief executive officer.

called or that new items be added to the agenda for a meeting that has already been called (article 49.bis.1 (i) of the Bylaws and article 14 of the Rules and Regulations of the Board).

When directors are unable to personally attend a meeting, they may grant any other director proxy, in writing and specifically for each meeting, to represent them for all purposes at such meeting. Proxy is granted with instructions and non-executive directors may only be represented by another non-executive director.

The board may meet in various rooms at the same time, provided that interactivity and communication among them in real time is ensured by audiovisual means or by telephone and the concurrent holding of the meeting is thereby ensured.

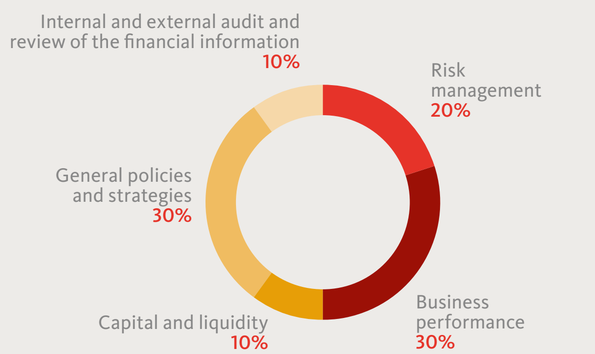
Board meetings shall be validly convened when more than half of its members are present in person or by proxy.

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. The chairman has the casting vote in the event of a tie.

In 2017 the board was kept continuously and fully informed of the performance of the various business areas of the Group through the management reports and risk reports submitted to it, among other things and especially -of the execution of the strategy of the Group with which it is fully involved-. During the year, the board has also been reported on the conclusions of the external and internal audits.

The chart below shows a breakdown of the approximate time devoted to each task at the meetings held by the board in 2016.

APPROXIMATE TIME DEVOTED TO EACH DUTY



Dedication to board duties

The duty of diligent management requires directors to dedicate the necessary time and effort to their position, among other requirements.

The maximum number of boards of directors to which they may belong is established in article 26 of Law 10/2014, of 26 June, on the organisation, supervision and solvency of credit institutions. The Bank's directors therefore may not at the same time hold 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 will be counted as a single position, while positions held at non-profit organisations or organisations not pursuing commercial ends will not be included. The European Central Bank 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.

Directors shall endeavour to ensure that absences from meetings of the board and of the committees to which they belong are reduced to cases of absolute necessity.

The appointments committee analyses directors' dedication to their position on an annual basis, using information received regarding their other professional obligations and other available information to evaluate whether the directors are able to dedicate the necessary time and effort to complying with the duty of diligent management and whether they are capable of carrying out good governance of the Group. Dedication is also taken into account for re-election, since proposals by the appointments committee must contain an assessment of their work and of effective dedication to the position during the most recent period of time in which the proposed director has performed his or her duties.

Training of directors and information or induction programme for new directors

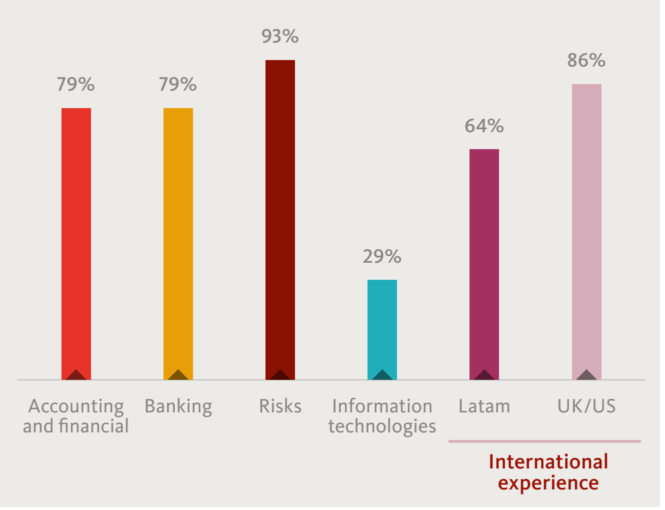
Given the Board´s commitment to continuous improvement, an ongoing training programme for directors is in place.

Within the framework of the Bank's ongoing director training programme, ten sessions were held in 2017. The following matters, among others, were covered in detail at these meetings: the new method for calculating provisions for credit risk; the regulatory and supervisory framework in the US (TLAC, CCAR); public reporting of financial information; risk identification assessment; Santander's operational risk framework and profile; credit risk models; cyber risk; anti-money laundering; in-depth look at the "Risk Appetite Statement" of 2018; MIFID II.

Likewise, the Rules and Regulations of the Board (article 26.7) establish that the board must make an information and induction programme available to new directors that provides swift and sufficient knowledge of the Bank and its Group, including their governance rules. Here, for example, Mr Ramiro Mato García-Ansorena (appointed to the board on 28 November 2017) is attending a rigorous induction programme for new directors covering all relevant dimensions of the Group.

In 2017, the audit committee also made an information and induction programme available to the new members that joined the committee regarding matters subject to its competence, which ensures their active participation from the very beginning. Here, for example, Ms Homaira Akbari (appointed as a member of the audit committee on 26 June 2017) attended this specific training programme for committee members.

% of board members with relevant experience



Decision-making process

- **The board of directors is aware of the business, is well balanced, diverse and has vast experience.**
- **It takes decisions by consensus and has a long-term vision.**
- **Debate of the issues, participation and effective challenge by external directors.**

Self-assessment by the board

Pursuant to article 24.7 of the Rules and Regulations of the Board, the board shall conduct a yearly assessment of its own functioning and the quality of its work. An assessment must also be conducted by an independent advisor once every three years.

In accordance with article 18.4.(j) of the Rules of the Regulations of the Board, the appointments committee reported on the self-assessment of the board and of its committees, which in 2017 was carried out by the board with the support of an external firm, the independence of which was verified by the committee.

The self-assessment includes a specific section for assessing the executive chairman, the chief executive officer, the lead director and the secretary. The executive chairman led the assessment of the lead director, who in turn led that of the executive chairman.

The self-assessment was based on a confidential and anonymous questionnaire and personal interviews with the directors. Moreover, best corporate governance practices at an international level and benchmarking with respect to 31 comparable international banks with regard to the composition and dedication of the board, the committees, remuneration and other aspects of corporate governance, in which the Bank ranks very highly, were taken into consideration.

The assessment process focused on the following aspects:

- In relation to the board as a whole: size, composition, organisation and functioning; internal arrangements and culture (planning of meetings, director support and training); knowledge and diversity; and performance of the supervisory function. Matters regarding the future (strategy and internal and external factors that might affect the Group's performance) as well as what its challenges and priorities should be for 2018 were also assessed.
- In relation to the committees: composition; functioning; board support and reporting; committee content; and their main challenges and priorities for 2018.
- In relation to the executive chairman: performance of her functions, leadership, defining the responsibilities with the lead director and with the chief executive officer, resulting in a clear and defined the separation of functions, whereby those related to the Bank's long-term strategy, culture and development of the management team correspond to the executive chairman.
- In relation to the chief executive officer: performance of his functions and distribution of responsibilities with the executive chairman, whereby he is responsible for ordinary management activities.
- In relation to the lead director: performance of his functions; leadership; relations with other directors and with institutional investors.
- In relation to the secretary of the board: performance of his functions and contribution to the smooth functioning of the board and the committees.

The directors consider the following to be strengths of the Group's corporate governance:

- The executive chairman has continued to promote the best international standard across the Group in terms of corporate governance practices, corporate culture, business performance and customer focus.
- The long term vision in the banking business of the chief executive officer, highly committed to the project, and the complmentarity of his profile with that of the Group Executive Chairman's.

- The implementation of all recommendations for improvement identified in the self-assessment processes carried out in previous years.
- The high level of dedication, participation and commitment of the members of the board and of the committees and their involvement in controlling all types of risks.
- A good balance between executive and non-executive directors on the board and the audit committee, appointments committee, remuneration committee, and risk supervision, regulation and compliance committee, all of which are exclusively made up of non-executive directors, the majority of which are independent.
- A good balance of experience, skills and knowledge among the members of the board and the high degree of diversity of their skills.
- The effective operation of the board committees.

The results of the assessment process for the board and its committees revealed the following: high levels of commitment and dedication from all board members; effective functioning of all committees; high quality debate and discussions on the board and sufficient time dedicated to board business; sound annual planning of board meetings and sufficient quality of the documents delivered at board meetings; annual strategic meeting deemed to be useful.

The contribution of the lead director in incorporating international best practices on the board and in the committees and in developing relations with institutional investors is also noteworthy of mention.

The report containing the conclusions and results of the assessment process for the board and its committees in 2017 was presented at the board meeting held on 19 December 2017. In view of these findings, the board, at its meeting held on 30 January 2018, approved an action plan that envisages improvements in the following areas, among others:

- Strengthen the composition of the board of directors, showing commitment to international diversity, especially from the strategic markets in which the Group operates, and ensure the suitability of the composition of the committees to improve performance of their functions and their respective areas of action.
- Increase the dedication of the board to strategic matters, which was already increased last year, and to the supervision of emerging risks, such as cybersecurity.
- Continue strengthening the functions and activities of the committees in advising the board.
- Increase the number of meetings of non-executive directors with the lead director.

Appointment, re-election and ratification of directors

Proposals for appointment, re-election and ratification of directors, regardless of the status thereof, that the board of directors submits to shareholders for consideration at the general shareholders' meeting and the appointment decisions adopted by the board itself by virtue of the legal powers of co-option, must be preceded by the relevant selection process and be subject to the corresponding report of the appointments committee which, if deemed adequate, submit the corresponding reasoned proposal to the board.

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 committee.

SKILLS MATRIX OF THE MEMBERS OF THE BOARD AND DIVERSITY ANALYSIS*

In accordance with the aforementioned director selection process, as set out in articles 6.1 of the Rules and Regulations of the Board and 42.4 of the Bylaws, the committee reviewed the director selection and succession policy on 23 January 2017. At the request of the appointments committee, at its meeting held on 19 December 2017, the board of directors approved the conclusions of the annual self-assessment process for the board carried out in 2017 with the support of an independent firm and assessed the balance of skills, ability, diversity and experience on the board. With this information, the board of directors approved at the aforementioned meeting the following skills matrix. The findings of the analysis identified the need to seek out new candidates with experience in the financial sector and with greater geographical diversity, especially in Latin America, without prejudice to the need to continue strengthening skills relating to new technologies.

		Group executive chairman	Chief executive officer	Vice chairmen			Members								
		Ana Botín	José Antonio Álvarez	Bruce Carnegie Brown (independent)	Guillermo de la Dehesa	Rodrigo Echenique	Javier Botín	Esther Giménez (independent)	Homaira Akbari (independent)	Carlos Fernández González (independent)	Sol Daurella (independent)	Juan Miguel Villar Mir (independent)	Ignacio Benjumea	Belén Romana (independent)	Ramiro Mato García-Ansorena (independent)
	High Level Management	🔴🔵	🔴🔵	🔴🔵	🔴🔵	🔴🔵	🔴🔵	🔴	🔴🔵	🔴🔵	🔴🔵	🔴🔵	🔴	🔴🔵	🔴
Financial services experience	General	🔴🔵	🔴🔵	🔴🔵	🔴🔵	🔴🔵	🔴🔵			🔴🔵	🔵		🔵	🔴🔵	🔴🔵
	Banking	🔴🔵	🔴🔵	🔴🔵	🔴🔵	🔴🔵	🔵			🔵	🔵		🔴🔵	🔵	🔴🔵
	International diversity			🟣					🟣	🟣					
Internacional experience	Spa	🔴🔵	🔴🔵	🔵	🔴🔵	🔴🔵	🔴	🔴🔵		🔴🔵	🔴🔵	🔴🔵	🔴🔵	🔴🔵	🔴
	Latam	🔴🔵	🔴🔵		🔵	🔵	🔴	🔵		🔴🔵		🔵			🔴
	UK/US.	🔴🔵	🔴🔵	🔴🔵	🔵	🔵	🔴	🔵	🔴🔵	🔴🔵	🔵			🔵	🔴
	Others	🔴	🔴🔵	🔴🔵	🔵	🔵	🔴	🔵	🔴🔵	🔴🔵	🔵	🔵		🔵	🔴
	Accounting and financial background	🔴🔵	🔴	🔴🔵	🔴🔵	🔴🔵			🔴🔵		🔵	🔴🔵	🔴	🔴🔵	🔴🔵
	Other commercial	🔴🔵			🔵	🔵			🔴🔵	🔴🔵	🔴🔵	🔴🔵	🔵	🔴🔵	🔵
	Risks	🔴🔵	🔴	🔴🔵	🔴🔵	🔵	🔴	🔵	🔴🔵	🔵		🔵	🔴🔵	🔴🔵	🔴🔵
	Government/ Academic/ Research	🔵		🔵	🔴🔵	🔵		🔴🔵	🔵	🔵	🔵	🔴🔵	🔴🔵	🔴🔵	🔵
	IT/Digital	🔴🔵	🔴						🔴🔵			🔵			
	Strategy	🔴🔵	🔴	🔴🔵	🔴🔵	🔴🔵	🔴🔵		🔴🔵	🔴🔵	🔴🔵	🔴🔵	🔴	🔴	🔴🔵
	Regulation/ Regulatory realtions	🔴🔵	🔴	🔴🔵	🔴🔵	🔴🔵	🔴		🔴	🔴			🔴🔵	🔴🔵	🔴🔵
	Experience in corporate governance	🔴🔵	🔴🔵	🔴🔵	🔴🔵	🔴🔵	🔴		🔴🔵	🔴🔵		🔴🔵	🔴	🔴🔵	🔵
	Gender diversity	🟣						🟣	🟣		🟣			🟣	

🔴 Skills as executive 🔵 Skills as non-executive 🟣 Nature * * Data at December 2017

Total number of independent directors	**8**
Total number of board members	**14**

Remuneration system

At the general shareholders' meeting of 28 March 2014, shareholders resolved to amend the Bylaws to bring the remuneration system for executive directors into line with the provisions of Spanish Law 10 of 26 June 2014, on the planning, supervision and capital adequacy of credit institutions, and Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013, on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, so as to ensure that the variable components of their remuneration do not exceed 100% of the fixed components, unless the general meeting approves a higher ratio, which may in no event exceed 200%. The shareholders acting at the general shareholders' meeting of 7 April 2017 approved a maximum ratio between fixed and variable components of executive directors' remuneration of 200% for 2017.

At the general shareholders' meeting of 27 March 2015, the shareholders once again amended the Bylaws to bring the directors remuneration system into line with the new developments introduced in the Spanish Limited Liability Companies Law by Law 31/2014.

The remuneration of directors acting as such, whether they are executive or not, is made up of fixed annual allotments and attendance fees, as set forth in the Bylaws, which are determined by the board of directors within the maximum amount approved by the shareholders at the general meeting based on the positions held by each director on the board, their membership on and attendance at the various committees and any other objective circumstances that the board may take into account. The board of directors, at the proposal of the remuneration committee, is also responsible for establishing director remuneration for carrying out executive functions, taking into account for such purpose the director remuneration policy approved by the shareholders at the general meeting. The shareholders at the general meeting also approved those remuneration plans that entail the delivery of shares of the Bank or options thereon or that entail remuneration tied to the value of the shares.

On the proposal of the appointments committee, the board of directors has undertaken to adapt the contracts of executive directors in relation to the performance of non-director functions so as to bring them in line with the terms of Bank of Spain Circular 2/2016, of 2 February, on credit institutions, supervision and capital adequacy.

Remuneration of the board in 2017

Bylaw-stipulated emoluments earned by the board amounted to 4.7 million euros in 2017, which is 22% lower than the maximum amount of 6 million euros approved by the shareholders at the general shareholders' meeting on 7 April 2017.

Full details regarding director remuneration and the policy for 2017 can be found in the activities report of the remuneration committee, which forms part of the corporate documentation of Banco Santander, in the Annual Corporate Governance Report and in the Annual Report on the Remuneration of Directors.

The chart below shows the evolution of total remuneration of directors with executive duties against the total return for shareholders (pay for performance).

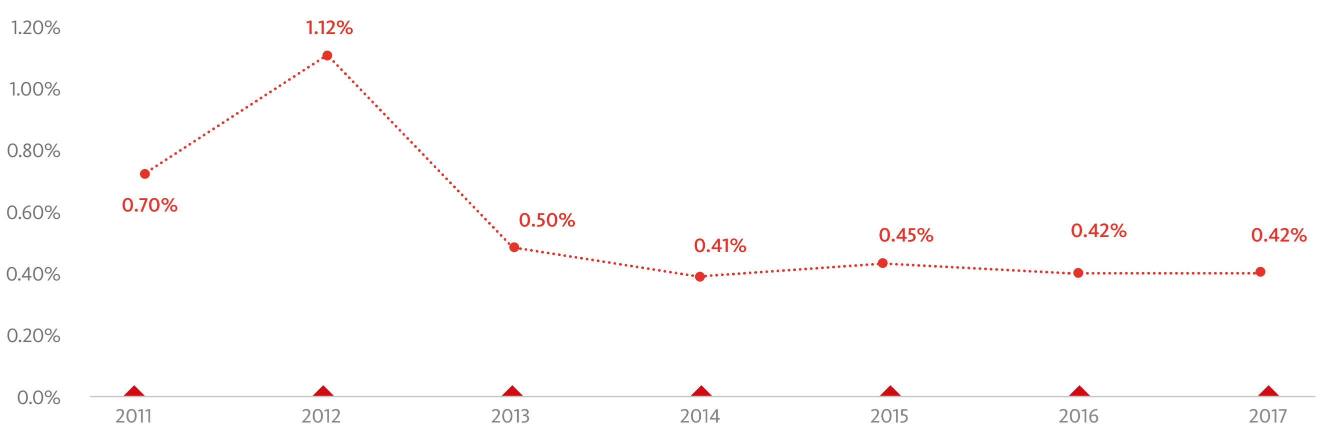
Anticipation of and adjustment to the regulatory framework

At the proposal of the remuneration committee, the board of directors promotes and encourages a remuneration system that fosters rigorous risk management, and implements ongoing monitoring of the recommendations issued by the main Spanish, European and international bodies with authority in this field.

Director remuneration policy and annual report on director remuneration

As provided in article 541 of the Spanish Limited Liability Companies Law and article 59.bis.1 of the Bylaws, each year the board of directors approves an annual report on director remuneration, which sets forth the standards and basis for determining remuneration for the current financial year, as well as an overall summary of the application of the remuneration policy during the financial year ended, and a breakdown of the individual remuneration earned for all items by each of the directors during such year. The report is available to shareholders with the call notice for the annual general shareholders' meeting and is submitted to a consultative vote.

EVOLUTION OF TOTAL COMPENSATION FOR ALL EXECUTIVE DIRECTORS RELATIVE TO THE ATTRIBUTABLE NET PROFIT



The content of such report is subject to the provisions of article 10 of Order ECC/461/2013 and CNMV Circular 4/2013, of 12 June (amended by Circular 7/2015, of 22 December).

In 2017, the report corresponding to 2016 was submitted at the general shareholders' meeting held on 7 April for an advisory vote by shareholders, as a separate item on the agenda, with 93.531% of the votes being in favour of the report.

The director remuneration policy for 2017, 2018 and 2019 was also submitted for approval, on a binding basis, by shareholders at the annual general shareholders' meeting held on 7 April 2017, in accordance with article 529 novodecies of the Spanish Limited Liability Companies Law. The policies were approved with 93.828% of the votes in favour.

Lastly, the 2017 annual report on director remuneration will submitted at the annual general shareholders' meeting foreseen to be held on 22 or 23 March (on first or second call, respectively) for an advisory vote by shareholders, as a separate item on the agenda. Meanwhile, the director remuneration policy for 2018, 2019 and 2020 will be laid before that same meeting for a binding and final vote by shareholders.

Transparency

Pursuant to the Bylaws (article 59.bis.5), 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 annual report.

SOME MEASURES TAKEN BY THE BOARD WITH REGARD TO REMUNERATION

2013: cap on annual remuneration of the directors by reason of their position

The ordinary general shareholders' meeting of 2013 established a maximum amount of 6 million euros, which may only be amended by a decision of the shareholders acting at the general shareholders' meeting.

2014: maximum variable remuneration for executive directors

The ordinary general shareholders' meeting of 2014 approved an amendment to the Bylaws establishing a maximum ratio between the fixed and variable components of total remuneration of the executive directors and other employees belonging to categories with professional activities that significantly affect the Group's risk profile.

2015: approval of the remunerations policy for directors

The ordinary general shareholders' meeting of 2015 approved the remunerations policy for directors for years 2015 and 2016, which is consistent with the principles and rules included in the By-laws and in the Rules and Regulations of the board, being unchanged the maximum amount of the remunerations approved in the general shareholders' meeting of 2013

2016: changes in the remunerations policy

A number of changes were proposed at the 2016 general shareholders' meeting with regard to the remunerations policy for executive directors and senior management, in line with the Simple, Personal and Fair culture. The main new developments with regard to the previous policy are as follows:

- Simplification: a new streamlined structure for variable and long-term annual remuneration.
- Alignment with the objectives announced at Investor day held in September 2015: a new set of objectives linked to variable remuneration which includes the four categories on which the Bank's strategy is based: employees, customers, shareholders and society.
- Closer alignment with shareholder interests by setting a mandatory requirement for senior executives to invest in shares and increasing the weighting of remuneration pegged to long-term targets, specifically earnings per share, total shareholder return, capital targets and profitability .

2017: changes to the remuneration policy of executive directors

A number of changes to the remuneration policy of executive directors were laid before shareholders for their approval at the 2017 general shareholders' meeting, intended to:

- Streamline the system of metrics and indicators so that only the most relevant remain in the policy.
- In relation to individual remuneration, increase the weighting of corporate behaviours that reflect the Simple, Personal and Fair culture of the Santander Group.

2018: changes to the remuneration policy of executive directors

The approval of some amendments to the remuneration policy of executive shareholders will be submitted to the shareholders for their approval at the general shareholders' meeting foreseen to be held on 22 or 23 March 2018. The amendments are aimed to:

- Reduce the amount of the annual contributions to the pension system (sistema de previsión), proportionally increasing the annual fixed allocation and with no increase of the total cost for the Bank.
- Allow the required changes to eliminate the complementary pension system (sistema de prevision complementario) for the events of death (for widows and orphans) and disability of directors, including a fixed complement of remuneration and enhancing the life insurance cover of the affected directors, with no increase of the total cost for the Bank.

Duties of directors, related party transactions and conflicts of interest

Duties

The duties of directors are governed by the Rules and Regulations of the Board, which are compliant with the laws of Spain and with the recommendations of the Good Governance Code of Listed Companies.

The Rules and Regulations expressly include the duties of diligent management and loyalty and the duty to refrain from taking any action should the director come into the possession of inside or privileged information.

The duty of diligent management includes the directors' duty to adequately inform themselves of the Bank's business and to dedicate the time and effort needed to effectively carry out their duties, and also to adopt the measures needed to ensure the sound management and control of the Bank.

Related party transactions

In accordance with that stipulated by law, article 53 of the Bylaws and articles 3, 17 and 40 of the Rules and Regulations of the Board, the board of directors will be aware of any transactions that the company or companies belonging to its Group carry out with directors, under the terms envisaged by law and in the Rules and Regulations of the Board; with shareholders, either individually or in concert with other shareholders, holding a significant ownership interest, including shareholders represented on the board of directors of the company or of other Group companies; or with persons related thereto.

These transactions will require board authorisation, based on a favourable report from the audit committee, except for those cases where approval by law is required by the shareholders at the general shareholders' meeting. All affected directors, those representing shareholders affected or who are related parties must abstain from participating in the deliberation and voting on the resolution in question.

Such transactions will be evaluated from the point of view of equality of treatment and of market conditions, and will be included in the annual corporate governance report and in the periodic public information under the terms envisaged in applicable regulations.

By way of exception, when advisable for reasons of urgency, related transactions may be authorised by the executive committee and subsequently ratified by the board.

The audit committee has verified that all transactions completed with related parties during the year were fully compliant with the Rules and Regulations of the Board and did not require approval from the governing bodies; otherwise, approval was duly obtained following a positive report issued by the committee, once the agreed consideration and other terms and conditions were found to be within market parameters.

Control mechanisms

As provided in the Rules and Regulations of the Board (article 36), directors must inform the board of any direct or indirect conflict of interest between their own interests, or those of their related parties, and those of the Bank. If the conflict relates to a related transaction, the director may not carry it out without the approval of the board, following a report from the audit committee.

The director involved must abstain from participating in the discussion and voting on the transaction to which the conflict refers, the body in charge of resolving any disputes being the board of directors itself.

In 2017, there were 86 occasions in which directors abstained from participating in discussions and voting on matters at the meetings of the board of directors or of its committees.

The breakdown of the 86 cases is as follows: on 27 occasions the abstention was due to proposals to appoint, re-elect or withdraw directors, and its appoint as members of board committees or as member of other boards at Group companies; on 25 occasions the matter under consideration related to remuneration or granting loans or credits; on 22 occasions the matter concerned the discussion of financing or investment proposals or other risk transactions involving entities related to any of the directors; and on 12 occasions the abstention concerned the annual verification of the status of directors and the suitability of directors.

Board committees

General information

The board has set up an executive committee to which general decision-making powers have been delegated.

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

At the meeting of 13 February 2018, the board of directors approved an amendment of the Rules and Regulations of the board whereby it creates and regulates a new responsible banking, sustainability and culture committee. In addition, given that the board has formed an international advisory board which, among other functions, advises the board on the design and development of the global business strategy, on the same date the board decided to disband the international committee.

The committees of the board hold their meetings in accordance with an annual calendar and there is a suggested agenda of annual matters to be discussed for committees with supervisory powers.

The board is tasked with promoting and encouraging communication between the various committees, especially between the risk supervision, regulation and compliance committee and the audit committee, and also between the former and the remuneration committee.

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 delegated pursuant to the law, the Bylaws or the Rules and Regulations of the Board). It reports to the board on the principal matters dealt with and resolutions adopted and provides directors with a copy of the minutes of its meetings. It generally meets once a week and in 2017 it held 47 meetings.

There are currently seven directors sitting on the committee, three of whom are executive and the other four are non-executive, two of which are independent.

Its duties, composition and functioning are established in the Bylaws (article 51) and in the Rules and Regulations of the Board (article 16).

Audit committee
The audit committee, among other duties, reviews the Group's financial information and its internal control systems, serves as a communication channel between the board and the external auditor, ensuring the independent exercise of the latter's duty, and supervises work regarding the Internal Audit function. It normally meets on a monthly basis and met 12 times in 2017.

As provided in the Bylaws (article 53) and the Rules and Regulations of the Board (article 17), the committee must be made up of non-executive directors, the majority of whom must be independent, including the chairman.

The committee currently comprises four independent non-executive directors.

Ms Belén Romana García, the committee's chairman, is considered a financial expert, as defined in SEC Form 20-F, in accordance with Section 407 of the Sarbanes-Oxley Act, given her training and expertise in accounting, auditing and risk management.

Appointments committee
The appointments committee, among other duties, proposes appointments of members of the board, including executive directors, and those of the other members of senior management and the Group's key personnel.

The committee met on 11 occasions in 2017.

The Bylaws (article 54) and the Rules and Regulations of the Board (article 18) state that this committee is also to be made up exclusively of non-executive directors and that its chairman and the majority of its members must be independent directors.

The committee currently comprises five non-executive directors, three of whom are independent

Remuneration committee
Among other duties, the remuneration committee proposes the director remuneration policy to the board, drawing up the corresponding report, and proposes the remuneration of board members, including executive directors and the remuneration of other members of senior management and draws up their remuneration policy.

The committee met on 11 occasions in 2017.

The Bylaws (article 54 bis) and the Rules and Regulations of the Board (article 19) state that the remuneration committee is also to be made up exclusively of non-executive directors and that its chairman and the majority of its members must be independent.

The committee currently comprises five non-executive directors, three of whom are independent.

Risk supervision, regulation and compliance committee
The risk supervision, regulation and compliance committee, among other duties, supports and advises the board on the definition and assessment of the risk strategy and policies and on the evaluation of the risks associated to the most relevant corporate transactions. It assists the board in the relation with supervisors and regulators in the various countries in which the Group has a presence, in the drawing up of its capital and liquidity strategy, and it monitors compliance with the General Code of Conduct and, in general, with the Bank's governance rules and compliance and criminal risk prevention programmes. It also oversees the corporate governance system and the policy of communication and relations with the Bank's stakeholders.

The committee met on 12 occasions in 2017.

As provided in the Bylaws (article 54 ter) and the Rules and Regulations of the Board (article 20), the committee must be made up of non-executive directors, the majority of whom must be independent, including the chairman.

The committee is currently made up of six non-executive directors, four of which are independent.

Innovation and technology committee
The functions of the innovation and technology committee include the following: (i) to study and report on relevant projects regarding innovation and technology; (ii) to assist the board in assessing the quality of technological services, new business models, technologies, systems and platforms; and (iii) to assist the risk supervision, regulation and compliance committee in monitoring the technology and security risks and to supervise all matters relating to cybersecurity.

The committee met on 3 occasions in 2017.

This committee comprises nine directors, of whom three are executive and six are non-executive, four of which are independent.

The Bank continues to increase the role played by board committees by broadening their functions and arranging joint meetings to address matters that fall within the remit of more than one such committee with the appropriate coordination.

* * *

In accordance with the Rules and Regulations of the Board, any director may attend and participate but not vote at meetings of board committees of which they are not a member, by invitation of the chairman of the board and of the chairman of the respective committee, after having requested such attendance from the chairman of the board.

Additionally, all board members who are not also members of the executive committee may attend its meetings, whatever the chairman's reason is for calling such meeting. In 2017, directors with no seat on the executive committee attended an average of 10.9 meetings of that committee.

The audit, appointments, remuneration and risk supervision, regulation and compliance committees have prepared reports on their activities in 2017. The remuneration committee's report also includes the director remuneration policy. All such reports are made available to shareholders as part of the Bank's annual documentation for 2017.

International advisory board

Banco Santander's international advisory board, comprising experts in strategy, IT and innovation, and those outside the Group, held its first meeting on 26 April 2016 in Boston (US). The international advisory board meets at least twice per year.

The international advisory board's objective is to provide strategic advice to the Group, with a special focus on innovation, digital transformation, cybersecurity and new technologies. It also provides its views on trends in capital markets, corporate governance, brand and reputation, regulation and compliance, and global financial services with a customer-based approach.

The international advisory board met on 4 May 2017 in London and on 11 October 2017 in New York.

Chairman

Mr Larry Summers
Former US Treasury Secretary and President Emeritus of Harvard University

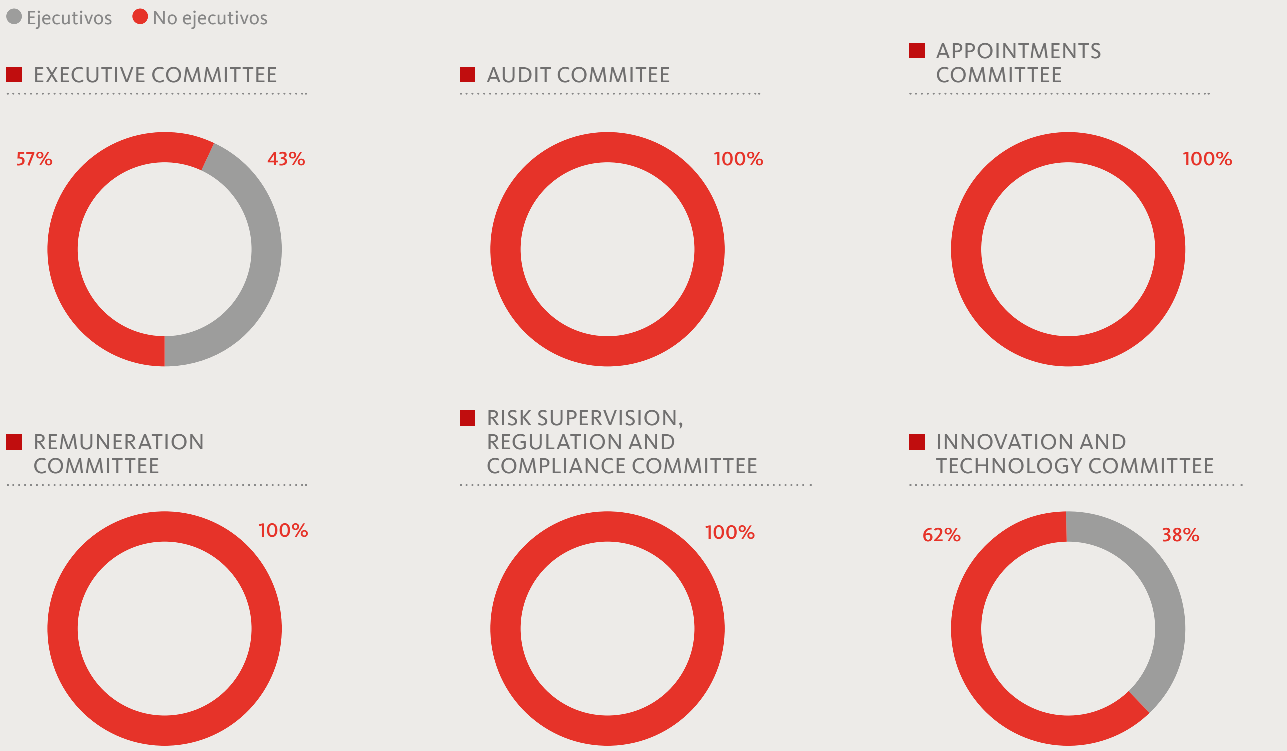
Members

Ms Sheila Bair *Former Chair of the Federal Deposit Insurance Corporation and President of Washington College*	Mr Frank D'Souza *CEO of Cognizant and director of General Electric*	Mr George Kurtz *CEO and co-founder of CrowdStrike*	Ms Blythe Masters *CEO of Digital Asset Holdings*
Mr Mike Rhodin *Board member of TomTom, HzO and Syncsort. Former IBM senior Vice President*	Ms Marjorie Scardino *Former CEO of Pearson and member of the Board of Directors of Twitter*	Mr James Whitehurst *CEO of Red Hat*	

Secretary

Mr. Jaime Pérez Renovales

COMPOSITION OF THE BOARD COMMITTEES



NUMBER OF MEETINGS AND ESTIMATED AVERAGE HOURS DEVOTED BY EACH DIRECTOR

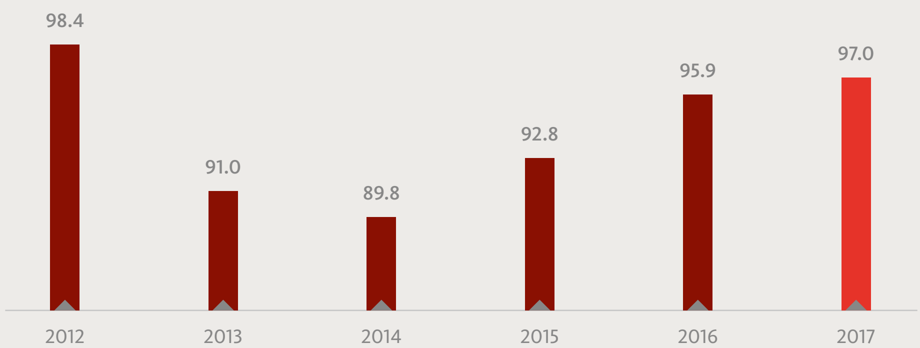
Committees	No. of meetings	Hours/meeting[1]	Hours/year
Executive committee	47	5	235
Audit committee	12	10	120
Appointments committee	11	4	44
Remuneration committee	11	4	44
Risk supervision, regulation and compliance committee	12	10	120
Innovation and technology committee	3	4	12

1. Includes the dedication to preparing and attending the meetings.

ATTENDANCE AT MEETINGS OF THE BOARD OF DIRECTORS AND ITS COMMITTEES IN 2017

Pursuant to the Rules and Regulations of the Board (article 25.1), absences from meetings must be limited to unavoidable cases. The average attendance rate at board meetings in 2017 was 97%.

RATE OF ATTENDANCE AT BOARD MEETINGS



Directors	Board	Comisiones: Executive	Audit	Appointments	Rmuneration	Risk supervision, regulation and compliance	Innovation and technology
Average attendance	**97%**	**95%**	**90%**	**100%**	**100%**	**95%**	**85%**
Individual attendance							
Ms Ana Botín-Sanz de Sautuola y O´Shea	15/15	44/47					3/3
Mr José Antonio Álvarez Álvarez	15/15	46/47					3/3
Mr Bruce Carnegie-Brown	15/15	38/47		11/11	11/11	12/12	1/3
Mr Rodrigo Echenique Gordillo	14/15	44/47					1/3
Mr Matías Rodríguez Inciarte[1]	14/14	44/44					3/3
Mr Guillermo de la Dehesa Romero	15/15	47/47		11/11	11/11	11/12	3/3
Ms Homaira Akbari	14/15		6/6				3/3
Mr Ignacio Benjumea Cabeza de Vaca	15/15	47/47		11/11	11/11	12/12	3/3
Mr Javier Botín-Sanz de Sautuola y O´Shea	14/15						
Ms Sol Daurella Comadrán	14/15			11/11	11/11		
Mr Carlos Fernández González	15/15		10/12	11/11	2/2	10/11	
Ms Esther Giménez-Salinas i Colomer	15/15					6/6	3/3
Mr Ramiro Mato García-Ansorena[2]	1/1	3/3	1/1			1/1	
Ms Belén Romana García[3]	15/15		12/12			12/12	0/0
Ms Isabel Tocino Biscarolasaga[1]	14/14	42/44	11/11		9/9	11/11	
Mr Juan Miguel Villar Mir	13/15		3/6			4/6	

1. Withdrawal from position of director on 28 November 2017.
2. Director since 28 November 2017.
3. Member of the Innovation and Technology committee since 19 December 2017.

4. Group structure and governance framework

The structure of the Santander Group is one of a model of subsidiaries whose parent is Banco Santander, S.A. The Group has its traditional headquarters in the city of Santander (Cantabria, Spain) and its corporate centre in Boadilla del Monte (Madrid, Spain).

The Santander Group's subsidiaries model has the following features:

- The governing bodies of each subsidiary shall see to it that their company is managed rigorously and prudently, while ensuring their economic solvency and upholding the interests of their shareholders and other stakeholders.

- Management of the subsidiaries is a local affair carried out by local management teams who provide immense knowledge and experience in relation to local customers and markets, while also benefiting from the synergies and advantages of belonging to the Santander Group.

- The subsidiaries are subject to the regulation and supervision of their respective local authorities, without prejudice to the global supervision of the Group by the European Central Bank.

- Customer funds are secured by virtue of the deposit guarantee funds in place in the relevant country.

Subsidiaries finance themselves autonomously when it comes to both capital and liquidity. The Group's capital and liquidity positions are coordinated by the corporate committees. Intragroup exposure is limited and transparent and any such transactions are invariably arranged under arm's length conditions. Moreover, the Group has listed subsidiaries in certain countries, in which it always retains a controlling stake.

The subsidiaries' autonomy limits the contagion risk between the Group's different units, which reduces systemic risk. Each subsidiary has its own resolution plan.

Corporate centre

The subsidiaries model of Banco Santander is further complemented with a corporate centre that brings together Group support and control units tasked with functions relating to strategy, risks, auditing, technology, human resources, legal services, communication and marketing, among others. The corporate centre adds value to the Group by:

- Making its governance more robust, through policies, models and control frameworks that allow the Group to implement corporate criteria and ensure effective supervision over the Group.

- Making the Group's units more efficient by unlocking cost management synergies, economies of scale and achieving a common brand.

- Sharing the best commercial practices, focusing on global connectivity, launching global commercial initiatives and fostering digitalisation.

Internal governance of the Santander Group

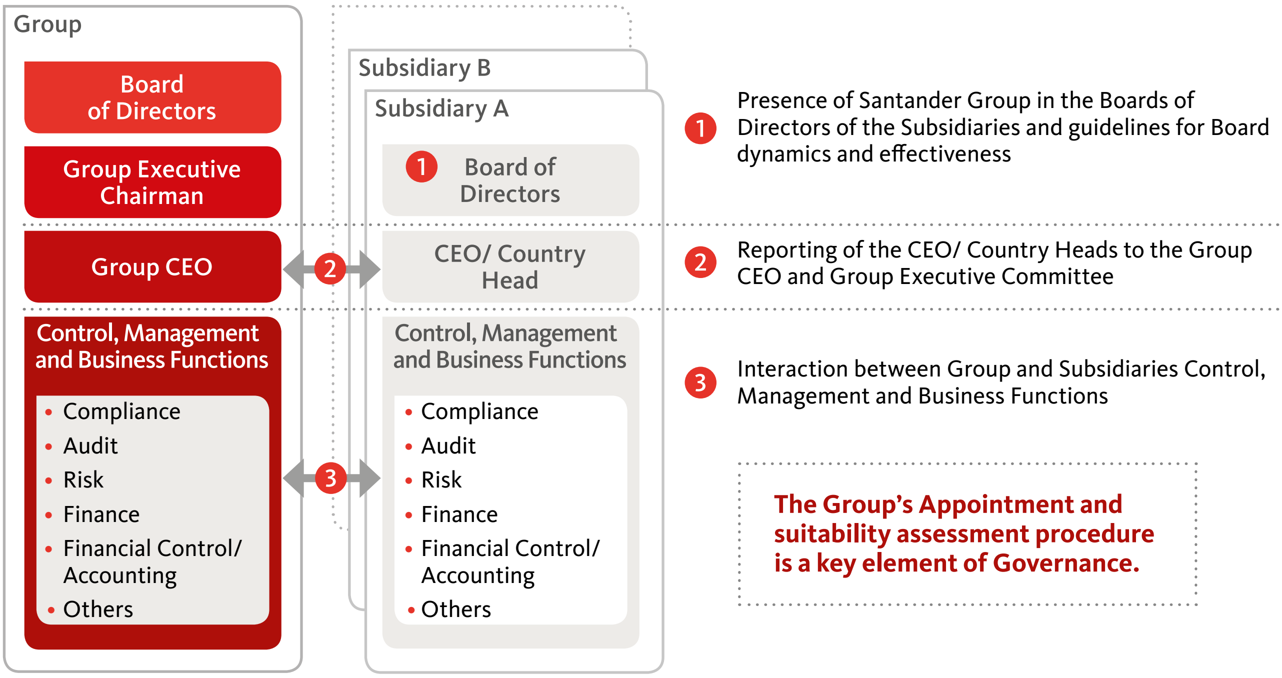
Santander has an internal governance framework that takes the form of a governance model, establishing a set of principles that regulate relations and the interaction that must exist between the Group and its subsidiaries on three levels:

- On the governing bodies of the subsidiaries, where the Group has devised rules and procedures regulating the structure, composition, make-up and functioning of the boards and their committees (audit, appointments, remuneration and risks), in accordance with international standards and good governance practices, as well as other rules and regulations concerning the appointment, remuneration and succession planning of members of governing bodies, in full compliance with the regulations and local supervisory criteria .

- Between the CEOs (Chief Executive Offices) and country heads of the subsidiaries.

- And between the Group and the officers and teams deemed fit to exercise control functions within the Group and at the subsidiaries: CRO (Chief Risk Officer), COO (Chief Compliance Officer), CAE (Chief Audit Executive); CFO (Chief Financial Officer), CAO (Chief Accounting Officer) or general auditor, and also between certain support functions (IT, Operations, HR, General Secretary's Office, Legal Services, Marketing, Communication and Strategy) and business functions.

In relation to CEO, country head and other significant office holders, the governance model establishes, among other aspects, the relevant rules and regulations to be followed in relation to their appointment, fixing of objectives, assessment, and fixing of variable remuneration and succession planning. It also explains how Group officers and their counterparts at the subsidiaries should liaise and interact.



Santander also has thematic frameworks (corporate frameworks) for those matters considered important due to their impact on the Group's risk profile, notable among which are risks, compliance, technology, auditing, accounts, finances, strategy, human resources, cybersecurity and communication and brand, and which specify:

- The way of exercising oversight and control by the Group over the subsidiaries.
- The Group's involvement in certain of the subsidiaries' important decisions, as well as the subsidiaries' involvement in the Group's decision-making processes.

The aforementioned governance model and corporate frameworks effectively make up the internal governance system and have been approved by the board of directors of Banco Santander, S.A. for subsequent adherence by the governing bodies of the subsidiaries, with due regard to any local requirements to which the subsidiaries may be subject. Both the model and the frameworks are maintained up to date on an ongoing basis through the recurring adoption of legislative changes and international best practices.

Based on the corporate frameworks, the functions included in the governance model prepare regulatory documents that are given to the Group's subsidiaries as reference and development documentation, promoting their effective implementation at the local level..

Internal control framework

- In line with the objective of strengthening the Group's corporate governance, in recent years governance of the risk control functions has been updated and reinforced, and best international practices have been incorporated. The Group is convinced of the need to establish an organisational structure that includes a proper and clear separation of functions, with well-defined responsibilities that are both transparent and consistent so as to ensure the healthy and prudent management of the Group and all its companies.
- The Group relies on a risk management and control model based on three lines of defence: the first is located at the different business and support functions; the second is exercised by the Risks and Compliance functions; while the third is wielded by Internal Audit. There is a sufficient degree of segregation between the risk function, the compliance function and the internal audit function, and also between them and other functions which control or supervise them.
- The risk control function, the compliance function and the internal audit function are headed by the following senior executive vice presidents, each of whom has independent and direct access to the Bank's board of directors and its committees for the purpose of reporting on their verification and inspection work

- Risk function: Mr José María Nus Badia (Group Chief Risk Officer - Group CRO).

- Compliance function: Ms Mónica López-Monís Gallego (Group Chief Compliance Officer - Group CCO).

- Internal Audit function: Mr Juan Guitard Marín (Group Chief Audit Executive - Group CAE).

The risk and compliance functions report to the risk supervision, regulation and compliance committee and answer requests for information received from this committee, while the internal audit function reports to the audit committee.

- Furthermore, a further two functions are considered relevant at Group level, one tasked with financial control functions and the other with management control functions. Reporting directly to the Group's chief executive officer, they are themselves headed by a senior executive vice president: These functions are:

  - Financial function: Mr José García Cantera (Group Chief Financial Officer - Group CFO).

  - Financial Accounting and Control function: Mr José Doncel Razola (Group Accounting Officer - Group CAO).

Governance of the risk function

- The risk governance model, approved by the board of directors, is based on the following principles:

  - Separate decision-making functions from control functions.

  - Strengthen the responsibility of the first line of defence in decision-making.

  - Ensure that all decisions concerning risk follow a formal approval process.

  - Ensure there is an overall vision of all types of risks, including those outside the scope of control of the risk function.

  - Strengthen the role of risk control committees, affording them additional powers.

  - Simplify the committee structure.

- There are currently two internal risk committees not specifically envisaged in the Bylaws: the executive risk committee (chaired by the CEO and in which the CRO has the right to veto), tasked with global risk management functions and comprising two executive members; and the risk control committee (chaired by the CRO), which is charged with the global risk supervision and control. This organisational model is compliant with best risk governance practices.

- The Bank's risk supervision, regulation and compliance committee was granted general powers to support and advise the board of directors with regard to the supervision and control of risks, and the definition of the Group's risk policies.

- The executive committee devotes a significant amount of its time to discussions on the Group's risks.

5. Shareholder rights and the general shareholders' meeting

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

The Bank does not have any defensive mechanisms in the Bylaws, fully conforming to the principle of one share, one vote, one dividend.

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 shares giving preferential treatment in the distribution of dividends, or shares that limit the number of votes that can be cast by a single shareholder, or quorum requirements or qualified majorities other than those established by law.

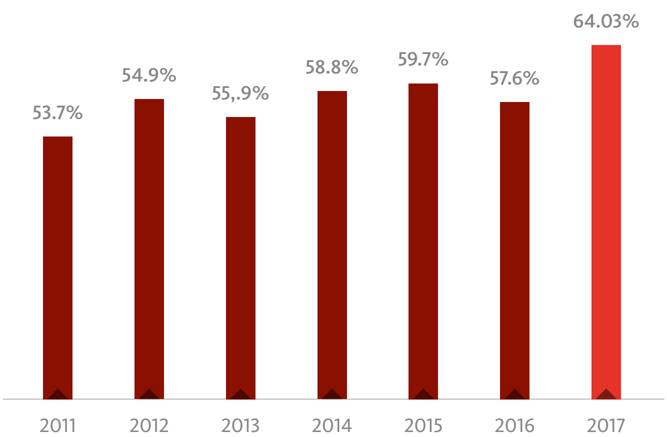
Any individual is eligible for a director position, subject, exclusively, to the limitations established by law.

Quorum at the annual general shareholders' meeting held in 2017

The general shareholders' meeting is the main vehicle in the direct relationship with shareholders. The informed participation of shareholders at general shareholders' meetings is an objective expressly acknowledged by the board (article 37.3 of the Rules and Regulations of the Board).

The quorum for the annual general meeting for 2017 rose to 64.03%, the highest to date.

QUORUM AT ANNUAL GENERAL SHAREHOLDERS' MEETINGS



Encouraging the informed participation of shareholders at general shareholders' meetings

Remote attendance at the shareholders' meetings has been made possible and shareholders are now able to exercise their information and voting rights in real time.

Another channel of communication available to shareholders is the electronic shareholders' forum. Since the annual general meeting held in 2011, shareholders have had access to the electronic shareholders' forum in compliance with the provisions of the Spanish Limited Liability Companies Law. The forum, which the Bank has set up on the corporate website (www.santander.com), allows shareholders to post supplementary proposals to the agenda announced in the call notice, along with requests for support for those proposals, initiatives aimed at reaching the percentage required to exercise any of the minority shareholder rights provided for by law, as well as offers or requests to act as a voluntary proxy.

KEY POINTS OF THE 2017 ANNUAL GENERAL SHAREHOLDERS' MEETING

- **Shareholders approved the corporate management of the Bank in 2016 with 97.74% voting in favour.**
- **The 2016 annual report on director remuneration received a 93.83% favourable vote.**

Annual general shareholders' meeting held on 7 April 2017

Information on the call notice, establishment of a quorum, attendance, proxy-granting and voting

A total of 641,150 shareholders attended in person or by proxy, with 9,336,283,351 shares. The quorum was thus 64.03% of the Bank's share capital at the date of the meeting.

The average percentage of affirmative votes upon which the proposals submitted by the board were approved was 96.56%.

The following data are expressed as percentages of the Bank's share capital at the date of the meeting:

Physically present	0.905%[1]
By proxy	47.485%[2]
Absentee votes	15.635%[3]
Total	**64.025%**

1. Of this percentage (0.905%), 0.004% corresponds to the share capital that attended the meeting remotely via Internet connection.
2. The percentage of share capital that granted proxies through the Internet was 1.380%.
3. Of this percentage (15.635%), 15.266% corresponds to votes cast by post, while the rest is the percentage of electronic votes.

In accordance with article 186 of the Spanish Limited Liability Companies Law, 9 of the board's 15 directors at that date exercised the right to vote on behalf of a total of 6,800,091,194 shares, equivalent to the same number of votes, the breakdown being as follows:

Mr. Matías Rodríguez Inciarte*	658,277
Ms Ana Botín-Sanz de Sautuola O'shea	6,657,283,403
Mr José Ignacio Benjumea Cabeza de Vaca	27,487
Mr Rodrigo Echenique Gordillo	570,534
Mr Francisco Javier Botín-Sanz de Sautuola O'shea	56,544,602
Mr José Antonio Álvarez Álvarez	49,049
Ms Esther Giménez-Salinas I Colomer	17,465
Ms Belén Romana García	17,824
Mr. Carlos Fernández González	84,922,553

*Stood down from the board on 28 November 2017.

Resolutions adopted at the 2017 general shareholders' meeting

The full texts of the resolutions adopted at the general shareholders' meeting held in 2017 can be viewed on the corporate website of the Group (www.santander.com) and on the CNMV's own website (www.cnmv.es), since it was filed as a significant event on 7 April 2017.

Information provided to shareholders and communication with them

In line with the policy for communicating with shareholders, investors and proxy advisors approved by the board of directors on 12 February 2016, in 2017 Banco Santander continued to strengthen communications with, service to and relationships with its shareholders and investors.

In 2017, for the first time, it was created a WhatsApp line of communication, as another customer service channel in addition to those already existing (electronic mailboxes, telephone lines, in person and postal mail) in accordance with the digital transformation and the Bank's Simple, Personal and Fair culture, promoting transparency and maintaining the highest quality standards in providing service to our shareholders.

CHANNELS FOR SHAREHOLDER INFORMATION AND SERVICE

Telephone service lines	159,522 queries received
Shareholder and investor mailbox	18,831 e-mails answered
Postal Mailbox	322,587 queries answered

In 2017, there were a total of 1,560 interactions with investors, analysts and rating agencies, which entailed contact with 959 investors/analysts. In addition, the area of shareholder relations maintained direct contact with the Bank's main shareholders during the year to offer them information on Group policies relating to sustainability and governance. In October the Group organised the Group Strategy Update in New York, an event where senior management reviewed the strategic objectives for 2018 in relation to both the Group and its main business units. Over 260 delegates took part in the various Group Strategy Update events, including the Group's main analysts and investors. Liwewise, 175 road shows were held, 19 conference were attended and 1.560 meetings were held with fixed and variable income investors. Also, meetings with 12.517 retail shareholders were held in 241 corporate events.

In line with CNMV recommendations, announcements of meetings to be held with analysts and investors and the documentation to be used at those meetings are published by the Bank sufficiently in advance.

Policy for contacting and communicating with shareholders

The policy for contacting and communicating with shareholders, institutional investors and proxy advisors is published on the Group's corporate website (www.santander.com), contains the general principles governing communication and contact between the Bank and its shareholders, institutional investors and proxy advisors. It also explains the main channels and procedures in a bid to improve the Bank's existing relations with those stakeholders. In accordance with the principles of transparency, equal treatment and protection of shareholder interests and within the framework of the new Simple, Personal and Fair culture, the Bank makes available to its shareholders and investors the information and communication channels set out in section 36 "Shareholders" of this annual report.

Communication between the board and shareholders and investors continued to be strengthened through the shareholders' meeting, the Group Strategy Update and the corporate governance road shows arranged and held by the lead independent director.

6. Santander Group management team[1]

Composition

Chairman	**Ms Ana Botín-Sanz de Sautuola y O'Shea**
Chief executive officer	**Mr José Antonio Álvarez Álvarez**
Executive vice chairman	Mr Rodrigo Echenique Gordillo
Businesses	
Argentina	Mr Enrique Cristofani
Brazil	Mr Sérgio Rial
Chile	Mr Claudio Melandri Hinojosa
US	Mr Scott Powell
Spain[2]	Mr Rami Aboukhair Hurtado
Consumer Finance	Ms Magda Salarich Fernández de Valderrama
Mexico	Mr Héctor Grisi Checa
Poland	Mr Gerry Byrne
	Mr Michal Gajewski
Portugal	Mr António Vieira Monteiro
United Kingdom	Mr Nathan Bostock
Business divisions	
Wholesale Global Banking	Mr José Linares Pou
Wealth Management	Mr Víctor Matarranz Sanz de Madrid
Business support divisions	
Santander Digital	Ms Lindsey Tyler Argalas
Support and control functions	
Risks	Mr José María Nus Badía *(Group Chief Risk Officer)*
	Mr Keiran Foad[3]
Compliance	Ms Mónica López-Monís Gallego *(Group Chief Compliance Officer)*
Internal Audit	Mr Juan Guitard Marín *(Group Chief Audit Executive)*
Financial	Mr José Antonio García Cantera *(Group Chief Financial Officer)*
Office of the General Secretary and Human Resources	Mr Jaime Pérez Renovales
Communication, Corporate Marketing and Research	Mr Juan Manuel Cendoya Méndez de Vigo
	Ms Jennifer Scardino
Corporate Development	Mr José Luis de Mora Gil-Gallardo
Financial Accounting and Control	Mr José Francisco Doncel Razola *(Group Chief Accounting Officer)*
Executive Chairman's Office and Strategy	Mr Enrique Álvarez Labiano
Costs	Mr Javier Maldonado Trinchant
Technology and Operations	Mr Andreu Plaza López
Santander Universities	Mr Javier Roglá Puig

1. Information on 31 December 2017.
2. It includes Santander and Banco Popular.
3. Reports to the Group Chief Risk Officer.

Remuneration

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

Related party transactions

To the Bank's knowledge, 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 carried out any unusual or significant transaction therewith during 2017 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 corporate website (www.santander.com).

7. Transparency and independence

We promote the implementation of good corporate governance to generate confidence in the international environment in which the Group operates.

Financial information and other relevant information

Financial information

Pursuant to the provisions of its Rules and Regulations (article 41.2), the board has taken the necessary actions to ensure that the quarterly and half-yearly information and any other information made available to the markets is prepared following the same principles, standards and professional practices as are used to prepare the financial statements. To such end, this information is reviewed by the audit committee prior to being released.

Other relevant information

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

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

In 2017, the Bank published 73 significant events, which are available on the Group's corporate website (www.santander.com) and from the website of the CNMV (www.cnmv.es).

Relationship with the external auditor

Independence of the auditor

The Bank has the necessary mechanisms in place to ensure the independence of the external auditor, and its audit committee verifies that the services provided by this auditor comply with applicable legislation.

In addition, the Rules and Regulations of the Board imposes certain restrictions when arranging non-audit services with the audit firm insofar these could jeopardise the independence of the auditor. In this regard, the audit committee must approve such services. They also require the board to make public the overall fees paid by the Bank to the auditor for non-audit services. The information for 2017 is contained in note 48 to the Group's legal report.

The Rules and Regulations of the Board set out the mechanisms used to prepare the accounts so as to ensure that an unqualified audit report is eventually issued. Nevertheless, the Bylaws and 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 committee, of the content and scope of the discrepancy and shall endeavour to ensure that the auditor issues a report in this regard. The financial statements of the Bank and of the consolidated Group for 2017 are submitted without qualifications.

At its meeting of 8 February 2018, the audit committee received written confirmation from the external auditor 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, in accordance with that provided in legislation governing financial audits.

At that same meeting, the audit committee issued a report expressing a favourable opinion regarding the independence of the external auditors and reporting, among other matters, on the provision of additional services as mentioned in the preceding paragraph.

The report, which was issued prior to the financial audit report, can be viewed on the Group's corporate website (www.santander.com) as part of the annual report on the activities of the audit committee.

Group's corporate website

Since 2004, the Group's corporate website (www.santander.com) has disclosed, in the Shareholders and Investors section of the main menu, all information required under applicable law (mainly the Spanish Limited Liability Companies Law; Order ECC/461/2013, of 20 March; CNMV Circular 3/2015, of 23 June; and Bank of Spain Circular 2/2016, of 2 February).

The Group's website, which is presented with specific sections for institutional investors and shareholders and can be viewed in Spanish, English and Portuguese, receives approximately 175,000 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 composition of the board and its committees.
- Professional profiles and other information on the directors.
- The Group's annual report.
- The annual corporate governance report and the annual report on director remuneration.
- The Code of Conduct in Securities Markets.
- The General Code of Conduct.
- The sustainability report.
- The reports of the board committees.
- Pillar III disclosures report.

The call notice for the 2018 annual general shareholders' meeting may be viewed as from the date of publication thereof, together with the information relating thereto, which shall include the proposed resolutions and mechanisms for exercising rights to receive information, to grant proxies and to vote, including an explanation of the mechanisms for exercising such rights by means of data transmission and the rules applicable to the electronic shareholders' forum that the Bank will make available on the Group's corporate website (www.santander.com).

Compliance with corporate governance recommendations

Banco Santander follows the corporate governance principles and recommendations contained in the Good Governance Code of Listed Companies, published by the Spanish National Securities Market Commission in February 2015, and the recommendations and good operating practices established in Technical Guide 3/2017 of the Spanish National Securities Market Commission, on Audit Committees of Public Interest Entities, of 27 June 2017, with regard to the functioning of the audit committee.

Banco Santander also takes into account the good governance recommendations and best practices for credit institutions established by the Supervisors, such as the Corporate Governance Principles for Banks of the Basel Committee on Banking Supervision of July 2015; the Corporate Governance Principles of the Organisation for Economic Co-operation and Development (OECD) approved in July 2015; guidelines on various matters (internal governance, suitability assessment of the members of the managing body, remuneration) published by the European Banking Authority (EBA) and the European Securities and Markets Authority (ESMA), and the good governance codes of the stock markets on which its shares are listed.

The Bank's board of directors approved several changes to its Rules and Regulations of the Board aimed at strengthening the supervisory function of the various board committees, among other points, in line with the recommendations and best practices published in 2017 by different Spanish, European and international bodies.

8. Goals for 2018

The board's goals and priorities for 2018 with regard to corporate governance are as follows:

- Strengthen the composition of the board of directors, showing commitment to international diversity, especially from the strategic markets in which the Group operates, and ensure the suitability of the composition of the committees to improve performance of their functions and their respective areas of action (Board refreshment).
- Further improve the independence of the board by increasing the number of meetings between the independent board members and the lead independent director (Boardroom).
- Intensify the board's dedication to strategic matters and, in addition to the annual meetings dedicated specifically to strategic matters, hold a meeting every six months on the progress of the strategic plan. The dedication to the supervision of emerging risks and cybersecurity will also be strengthened (Board dynamics).
- Continue strengthening the functions and activities of the committees in advising the board (Board committees).
- Increase the amount of time dedicated to the board to responsible business practices and sustainability and, in particular, to the supervision of the corporate culture and values and in relation to the various stakeholders, through the new responsible business practices and sustainability committee (Sustainability).
- Execute the modifications introduced in the Rules and Regulations of the Board, putting into practice the best operating practices of our governance bodies that arise from the new guidelines issued by the European Banking Authority (EBA) and the European Securities and Markets Authority (ESMA) that also meet the expectations of the supervisor (Regulatory framework).
- Establish the new responsible banking, sustainability and culture committee, intensifying the Board's involvement in the development of corporate culture and its commitment to responsible business practices in relation to diversity, inclusion and sustainability.

4

ECONOMIC AND FINANCIAL REVIEW

Consolidated Financial Report

Grupo Santander 2017 summary

Grupo Santander conducted its business in a more favourable economic environment than in previous years. Low interest rates in mature markets continued to be the most unfavourable factor for banking activity. The soundness of our business model enabled us to deliver double-digit growth in the Group's underlying profit and that of most of the countries where we operate. Our RoTE was among the best in the sector, and we combined balance sheet growth with better capital ratios and a higher dividend per share.

Our strategic priorities were:

1. Continue our **commercial transformation**, both in the traditional banks and through our independent units operating under the start-up model. The three pillars of our transformation programme are:

   - Improve customer loyalty through innovative, simple and tailored solutions. Among other actions, we continued to secure the *1/2/3* strategy in various countries, adapted our global strategy for the SME segment to the local features of each market, achieved strong growth in the cards market, particularly in Spain and Brazil, and created the Wealth Management division in order to enhance the service we provide to our private banking and asset management clients. Thanks to this transformation process, we now have 17.3 million loyal customers (+13%).

   - Promote the digital transformation of channels, products and services. Initiatives such as *Digilosofia* in Spain, the fully digital Openbank, *Superdigital* in Brazil, the *Cash Nexus* payment platform, *Santander Pay*, the new global machine learning platform and other initiatives are driving the digital transformation and significantly improving the customer experience as well as opening new sources of revenue. This strategy enabled us to increase the number of digital clients in 2017 by more than four million to over 25 million, as well as digital transactions (around 40% of total transactions).

   - Continue to improve customer satisfaction and experience with simpler and more efficient processes, underpinned by a multichannel offering. We ended the year with seven units among the three best local banks for customer satisfaction and were recognised as Global Bank of the Year and Bank of the Year, Latin America by *The Banker* magazine and Best Bank in the World for SMEs and Best Bank in Latin America by *Euromoney*.

2. **Strengthen our position in the markets where we operate**. The most notable transaction was our acquisition of Banco Popular, which enabled us to strengthen our leading position in Spain and makes us the largest private sector bank in Portugal by domestic business. We also reinforced our position in retail banking in Argentina, increased stake in the United States and closed an agreement to acquire Deutsche Bank's commercial and retail banking business in Poland.

3. **Exit non-core businesses**. Our main actions were the sale of TotalBank in the United States and 51% of Banco Popular's real estate business.

   As regards business performance, **activity and results grew, profitability was higher and the balance sheet stronger**.

Growth. The change in exchange rates and in the perimeter significantly affected balances during 2017.

Lending rose 12% excluding the forex impact, spurred by Popular's integration (+2% excluding it). On a like-for-like basis, seven units of the core countries improved. Of note were Argentina (+44%, driven by consumer credit and SMEs), Brazil (+7%, due to the good evolution of individual customers and SMEs), Portugal (+8%, partly thanks to a corporate operation), SCF (+6% due to auto finance) and Poland (+5% from SMEs and companies).

Customer funds rose 17% (excluding the forex impact), benefiting from the integration of Banco Popular. Excluding Popular, funds increased 8%, due mainly to demand deposits and investment funds, and they rose in eight of the core countries (including double-digit growth in Latin America).

Santander's business model and geographic diversification between mature and developing countries enabled it to generate stable, recurring profits.

Unlike the balance sheet, the forex impact on the P&L statement was virtually zero.

Underlying profit before tax was €13,550 million, 20% more than in 2016. The Group's strength is reflected in its main line items:

- Record year in gross income (€48,392 million, up 10%), with double-digit growth in net interest income and fee income (together they generated 95% of total revenues).
- Stable costs in real terms and on a like-for-like basis, despite higher costs related to regulatory matters and investments in transformation. Grupo Santander is one of the world's most efficient banks, with a cost-to-income ratio of 47%.
- Continuous improvement in credit quality, reflected in a 4% fall in provisions and an improvement in the cost of credit to 1.07%.

A higher tax charge in the lower part of the P&L statement, as well as the recording of some positive and negative non-recurring results in Net capital gains and provisions, which totalled a charge of €897 million net of tax (€417 million in 2016).

The Group's **attributable profit was €6,619 million** (+7%). Excluding Banco Popular, which recorded a loss of €37 million because of integration costs, attributable profit was €6,656 million.

Profitability. Greater profitability and creating shareholder value were among our main priorities.

Our capacity to generate stable, recurring profits over the last few years has enabled us to accumulate capital, finance business growth and boost total shareholder return in cash.

The underlying RoTE was 11.8% and the underlying RoRWA 1.48%, both better than in 2016. We increased attributable profit per share by 1% (8% in underlying profit terms) and increased the cash dividend per share by 11%.

The market viewed our strategy and its impact on business and results favourably. Total shareholder return (TSR) was 17%, outperforming the DJ Stoxx Banks and DJ Stoxx 50.

Strength. In 2017, we generated capital quarter after quarter (+29 bp), reaching a fully loaded CET1 of 10.84%, higher than our target and putting us well on track to attain our objective of 11% in 2018.

We comfortably met the minimum regulatory requirements, ending the year with a phased-in CET1 of 12.26%, well above the minimum requirement.

Santander has a medium-low risk profile and high-quality assets. Our proactive risk management gives us credit quality ratios that are among the best in the sector. We have an NPL ratio of 4.08% (+15 bp as a result of the acquisition of Banco Popular) and a coverage ratio of 65%. Excluding Popular, the NPL ratio was 3.38%, 55 b.p. lower than in 2016 and a reduction for the fourth year running.

In addition, our cost of credit improved further, to 1.07%, 11 bp lower than in 2016.

Almost all the countries where the Group operates improved their credit quality ratios. The NPL ratio was lower in eight of them and the cost of credit in seven.

The Group's results and balance sheet are set out in this chapter in greater detail, as well as the global and country businesses.

EXCHANGE RATES: 1 EURO / CURRENCY PARITY

	2017		2016	
	Period-end	Average	Period-end	Average
US$	1.199	1.127	1.054	1.106
Pound sterling	0.887	0.876	0.856	0.817
Brazilian real	3.973	3.594	3.431	3.831
Mexican peso	23.661	21.291	21.772	20.637
Chilean peso	736.922	731.538	707.612	747.500
Argentine peso	22.637	18.566	16.705	16.316
Polish zloty	4.177	4.256	4.410	4.362

GRUPO SANTANDER. INCOME STATEMENT (Including Banco Popular)

Attributable profit of €6,619 million, 7% more than in 2016, including a charge of €897 million net for capital gains and provisions. Underlying profit before tax increased 20% to €13,550 million
Record year in gross income, with double digit growth in net interest income and fee income
Stable costs adjusted for inflation and on a like-for-like basis. Grupo Santander remains one of the world's most efficient banks, with a cost-to-income ratio of 47%
Continuous improvement in credit quality reflected in a 4% fall in provisions and an improvement in the cost of credit to 1.07%
The Group's underlying RoTE, based on this profit, was 11.8% (+70 b.p.) and the underlying RoRWA 1.48% (1.36% in 2016)
Earnings per share (EPS) rose 1% and underlying earnings per share 8%

INCOME STATEMENT (including Popular from 7 June 2017)

(€ million)

	2017	2016	Change amount	%	% excl. FX	2015
Net interest income	**34,296**	**31,089**	**3,207**	**10.3**	**10.2**	**32,189**
Net fee income	11,597	10,180	1,417	13.9	13.4	10,033
Gains (losses) on financial transactions	1,703	1,723	(20)	(1.1)	0.4	2,386
Other operating income	796	862	(66)	(7.6)	(6.5)	665
Dividends	384	413	(29)	(7.1)	(7.9)	455
Income from equity-accounted method	704	444	260	58.5	57.3	375
Other operating income/expenses	(291)	5	(296)	—	—	(165)
Gross income	**48,392**	**43,853**	**4,538**	**10.3**	**10.2**	**45,272**
Operating expenses	(22,918)	(21,088)	(1,831)	8.7	9.0	(21,571)
General administrative expenses	(20,325)	(18,723)	(1,602)	8.6	8.8	(19,152)
Personnel	*(11,972)*	*(10,997)*	*(975)*	*8.9*	*9.0*	*(11,107)*
Other general administrative expenses	*(8,353)*	*(7,727)*	*(627)*	*8.1*	*8.6*	*(8,045)*
Depreciation and amortisation	(2,593)	(2,364)	(229)	9.7	9.9	(2,419)
Net operating income	**25,473**	**22,766**	**2,708**	**11.9**	**11.4**	**23,702**
Net loan-loss provisions	(9,111)	(9,518)	407	(4.3)	(5.6)	(10,108)
Impairment losses on other assets	(414)	(247)	(167)	67.7	68.9	(462)
Other income	(2,398)	(1,712)	(686)	40.0	38.2	(2,192)
Underlying profit before taxes	**13,550**	**11,288**	**2,262**	**20.0**	**20.7**	**10,939**
Tax on profit	(4,587)	(3,396)	(1,191)	35.1	36.0	(3,120)
Underlying profit from continuing operations	**8,963**	**7,892**	**1,071**	**13.6**	**14.1**	**7,819**
Net profit from discontinued operations	—	0	(0)	(100.0)	(100.0)	—
Underlying consolidated profit	**8,963**	**7,893**	**1,070**	**13.6**	**14.1**	**7,819**
Minority interests	1,447	1,272	175	13.8	13.1	1,253
Underlying attributable profit to the Group	**7,516**	**6,621**	**895**	**13.5**	**14.3**	**6,566**
Net capital gains and provisions*	(897)	(417)	(480)	115.2	117.0	(600)
Attributable profit to the Group	**6,619**	**6,204**	**415**	**6.7**	**7.4**	**5,966**
Underlying EPS (euros) **	**0.463**	**0.429**	**0.034**	**7.8**		**0.438**
Underlying diluted EPS (euros) **	**0.461**	**0.428**	**0.033**	**7.8**		**0.438**
EPS (euros) **	**0.404**	**0.401**	**0.004**	**0.9**		**0.397**
Diluted EPS (euros) **	**0.403**	**0.399**	**0.004**	**0.9**		**0.396**
Pro memoria:						
Average total assets	1,407,681	1,337,661	70,020	5.2		1,345,657
Average stockholders' equity	92,638	88,744	3,894	4.4		90,798

(*) Detail on the following page

(**) Data adjusted to capital increase of July 2017

QUARTERLY INCOME STATEMENT (including Popular from 7 June 2017)

(€ million)

	2016				2017			
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
Net interest income	**7,624**	**7,570**	**7,798**	**8,096**	**8,402**	**8,606**	**8,681**	**8,607**
Net fee income	2,397	2,549	2,597	2,637	2,844	2,916	2,888	2,949
Gains (losses) on financial transactions	504	366	440	412	573	286	422	421
Other operating income	204	270	245	142	211	240	260	85
Dividends	44	209	37	124	41	238	31	75
Income from equity-accounted method	83	112	119	130	133	160	188	223
Other operating income/expenses	78	(51)	90	(112)	37	(157)	42	(213)
Gross income	**10,730**	**10,755**	**11,080**	**11,288**	**12,029**	**12,049**	**12,252**	**12,062**
Operating expenses	(5,158)	(5,227)	(5,250)	(5,453)	(5,543)	(5,648)	(5,766)	(5,961)
General administrative expenses	(4,572)	(4,632)	(4,692)	(4,828)	(4,915)	(4,983)	(5,161)	(5,267)
Personnel	*(2,683)*	*(2,712)*	*(2,726)*	*(2,876)*	*(2,912)*	*(2,943)*	*(3,000)*	*(3,116)*
Other general administrative expenses	*(1,889)*	*(1,920)*	*(1,966)*	*(1,952)*	*(2,002)*	*(2,039)*	*(2,161)*	*(2,151)*
Depreciation and amortisation	(586)	(595)	(558)	(626)	(629)	(665)	(605)	(694)
Net operating income	**5,572**	**5,528**	**5,831**	**5,835**	**6,486**	**6,401**	**6,486**	**6,101**
Net loan-loss provisions	(2,408)	(2,205)	(2,499)	(2,406)	(2,400)	(2,280)	(2,250)	(2,181)
Impairment losses on other assets	(44)	(29)	(16)	(159)	(68)	(63)	(54)	(230)
Other income	(389)	(515)	(376)	(432)	(707)	(785)	(591)	(315)
Underlying profit before taxes	**2,732**	**2,779**	**2,940**	**2,838**	**3,311**	**3,273**	**3,591**	**3,375**
Tax on profit	(810)	(915)	(904)	(767)	(1,125)	(1,129)	(1,243)	(1,090)
Underlying profit from continuing operations	**1,922**	**1,864**	**2,036**	**2,071**	**2,186**	**2,144**	**2,347**	**2,285**
Net profit from discontinued operations	—	0	(0)	0	—	—	—	—
Underlying consolidated profit	**1,922**	**1,864**	**2,036**	**2,072**	**2,186**	**2,144**	**2,347**	**2,285**
Minority interests	288	338	341	305	319	395	371	362
Underlying attributable profit to the Group	**1,633**	**1,526**	**1,695**	**1,766**	**1,867**	**1,749**	**1,976**	**1,924**
Net capital gains and provisions*	—	(248)	—	(169)	—	—	(515)	(382)
Attributable profit to the Group	**1,633**	**1,278**	**1,695**	**1,598**	**1,867**	**1,749**	**1,461**	**1,542**
Underlying EPS (euros) **	**0.106**	**0.099**	**0.110**	**0.114**	**0.120**	**0.112**	**0.118**	**0.113**
Underlying diluted EPS (euros) **	**0.106**	**0.098**	**0.110**	**0.114**	**0.120**	**0.111**	**0.119**	**0.111**
EPS (euros) **	**0.106**	**0.082**	**0.110**	**0.103**	**0.120**	**0.112**	**0.084**	**0.088**
Diluted EPS (euros) **	**0.106**	**0.081**	**0.110**	**0.103**	**0.120**	**0.111**	**0.085**	**0.087**

(*) Including:

– In 2Q'16, capital gains from the disposal of the stake in VISA Europe (€227 million) and restructuring costs (-€475 million).

– In 4Q'16 PPI UK (-€137 million) and restatement Santander Consumer USA (-€32 million).

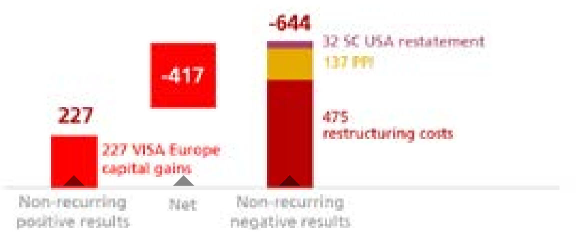
– In 3Q'17, integration costs (Popular: -€300 million and Germany -€85 million) and charge for equity stakes and intangible assets (-€130 million).

– In 4Q'17, capital gains from the disposal of the stake in Allfunds Bank (€297 million), USA tax reform (€73 million), goodwill charges (-€603 million) and in the US provisions for hurricanes, increased stake in Santander Consumer USA and other (-€149 million).

(**) Data adjusted to capital increase of July 2017.

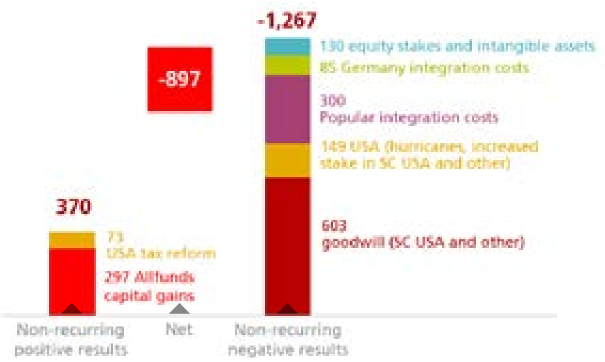
NET CAPITAL GAINS AND PROVISIONS. 2016

(€ million)



NET CAPITAL GAINS AND PROVISIONS. 2017

(€ million)



Grupo Santander conducted its business during 2017 in a more favourable economic climate than in the last few years. Low interest rates in mature countries continued to be the most unfavourable factor for banking activity.

In this environment, our solid business model enabled us to achieve double-digit growth in the Group's underlying profit and in most of the countries where we operate. The RoTE was among the highest of the sector and we combined growth in the balance sheet with better capital ratios and a higher dividend per share.

The Group posted an attributable profit of €6,619 million, 7% more than in 2016. Excluding the non-recurring results set out below and tax, which reflect the increased fiscal pressure, the underlying pre-tax profit was 20% higher at €13,550 million.

Before looking at the P&L statement, details on some of the aspects affecting year-on-year comparisons, are given:

- The 2017 P&L includes Banco Popular. Since its incorporation on 7 June, it made a loss of €37 million, due to the €300 million charge for its integration into the Group made in the third quarter, in accordance with what was announced at the time.

- The evolution of exchange rates had little impact on the Group as a whole (less than one percentage point on attributable profit). The impact by units, however, varied: Brazil (+7 p.p.); Poland (+2 p.p.); Chile (+2 p.p.); US (-2 p.p); Mexico (-3 p.p.); UK (-7 p.p.) and Argentina (-14 p.p.).

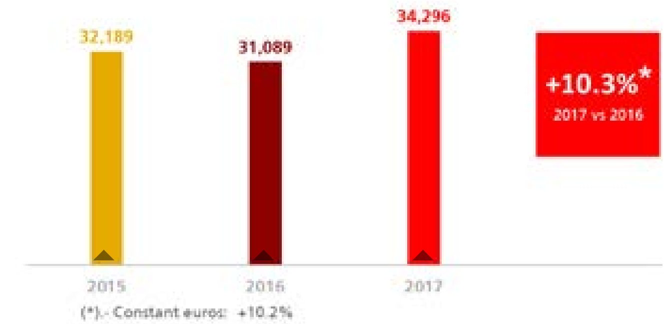
- In order to help explain the changes between 2016 and 2017, a summarised P&L account is included where non-recurring capital gains and provisions are shown net and separately in a line before the Group's attributable profit (Net capital gains and provisions).

The net negative impact in 2017 of non-recurring capital gains and provisions was €897 million. The positive impacts were capital gains of €297 million from the sale of Allfunds Bank and €73 million from the United States tax reform. The charges were €603 million for goodwill and €149 million in the US for hurricanes, the purchase of a stake in Santander Consumer USA and other funds, €385 million for charges related to integration processes (€300 million Popular and €85 million Santander Consumer Finance) and €130 million for equity stakes and intangible assets.

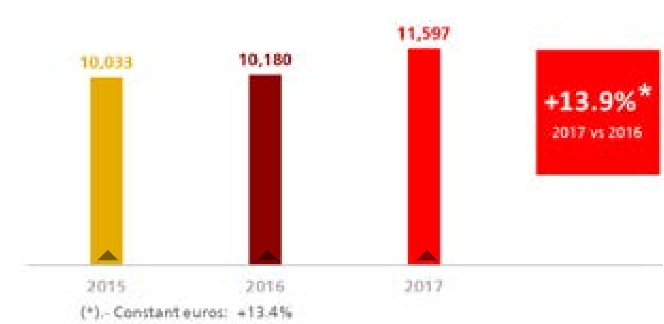
The net negative impact of non-recurring capital gains and provisions in 2016 was €417 million. Capital gains were €227 million from the sale of VISA Europe. Charges amounted to €644 million, as follows: restructuring costs (€475 million), provisions to cover eventual complaints related to payment protection insurance (PPI) in the UK (€137 million) and Santander Consumer USA restatement (€32 million).

The main developments between 2016 and 2017 were:

NET INTEREST INCOME
(%)



NET FEE INCOME
(%)



NET FEE INCOME

(€ million)

	2017	2016	Change amount	%	2015
Fees from services	7,142	6,261	881	14.1	6,040
Mutual & pension funds	762	757	5	0.6	862
Securities and custody	1,079	913	166	18.2	905
Insurance	2,325	2,249	76	3.4	2,225
Group net fee income (Excl. Popular)	**11,308**	**10,180**	**1,129**	**11.1**	**10,033**
Popular	**288**		**288**		
Group net fee income	**11,597**	**10,180**	**1,417**	**13.9**	**10,033**

Gross income

Gross income was up 10% at a record €48,392 million, and its quality improved as it was driven by customer revenues (+11%).

Our revenue structure, in which net interest income and fee income generated 95% of total revenues, continues to enable us to obtain consistent and recurrent growth.

- **Net interest income** rose 10% to €34,296 million.

  The largest rises in net interest income, excluding the forex impact in order to better assess the business performance, were in developing countries, particularly Brazil (+17%), Mexico (+13%), Argentina (+58%) and Poland (+9%), due to faster growth in volumes. Their interest rates were also higher than in mature countries, although with a varied performance (they rose in Mexico and declined significantly in Brazil).

  The only declines were in Spain because of interest rate pressure and lower volumes, in Portugal where the interest rate environment is similar, together with reduced revenues from the ALCO portfolio and in the US, affected by the fall in auto finance balances in Santander Consumer USA and the change of mix toward a lower risk profile.

- **Fee income** totalled €11,597 million, with double-digit growth stemming from greater activity and customer loyalty. Growth was faster in 2017 than in 2016 and 2015 (14%, 8% and 4%, respectively). By businesses, fee income rose in Retail Banking (86% of the total) as well as in Global Corporate Banking.

  It also rose in all countries, linked to the increase in loyal customers in all units, the offer of higher value-added products and a better customer experience.

- **Gains on financial transactions,** which only account for 3.5% of gross income, declined 1%.

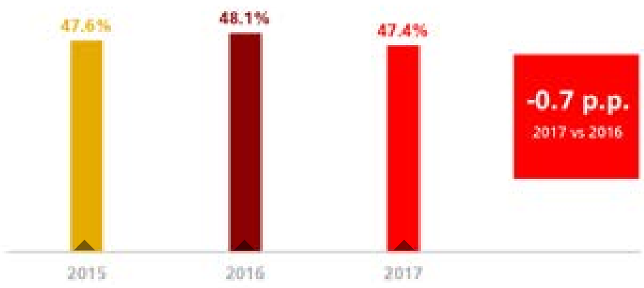
- The **rest of revenues** accounted for less than 2% of the total. This includes dividends, which were €29 million lower, results by the equity accounting method, which were €260 million higher, and other operating income, which was €296 million lower, partly due to larger contributions to the Deposit Guarantee Fund and to the Single Resolution Fund.

OPERATING EXPENSES

(€ million)

	2017	2016	Change amount	%	2015
Personnel expenses	11,551	10,997	554	5.0	11,107
General expenses	7,993	7,727	266	3.4	8,045
Information technology	1,219	1,094	125	11.4	1,039
Communications	513	499	14	2.8	587
Advertising	740	691	50	7.2	705
Buildings and premises	1,743	1,708	34	2.0	1,786
Printed and office material	131	146	(15)	(10.2)	157
Taxes (other than profit tax)	507	484	23	4.7	529
Other expenses	3,140	3,105	36	1.1	3,243
Personnel and general expenses	**19,544**	**18,723**	**821**	**4.4**	**19,152**
Depreciation and amortisation	2,501	2,364	137	5.8	2,419
Group operating expenses (Excl. Popular)	**22,045**	**21,088**	**957**	**4.5**	**21,571**
Popular	**873**		**873**		
Group operating expenses	**22,918**	**21,088**	**1,831**	**8.7**	**21,571**

EFFICIENCY RATIO (COST-TO-INCOME)
(%)



COST OF CREDIT (PROVISIONS / TOTAL CREDIT)
(%)

Operating expenses

Operating expenses were 9% higher at €22,918 million. Adjusted for inflation and on a like-for-like basis, they were virtually flat, despite incorporating higher costs linked to regulatory matters and investments in transformation.

We continued to manage costs very actively, adapting the business reality to each market. This enabled us to reduce or maintain them flat in seven of the ten core units in real terms and on a like-for-like basis. The two units whose costs rose the most were Mexico, because of significant investments in infrastructure and systems under the plan launched at the end of 2016, and Brazil, where they went hand in hand with the business dynamic and investments in transformation.

The revenue and costs performance produced an improvement of 70 b.p. in the efficiency ratio (to 47.4% from 48.1% on 2016), which kept us as one of the best among our peers. Excluding Popular which, at this time, is responsible for proportionately more costs, the cost-to-income ratio improved to 46.8%.

Loan-loss provisions

Loan-loss provisions fell 4% to €9,111 million. Excluding Popular, they were 5% lower. In local currency terms, provisions fell sharply in Continental Europe and the United States, and also in Latin America as a whole. They increased, on the other hand, in the UK because of some normalisation and a one-off in GCB. That country's cost of credit, however, was still low at 8 b.p. compared to 2 b.p. in 2016.

The cost of credit continued to improve, reflecting the selective growth strategy and the appropriate risk management policy. It dropped from 1.18% at the end of 2016 to 1.07% a year later. Excluding Popular, it was 1.12%. Almost all units improved, notably Brazil, US, Chile, Portugal, SCF and Poland. In the UK, Mexico and Argentina it increased.

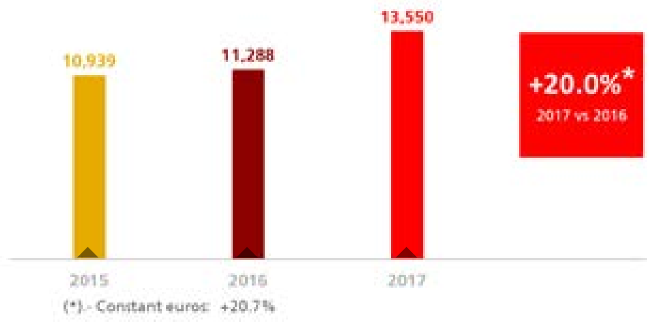
Other income and provisions

Other income and provisions were €2,812 million negative (€1,959 million also negative in 2016). This item records various kinds of provisions, as well as capital gains, capital losses and impairment of assets. The figure was higher in 2017 because we strengthened the balance sheet and there were some higher than usual charges, mainly in Brazil and in the UK.

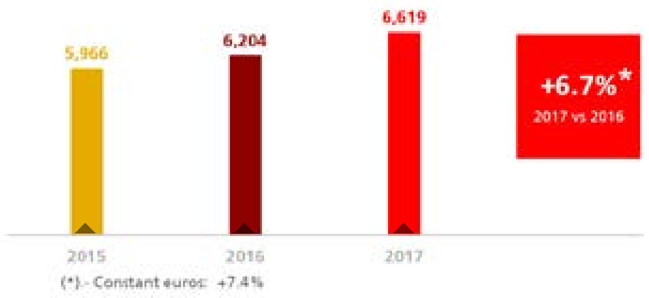
NET LOAN-LOSS PROVISIONS
(€ million)

	2017	2016	Change amount	%	2015
Non performing loans	10,612	11,097	(484)	(4.4)	11,484
Country risk	5	3	2	69.0	(0)
Recovery of written-off assets	(1,621)	(1,582)	(39)	2.5	(1,375)
Group net loan-loss provisions (Excl. Popular)	**8,997**	**9,518**	**(521)**	**(5.5)**	**10,108**
Popular	**114**		**114**		
Group net loan-loss provisions	**9,111**	**9,518**	**(407)**	**(4.3)**	**10,108**

UNDERLYING PROFIT BEFORE TAXES
(€ million)



ATTRIBUTABLE PROFIT
(€ million)



Profit and profitability

Underlying pre-tax profit was 20% higher at €13,550 million, reflecting the good evolution of revenues, cost control and the good performance of provisions and the cost of credit. Excluding Popular, profit was up 17%. Eight of the countries where we operate increased their profits in local currency and seven at double-digit rates.

Taxes were higher, increasing the fiscal pressure in some units, mainly Brazil, Spain, Poland, Chile and Argentina. The tax rate for the whole Group rose from 30% to close to 34%.

Minority interests rose 14%, with significant increases at Santander Consumer Finance, because of the agreement with Banque PSA, Brazil and Chile. On the othe hand, decline at Santander Consumer USA, partly due to lower profits and the purchase of a stake.

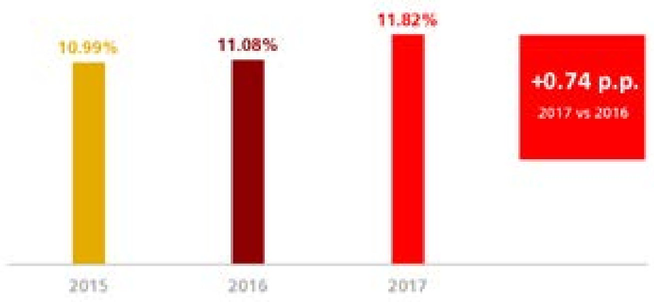
Underlying attributable profit (before net of capital gains and provisions) was €7,516 million, 14% higher (excluding Popular: +10%).

The Group's underlying RoTE, based on this profit, was 11.8% (+70 b.p.), the underlying RoRWA 1.48% (1.36% in 2016) and underlying earnings per share €0.463 (+8%).

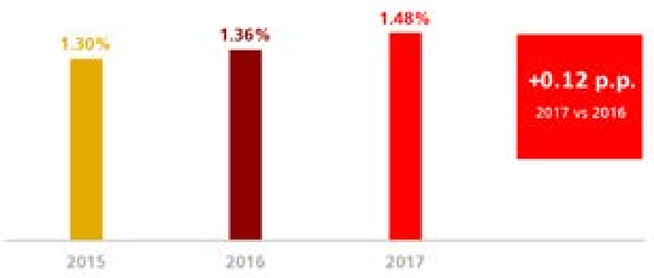
Lastly, the Group's attributable profit was 7% higher at €6,619 million (excluding Popular also +7%).

Earnings per share rose 1% to €0.404. Total RoTE was 10.41% (10.38% in 2016) and total RoRWA 1.35% (1.29% in 2016).

UNDERLYING RoTE
(%)



UNDERLYING RoRWA
(%)



Grupo Santander excluding Banco Popular

Since its incorporation on June 7, Banco Popular made a loss of €37 million, due to the €300 million charge for its integration into the Group made in the third quarter, in accordance with what was announced at the time.

Excluding this charge, underlying profit amounted to €263 million, coming from gross income of €1,309 million, operating expenses of €873 million and loan-loss provisions of €114 million.

The performance of the main P&L items, excluding the exchange rate impact and not on a like-for-like basis, is set out below.

The Group recorded gross income of €47,082 million, 7% more than in 2016, underpinned by customer revenues, where net interest income rose 7% and fee income 11%. Gains on financial transactions remained stable and other income declined 9%, impacted by the larger contribution to the Deposit Guarantee Fund and the Single Resolution Fund.

Operating expenses were €22,045 million, 5% more than in 2016, and remained flat when excluding inflation and Citibank's incorporation in Argentina. The revenue and costs evolution improved the cost-to-income ratio by 1.3 p.p., to 46.8%.

Loan-loss provisions declined 7% and stood at €8,997 million, and the cost of credit was 1.12%, down from 1.18% in 2016.

Underlying profit before tax amounted to €13,248 million, (+18%), underlying attributable profit stood at €7,253 million (+10%), and attributable profit was €6,656 million (+8%), including the charge already mentioned.

INCOME STATEMENT (EXCL. POPULAR)

(€ million)

	2017	2016	Change amount	%	% excl. FX	2015
Net interest income	**33,293**	**31,089**	**2,204**	**7.1**	**7.0**	**32,189**
Net fee income	11,308	10,180	1,129	11.1	10.6	10,033
Gains (losses) on financial transactions	1,702	1,723	(20)	(1.2)	0.4	2,386
Other operating income	779	862	(83)	(9.6)	(8.6)	665
Dividends	378	413	(35)	(8.4)	(9.2)	455
Income from equity-accounted method	609	444	165	37.2	36.2	375
Other operating income/expenses	(209)	5	(213)	—	—	(165)
Gross income	**47,082**	**43,853**	**3,229**	**7.4**	**7.3**	**45,272**
Operating expenses	(22,045)	(21,088)	(957)	4.5	4.8	(21,571)
General administrative expenses	(19,544)	(18,723)	(821)	4.4	4.7	(19,152)
Personnel	*(11,551)*	*(10,997)*	*(554)*	*5.0*	*5.2*	*(11,107)*
Other general administrative expenses	*(7,993)*	*(7,727)*	*(266)*	*3.4*	*3.9*	*(8,045)*
Depreciation and amortisation	(2,501)	(2,364)	(137)	5.8	6.0	(2,419)
Net operating income	**25,038**	**22,766**	**2,272**	**10.0**	**9.5**	**23,702**
Net loan-loss provisions	(8,997)	(9,518)	521	(5.5)	(6.8)	(10,108)
Impairment losses on other assets	(413)	(247)	(166)	67.1	68.3	(462)
Other income	(2,380)	(1,712)	(667)	39.0	37.2	(2,192)
Underlying profit before taxes	**13,248**	**11,288**	**1,960**	**17.4**	**18.0**	**10,939**
Tax on profit	(4,548)	(3,396)	(1,152)	33.9	34.8	(3,120)
Underlying profit from continuing operations	**8,700**	**7,892**	**808**	**10.2**	**10.8**	**7,819**
Net profit from discontinued operations	—	0	(0)	(100.0)	(100.0)	—
Underlying consolidated profit	**8,700**	**7,893**	**807**	**10.2**	**10.8**	**7,819**
Minority interests	1,447	1,272	175	13.8	13.0	1,253
Underlying attributable profit to the Group	**7,253**	**6,621**	**632**	**9.5**	**10.3**	**6,566**
Net capital gains and provisions*	(597)	(417)	(180)	43.3	44.4	(600)
Attributable profit to the Group	**6,656**	**6,204**	**452**	**7.3**	**8.0**	**5,966**

(*) In 2017, integration costs in Germany (-€85 million) and charges for equity stakes and intangible assets (-€130 million), capital gains from the disposal of the stake in Allfunds Bank (€297 million), USA tax reform (€73 million), goodwill charges (-€603 million) and in the US provisions for hurricanes, increased stake in Santander Consumer USA and other (-€149 million)

In 2016, capital gains from the disposal of the stake in VISA Europe (€227 million), restructuring costs (-€475 million), PPI in the UK (-€137 million) and restatement of Santander Consumer USA (-€32 million).

QUARTERLY INCOME STATEMENT (Excl. Popular)

(€ million)

	2016				2017			
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
Net interest income	**7,624**	**7,570**	**7,798**	**8,096**	**8,402**	**8,497**	**8,225**	**8,169**
Net fee income	2,397	2,549	2,597	2,637	2,844	2,885	2,760	2,820
Gains (losses) on financial transactions	504	366	440	412	573	287	413	429
Other operating income	204	270	245	142	211	240	220	108
Dividends	44	209	37	124	41	237	30	71
Income from equity-accounted method	83	112	119	130	133	154	140	182
Other operating income/expenses	78	(51)	90	(112)	37	(151)	50	(145)
Gross income	**10,730**	**10,755**	**11,080**	**11,288**	**12,029**	**11,910**	**11,617**	**11,526**
Operating expenses	(5,158)	(5,227)	(5,250)	(5,453)	(5,543)	(5,552)	(5,379)	(5,571)
General administrative expenses	(4,572)	(4,632)	(4,692)	(4,828)	(4,915)	(4,896)	(4,822)	(4,912)
Personnel	*(2,683)*	*(2,712)*	*(2,726)*	*(2,876)*	*(2,912)*	*(2,899)*	*(2,823)*	*(2,917)*
Other general administrative expenses	*(1,889)*	*(1,920)*	*(1,966)*	*(1,952)*	*(2,002)*	*(1,997)*	*(1,999)*	*(1,994)*
Depreciation and amortisation	(586)	(595)	(558)	(626)	(629)	(656)	(557)	(660)
Net operating income	**5,572**	**5,528**	**5,831**	**5,835**	**6,486**	**6,358**	**6,239**	**5,955**
Net loan-loss provisions	(2,408)	(2,205)	(2,499)	(2,406)	(2,400)	(2,272)	(2,212)	(2,114)
Impairment losses on other assets	(44)	(29)	(16)	(159)	(68)	(63)	(54)	(228)
Other income	(389)	(515)	(376)	(432)	(707)	(765)	(598)	(309)
Underlying profit before taxes	**2,732**	**2,779**	**2,940**	**2,838**	**3,311**	**3,258**	**3,375**	**3,305**
Tax on profit	(810)	(915)	(904)	(767)	(1,125)	(1,125)	(1,194)	(1,104)
Underlying profit from continuing operations	**1,922**	**1,864**	**2,036**	**2,071**	**2,186**	**2,133**	**2,180**	**2,200**
Net profit from discontinued operations	—	0	(0)	0	—	—	—	—
Underlying consolidated profit	**1,922**	**1,864**	**2,036**	**2,072**	**2,186**	**2,133**	**2,180**	**2,200**
Minority interests	288	338	341	305	319	395	371	361
Underlying attributable profit to the Group	**1,633**	**1,526**	**1,695**	**1,766**	**1,867**	**1,738**	**1,809**	**1,839**
Net capital gains and provisions*	—	(248)	—	(169)	—	—	(215)	(382)
Attributable profit to the Group	**1,633**	**1,278**	**1,695**	**1,598**	**1,867**	**1,738**	**1,594**	**1,457**

(*) Including:

- In 2Q'16, capital gains from the disposal of the stake in VISA Europe (€227 million) and restructuring costs (-€475 million).
- In 4Q'16 PPI UK (-€137 million) and restatement Santander Consumer USA (-€32 million).
- In 3Q'17, integration costs in Germany (-€85 million) and charge for equity stakes and intangible assets (-€130 million).
- In 4Q'17, capital gains from the disposal of the stake in Allfunds Bank (€297 million), USA tax reform (€73 million), goodwill charges (-€603 million) and in the US provisions for hurricanes, increased stake in Santander Consumer USA and other (-€149 million).

BALANCE SHEET (including Banco Popular)

(€ million)

Assets	2017	2016	Change amount	%	2015
Cash, cash balances at central banks and other demand deposits	110,995	76,454	34,541	45.2	77,751
Financial assets held for trading	125,458	148,187	(22,729)	(15.3)	146,346
Debt securities	36,351	48,922	(12,571)	(25.7)	43,964
Equity instruments	21,353	14,497	6,856	47.3	18,225
Loans and advances to customers	8,815	9,504	(689)	(7.3)	6,081
Loans and advances to central banks and credit institutions	1,696	3,221	(1,525)	(47.3)	1,352
Derivatives	57,243	72,043	(14,800)	(20.5)	76,724
Financial assets designated at fair value	34,781	31,609	3,172	10.0	45,043
Loans and advances to customers	20,475	17,596	2,879	16.4	14,293
Loans and advances to central banks and credit institutions	9,889	10,069	(180)	(1.8)	26,403
Other (debt securities an equity instruments)	4,417	3,944	473	12.0	4,347
Available-for-sale financial assets	133,271	116,774	16,497	14.1	122,036
Debt securities	128,481	111,287	17,194	15.5	117,187
Equity instruments	4,790	5,487	(697)	(12.7)	4,849
Loans and receivables	903,013	840,004	63,009	7.5	836,156
Debt securities	17,543	13,237	4,306	32.5	10,907
Loans and advances to customers	819,625	763,370	56,255	7.4	770,474
Loans and advances to central banks and credit institutions	65,845	63,397	2,448	3.9	54,775
Held-to-maturity investments	13,491	14,468	(977)	(6.8)	4,355
Investments in subsidaries, joint ventures and associates	6,184	4,836	1,348	27.9	3,251
Tangible assets	22,975	23,286	(311)	(1.3)	25,320
Intangible assets	28,683	29,421	(738)	(2.5)	29,430
o/w: goodwill	*25,769*	*26,724*	*(955)*	*(3.6)*	*26,960*
Other assets	65,454	54,086	11,368	21.0	50,572
Total assets	**1,444,305**	**1,339,125**	**105,180**	**7.9**	**1,340,260**

Liabilities and shareholders' equity	2017	2016	Change amount	%	2015
Financial liabilities held for trading	107,624	108,765	(1,141)	(1.0)	105,218
Customer deposits	28,179	9,996	18,183	181.9	9,187
Debt securities issued	—	—	—	—	—
Deposits by central banks and credit institutions	574	1,395	(821)	(58.9)	2,255
Derivatives	57,892	74,369	(16,477)	(22.2)	76,414
Other	20,979	23,005	(2,026)	(8.8)	17,362
Financial liabilities designated at fair value	59,617	40,263	19,354	48.1	54,768
Customer deposits	28,945	23,345	5,600	24.0	26,357
Debt securities issued	3,056	2,791	265	9.5	3,373
Deposits by central banks and credit institutions	27,027	14,127	12,900	91.3	25,037
Other	589	—	589	—	1
Financial liabilities measured at amortized cost	1,126,069	1,044,240	81,829	7.8	1,039,343
Customer deposits	720,606	657,770	62,836	9.6	647,598
Debt securities issued	214,910	226,078	(11,168)	(4.9)	222,787
Deposits by central banks and credit institutions	162,714	133,876	28,838	21.5	148,081
Other	27,839	26,516	1,323	5.0	20,877
Liabilities under insurance contracts	1,117	652	465	71.4	627
Provisions	14,490	14,459	31	0.2	14,494
Other liabilities	28,556	28,047	509	1.8	27,057
Total liabilities	**1,337,472**	**1,236,426**	**101,046**	**8.2**	**1,241,507**
Shareholders' equity	116,265	105,977	10,288	9.7	102,402
Capital stock	8,068	7,291	777	10.7	7,217
Reserves	103,608	94,149	9,459	10.0	90,765
Attributable profit to the Group	6,619	6,204	415	6.7	5,966
Less: dividends	*(2,029)*	*(1,667)*	*(362)*	*21.7*	*(1,546)*
Accumulated other comprehensive income	(21,777)	(15,039)	(6,738)	44.8	(14,362)
Minority interests	12,344	11,761	583	5.0	10,713
Total equity	**106,832**	**102,699**	**4,133**	**4.0**	**98,753**
Total liabilities and equity	**1,444,305**	**1,339,125**	**105,180**	**7.9**	**1,340,260**

GRUPO SANTANDER BALANCE SHEET*

Excluding the acquisition of Banco Popular:
- **Lending** rose 2%, and in eight of the ten core countries - **The NPL ratio** was 3.38% and the cost of credit 1.12%, both better than in 2016 - **Funds** increased 8%, due to demand deposits and mutual funds. They grew in eight core units
Including the balances of Banco Popular:
- **Loans** were up 12% and funds 17% - **The NPL ratio** was 4.08% and the cost of credit 1.07%
The net loan-to-deposit ratio was 109% (114% in 2016)

* Changes in constant currency

Grupo Santander including Banco Popular

Total gross loans at the end of 2017 amounted to €853,976 million (excluding repos), 7% more than in 2016 (+12% in constant euros) and total customer funds (excluding repos) plus mutual funds increased 12% (+17% in constant euros) to €890,135 million.

The net loan-to-deposit ratio was 109%, and the ratio of deposits plus medium- and long-term funding to the Group's loans was 115%.

Non-performing loans amounted to €37,596 million. The NPL ratio was 4.08%, coverage ratio of 65% and the cost of credit was 1.07%.

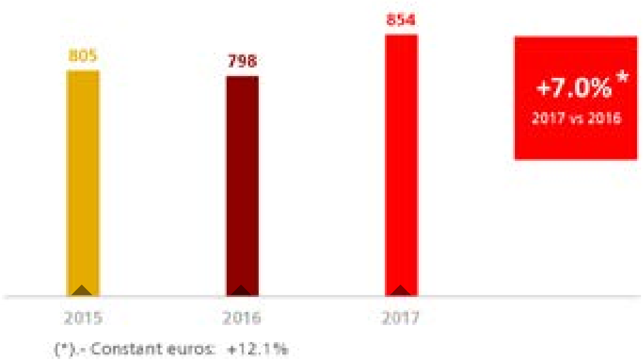
Regarding other items of the balance sheet, total financial assets available for sale stood at €133,271 million at the end of 2017, investments held to maturity was €13,491 million, and tangible assets amounted to €22,975 million.

Total goodwill was €25,769 million, after the amortisations carried out in the last quarter in the United States.

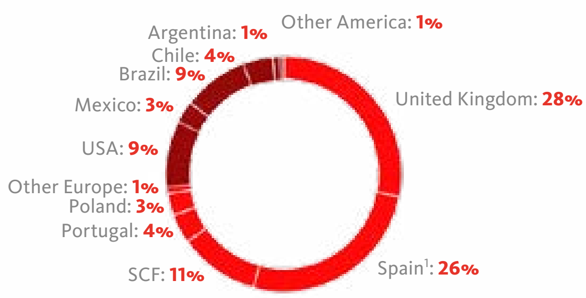
Balances were significantly affected by the exchange rates of the currencies in which the Group operates, as well as the change in perimeter.

- Negative impact of around five p.p. on the whole Group from the change in exchange rates. By units: Poland (+6 p.p.); UK and Chile (-4 p.p.); Mexico (-8 p.p.); US (-12 p.p.); Brazil (-14 p.p.) and Argentina (-38 p.p.).

GROSS CUSTOMER LOANS (including Popular)
excluding repos
(€ billion)

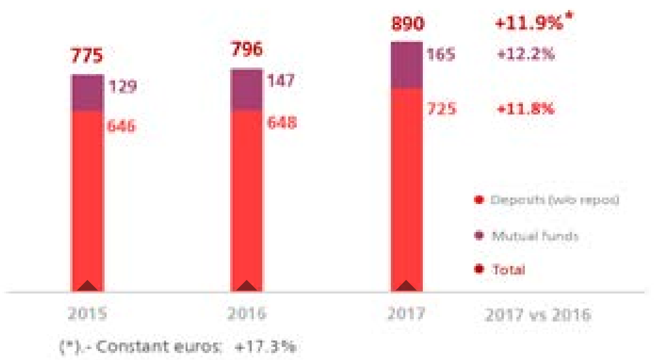


GROSS CUSTOMER LOANS
excluding repos
(% of operating areas), December 2017

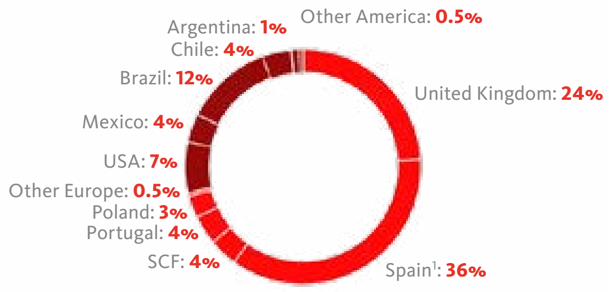


(1) Including Popular: 9%

CUSTOMER FUNDS (including Popular)
excluding repos
€ billion



CUSTOMER FUNDS
excluding repos
(% of operating areas), December 2017



(1) Including Popular: 8%

- Positive perimeter impact of 10 p.p. from the acquisition of Banco Popular in the second quarter of 2017.

In order to better assess management of customer balances, the figures and changes shown below do not take into account the evolution of exchange rates or the acquisition of Banco Popular.

Gross lending to customers excluding repos

Loans at the end of 2017 totalled €774,443 million, 2% more than in 2016. They increased in retail banking and in eight of the ten core units:

- The largest rises were in Argentina (+44%, driven by consumer credit), Portugal (+8%, benefiting from a corporate operation) and Brazil (+7% due to individual customers).

- Growth of 6% in Santander Consumer Finance, largely due to growth in auto finance and credit cards, 5% in Mexico and Poland thanks, in both cases, to SMEs, Chile's rose 3% thanks to individuals, high income customers and SMEs, and the UK's rose 1% due to residential mortgages and loans to companies, offsetting the drop in non-core loans.

- Fall of 2% in Spain, due to institutional balances and GCB, and 4% in the United States, from the sale of a Santander Consumer USA portfolio and the reduction in GCB at Santander Bank.

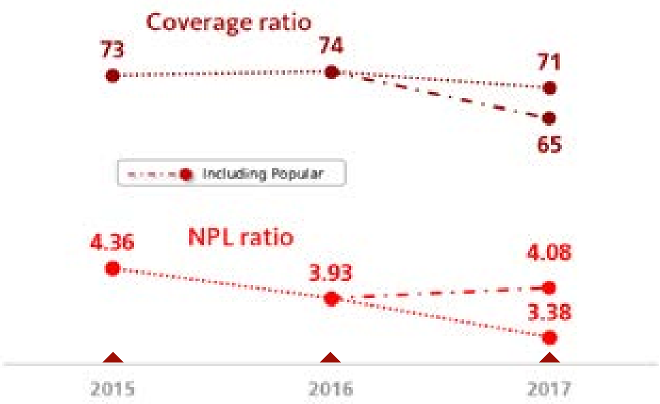
- Balanced by segments: individuals (47%), consumer credit (18%), SMEs and companies (24%) and GCB (11%). Growth in individual customers, consumer finance and SMEs, while loans to companies and GCB declined.

- Loans to the Real Estate Sector in Spain, excluding Banco Popular, fell 56%, continuing the strategy of previous years.

CUSTOMER LOANS
(€ million)

	2017	2016	Change amount	%	2015
Commercial bills	25,680	23,894	1,786	7.5	18,486
Secured loans	434,384	454,676	(20,291)	(4.5)	481,221
Other term loans	233,762	232,289	1,473	0.6	217,829
Finance leases	26,569	25,357	1,212	4.8	22,900
Receivable on demand	5,081	8,102	(3,020)	(37.3)	8,504
Credit cards receivable	21,792	21,363	428	2.0	20,270
Impaired assets	27,175	32,573	(5,398)	(16.6)	36,133
Gross customer loans (excluding repos)	**774,443**	**798,254**	**(23,811)**	**(3.0)**	**805,341**
Repos	18,378	16,609	1,769	10.7	12,024
Gross customer loans	**792,821**	**814,863**	**(22,041)**	**(2.7)**	**817,366**
Loan-loss allowances	19,424	24,393	(4,969)	(20.4)	26,517
Group net customer loans (Excl. Popular)	**773,398**	**790,470**	**(17,072)**	**(2.2)**	**790,848**
Popular	**75,516**		**75,516**		
Group net customer loans	**848,914**	**790,470**	**58,444**	**7.4**	**790,848**

NPL AND COVERAGE RATIOS. TOTAL GROUP
(%)



CREDIT RISK MANAGEMENT. December 2017
(%)

	NPL ratio	vs. 2016 (bp)	Coverage ratio
Spain	4.72	(69)	45.9
Spain's real estate activity	87.47	97	48.4
Consumer Finance	2.50	(18)	101.4
Poland	4.57	(85)	68.2
Portugal	5.71	(310)	59.1
United Kingdom	1.33	(8)	32.0
Brazil	5.29	(61)	92.6
Mexico	2.69	(7)	97.5
Chile	4.96	(9)	58.2
Argentina	2.50	101	100.1
USA	2.79	51	170.2
Banco Popular	10.75	—	48.7

Credit risk

Bad and doubtful loans, excluding Banco Popular, ended 2017 at €28,104 million, 16% lower than in 2016.

The NPL ratio, excluding Banco Popular, stood at 3.38%, (-55 b.p. over December 2016), after improving for the fourth straight year. Moreover, this NPL ratio is the lowest since the middle of 2010.

In order to cover bad loans, provisions amounted to €19,906 million (coverage of 71% compared to 74% in 2016). In order to properly view this figure, one has to take into account that the UK and Spain's ratios are affected by the weight of mortgage balances, which require fewer provisions as these loans have guarantees.

The improved credit quality is reflected in the reduction in loan-loss provisions.

The cost of credit also improved and dropped from 1.18% in 2016 to 1.12% in December 2017. It declined for the fifth year running.

This positive evolution of the credit quality ratios occurred in almost all the countries where the Group operates. The NPL ratio fell in eight of them and the cost of credit in seven of the ten core units.

More information on credit risk, the control and monitoring systems and the internal risk models for calculating provisions can be found in the specific section of the risk management report in this Annual Report.

CREDIT RISK MANAGEMENT (Excl. Popular)
(€ million)

	2017	2016	Change amount	%	2015
Non-performing loans	28,104	33,643	(5,539)	(16.5)	37,094
NPL ratio (%)	3.38	3.93	(0.55)		4.36
Loan-loss allowances	19,906	24,835	(4,929)	(19.8)	27,121
For impaired assets	*12,505*	*15,466*	*(2,961)*	*(19.1)*	*17,707*
For other assets	*7,401*	*9,369*	*(1,968)*	*(21.0)*	*9,414*
Coverage ratio (%)	70.8	73.8	(3.0)		73.1
Cost of credit (%)	1.12	1.18	(0.06)		1.25

Customer funds excluding repos

Total managed funds (deposits excluding repos and mutual funds) rose 8% to €815,849 million at the end of 2017.

Growth in eight of the ten core units, except for the United States (-9% due to lower institutional balances), as follows:

- Growth in Latin America (Argentina: +53%; Brazil: +24% and Mexico: +6%). In Europe, Spain rose 12% and the UK 3%.

- Moderate rises at Santander Consumer Finance, Poland and Portugal (+2% each). In all of them we focused on reducing the cost instead of increasing the volume and thus, growth in demand deposits was offset by the fall in time deposits.

- Chile remained unchanged.

Reflecting the strategy of loyalty and management of funding costs, demand deposits rose 9% increasing in almost all countries and mutual funds rose 14%, also in all countries. Time deposits, on the other hand, remained stable and with a varied performance by units.

As well as capturing customer deposits, Grupo Santander, for strategic reasons, maintains a selective policy of issuing securities in the international fixed income markets and strives to adapt the frequency and volume of its market operations to the structural liquidity needs of each unit, as well as to the receptiveness of each market.

In 2017, various Group units (excluding Banco Popular) carried out:

- Medium- and long-term senior debt issuances amounting to €12,769 million and covered bonds placed in the market of €5,181 million.

- Securitisations placed in the market (€13,965 million).

  - Issues eligible for Total Loss Absorbing Capacity (TLAC) amounting to €19,529 million, in order to strengthen the Group's situation, consisting of senior non-preferred: €16,222 million; subordinated debt: €1,282 million and preferred: €2,321 million.

  - Maturities of medium and long-term debt of €36,461 million.

Detailed information is in the chapter of liquidity and funding risk management.

CUSTOMER FUNDS

(€ million)

	2017	2016	Change amount	%	2015
Demand deposits	486,716	467,261	19,455	4.2	443,096
Time deposits	173,046	181,089	(8,043)	(4.4)	202,666
Mutual funds	155,794	147,416	8,378	5.7	129,077
Customer deposits excluding repos + Mutual funds	**815,556**	**795,766**	**19,790**	**2.5**	**774,839**
Pension funds	11,566	11,298	268	2.4	11,376
Managed portfolios	24,203	23,793	410	1.7	25,808
Subtotal	**851,326**	**830,858**	**20,468**	**2.5**	**812,023**
Repos	53,009	42,761	10,248	24.0	37,380
Group customer funds (Excl. Popular)	**904,334**	**873,618**	**30,716**	**3.5**	**849,403**
Popular	**81,369**		**81,369**		
Group customer funds	**985,703**	**873,618**	**112,085**	**12.8**	**849,403**

RATING AGENCIES

In 2017 four rating agencies confirmed their ratings and one of them (Scope) upgraded its rating from A+ to AA-
At the end of 2017, Banco Santander's rating exceeded the sovereign with the five agencies
These ratings recognise Santander's business model and financial strength

- The Group's access to the wholesale funding markets, as well as the cost of issuances, depends to some extent on the ratings of rating agencies.
- During 2017, DBRS, Fitch, Moody's and Standard & Poor´s confirmed Santander's rating, and the rating agency Scope upgraded the Bank's rating in April, from A+ to AA-, All rating agencies maintained the stable outlook.
- Rating agencies regularly review the Group's ratings. The rating depends on a series of internal (business model, strategy, capital, capacity to generate results, liquidity, etc.) and external factors related to the general economic environment, the banking sector's situation and the sovereign risk of the countries in which the Bank operates.
- At December 2017, Banco Santander's rating exceeded Spain's sovereign with the five agencies, recognising Banco Santander's business model and financial strength.

DEBT RATINGS
December 2017

	Long term	Short term	Outlook
DBRS	A	R-1(low)	Stable
Fitch Ratings	A-	F2	Stable
Moody's	A3	P-2	Stable
Standard & Poor's	A-	A-2	Stable
Scope	AA-	S-1	Stable

LIQUIDITY AND FUNDING RISK MANAGEMENT

The Group's liquidity remains at comfortable levels, well above regulatory requirements
Positive deposit evolution in the year, resulting in an improvement in the commercial gap
Issuance activity prioritised medium- and long-term funding instruments expected to be TLAC/MREL eligible
Grupo Santander's moderate encumbrance of assets continued

First, we present the Group's **liquidity management,** the principles on which it is based and the framework in which it is included.

We then look at the **funding strategy developed by the Group and its subsidiaries,** with particular attention on the **liquidity evolution in 2017.** We examine changes in the liquidity management ratios and the business and market trends that gave rise to these over the past year.

The section ends with a qualitative description of the **outlook** for funding in the coming year for the Group and its main countries.

1.1 Liquidity Management in Grupo Santander

Structural liquidity management aims to fund the Group's recurring activity optimising maturities and costs, while avoiding taking on undesired liquidity risks.

Santander's **liquidity management** is based on the **following principles:**

- Decentralised liquidity model.
- Medium- and long-term funding needs must be covered by medium- and long-term instruments.
- High contribution from customer deposits due to the retail nature of the balance sheet.
- Diversification of wholesale funding sources by instruments/investors, markets/currencies and maturities.
- Limited recourse to short-term wholesale funding.
- Availability of sufficient liquidity reserves, including standing facilities/discount windows at central banks to be used in adverse situations.
- Compliance with regulatory liquidity requirements both at Group and subsidiary level, as a new factor conditioning management.

The effective application of these principles by all institutions comprising the Group required the development of a unique **management framework** built upon three essential pillars:

- A **solid organisational and governance model** that ensures the involvement of the subsidiaries' senior management in decision-taking and its integration into the Group's global strategy. The decision-making process for all structural risks, including liquidity and funding risk, is carried out by Local Asset and Liability Committees (ALCO) in coordination with the Global ALCO, which is the body empowered by Banco Santander's board in accordance with the corporate Asset and Liability Management (ALM) framework. This governance model has been reinforced as it has been included within the Santander Risk Appetite Framework. This framework meets the demands of regulators and market players emanating from the financial crisis to strengthen banks' risk management and control systems.
- In-depth **balance sheet analysis and measurement of liquidity risk,** supporting decision-taking and its control. The objective is to ensure the Group maintains adequate liquidity levels necessary to cover its short- and long-term needs with stable funding sources, optimising the impact of their costs on the income statement,

both in normal and stressed conditions. The Group's liquidity risk management processes are contained within a conservative risk appetite framework established in each geographic area in accordance with its commercial strategy. This risk appetite defines maximum tolerance levels for key risk factors using internal and regulatory metrics in both normal and stressed market conditions, which establish the limits within which the subsidiaries can operate in order to achieve their strategic objectives.

- **Management adapted** in practice to the **liquidity needs of each business.** Every year, based on business needs, a liquidity plan is developed which ensures:
  - a solid balance sheet structure, with a diversified presence in the wholesale markets in terms of products and maturities, with moderate recourse to short-term products;
  - the use of liquidity buffers and limited encumbrance of assets;
  - compliance with both regulatory metrics and other metrics included in each entity's risk appetite statement.

Over the course of the year, all dimensions of the plan are monitored.

The Group continues developing the **ILAAP** (Internal Liquidity Adequacy Assessment Process), an internal self-assessment of liquidity adequacy which must be integrated into the Group's other risk management and strategic processes. It focuses on both quantitative and qualitative matters and is used as an input to the SREP (Supervisory Review and Evaluation Process). The ILAAP evaluates the liquidity position both in ordinary and stressed scenarios. In the Risk chapter of this report, there is a brief description of the considered scenarios.

As a result of the aforementioned process, a regulatory requirement is that once a year the Group must send the supervisor a document, signed by the Board of Directors, that concludes that the Group's funding and liquidity structure remains solid in all scenarios and that the internal processes are suitable to ensure sufficient liquidity. This conclusion is the result of analysis carried out by each of the subsidiaries, following the Group's autonomous liquidity management model.

The Group has a robust structure suited to the identification, management, monitoring and control of liquidity risks, established through common frameworks, conservative principles, clearly defined roles and responsibilities, a consistent committee structure, effective local lines of defence and a well-coordinated corporate supervision.

Additionally, frequent and detailed liquidity monitoring reports are generated for management, control and informational purposes. The most relevant information is periodically sent to senior management, the Executive Committee and the Board of Directors.

Over the last few years, the Group and each of its subsidiaries have developed a comprehensive special situations management framework which centralises the Bank's governance in these scenarios. Contingency funding plans are integrated within this governance model, detailing a series of actions which are feasible, pre-assessed, with an established execution timeline, categorised, prioritised and sufficient both in terms of volumes as well as timeframes to mitigate stress scenarios.

1.2 Funding strategy and liquidity evolution in 2017

1.2.1. Funding strategy and structure

Santander's funding activity over the last few years has focused on extending its management model to all Group subsidiaries, including new incorporations, and, in particular, adapting the strategies of the subsidiaries to the increasingly demanding requirements from both markets and regulators.

- Santander has 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 solid retail banking business model in order to maintain comfortable liquidity positions at Group level and in its main units, even during periods of market stress.
- Over the last few years, it has been necessary to adapt funding strategies to reflect commercial business trends, market conditions and new regulatory requirements.
- In 2017, Santander continued to improve in specific aspects based on a very comfortable liquidity position both at Group and subsidiary levels, with no significant changes in liquidity management or funding policies or practices. All of this enables us to face 2018 from a strong starting point, with no material growth restrictions.

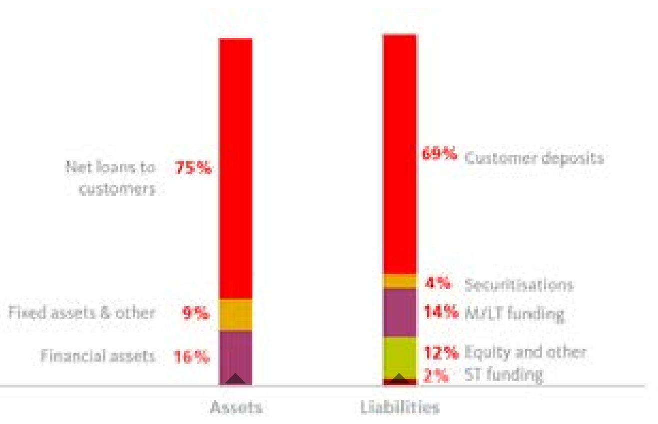
In general terms, the funding strategies and liquidity management **approaches** implemented by Santander subsidiaries **remain a**s follows:

- Maintain adequate and stable medium- and long-term wholesale funding levels.
- Ensure a sufficient volume of assets which can be discounted in central banks as part of the liquidity buffer.
- Strong liquidity generation from the commercial business through lower credit growth and increased emphasis on attracting customer deposits.

All these developments, built on the foundations of a solid liquidity management model, enable Santander to enjoy a **very robust funding structure** today. The basic features of this are**:**

- **High share of customer deposits due to its retail focused balance sheet.** Customer deposits are the Group's main source of funding, representing just over two-thirds of the Group's net liabilities (i.e. of the liquidity balance sheet) and 92% of net loans as of December 2017. Moreover, these deposits are a highly stable due to the fact that they mainly arise from retail client activity. This represents an increase with respect to the 2016 figure of 87%. The liquidity evolution explains the majority of this change.

GRUPO SANTANDER LIQUIDITY BALANCE SHEET
(%) December 2017

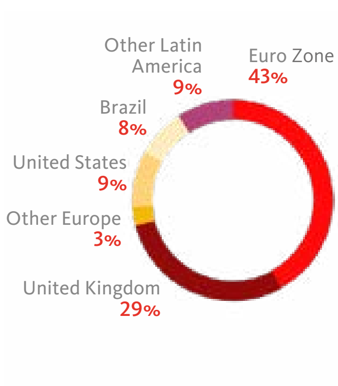


- **Wholesale funding diversified in terms of issuers, markets and instruments, focusing on medium- and long-term markets with a limited reliance on short-term funding.** Medium- and long-term wholesale funding accounts for 18% of the Group's net funding, compared with 20% at the end of 2016, and comfortably covers the lending not funded by customer deposits (commercial gap).

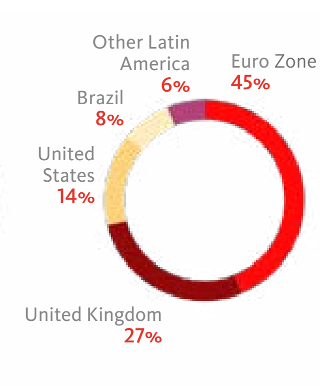
This funding is well balanced by instruments (approximately 43% senior debt, 23% securitisations and structured products with guarantees, 23% covered bonds, and the rest preferred shares and subordinated debt) and also by markets so that those with the highest weight in issuances are those where the Bank's investor activity is the strongest.

The following charts show the **geographic distribution** of the Group's customer loans and its medium and long-term wholesale funding, so that their similarity can be appreciated.

NET CUSTOMER LOANS
(%) December 2017



M/LT WHOLESALE FUNDING
(%) December 2017



With regards to the breakdown of net customer loans, compared to 2016 there has been a notable increase in the weight of the Euro Zone, largely due to the incorporation of Grupo Banco Popular into Grupo Santander, as its main area of operations was the Euro Zone. Likewise, there was a similar increase the Euro Zone's weight in medium- and long-term funding partly due to Popular and partly due to issuance activity throughout the year.

The bulk of the Bank's medium- and long-term funding is made up of debt issuances. The outstanding balance as of December 2017 was €153,961 million in nominal terms, with a comfortable maturity profile and a weighted average maturity of 5.0 years, a favourable increase compared to the 4.3 years as of end 2016.

The distribution of this funding by instrument over the last three years and maturity profile is as follows.

MEDIUM- AND LONG-TERM DEBT ISSUANCE. GRUPO SANTANDER
(€ million)

	Change in outstanding balance at nominal value		
	Dec 17	Dec 16	Dec 15
Preferred	10,365	8,515	8,491
Subordinated	12,049	11,981	12,262
Senior debt	85,962	89,568	83,630
Covered bonds	45,585	39,513	45,010
Total	**153,961**	**149,578**	**149,393**

MEDIUM- AND LONG-TERM DEBT ISSUANCES. GRUPO SANTANDER

(€ million)	Distribution by contractual maturity. December 2017*								
	0-1 month	1-3 months	3-6 months	6-9 months	9-12 months	12-24 months	2-5 years	more than 5 years	Total
Preferred	-	-	-	-	-	-	-	10,365	**10,365**
Subordinated	-	-	197	86	-	580	129	11,057	**12,049**
Senior debt	1,309	3,017	4,048	4,556	1,484	14,285	36,784	20,479	**85,962**
Covered bonds	3,100	-	2,133	250	-	5,001	18,693	16,408	**45,585**
Total	**4,409**	**3,017**	**6,377**	**4,891**	**1,484**	**19,866**	**55,606**	**58,310**	**153,961**

* In the case of issues with put option in favour of the holder, the first early redemption date of the put option is considered instead of the original contractual maturity date.
Note: there are no additional guarantees for any of the debt issued by the Group's subsidiaries.

It is worth noting that compared to 2016 the volume of issuances with a maturity date within the next year has decreased.

In addition to the debt issuances of the medium- and long-term wholesale funding, the Bank has securitisations placed in the market, collateralised funding and other specialist funding amounting to a total of €45,364 million with a residual maturity of 1.7 years.

Wholesale funding stemming from short-term issuance programmes is a residual part of the Group's funding structure (accounting for around 2% of net liabilities), is related to treasury activities and is comfortably covered by liquid assets.

The outstanding balance as of end 2017 was €20,999 million distributed as follows: various certificate of deposit and commercial paper programmes in the UK, 43%; European Commercial Paper, US Commercial Paper and domestic programmes issued by the parent bank, 17%; issuance programmes in other units, 40%.

On 9 November 2015, the Financial Stability Board (FSB) published its final principles and term sheet containing an international standard to enhance the loss absorbing capacity of global systemically important institutions (G-SIIs). The final standard consists of an elaboration of the principles on loss absorbing and recapitalisation capacity of G-SIIs in resolution and a term sheet setting out a proposal for the implementation of these proposals in the form of an internationally agreed standard on total loss absorbing capacity (TLAC) for G-SIIs. Once implemented in the relevant jurisdictions, these principles and terms will form a new minimum TLAC standard for G-SIIs.

Directive 2014/59/EU of 15 May 2014 on recovery and resolution of credit institutions and investment firms (BRRD) includes an additional loss absorption concept and a minimum eligible liabilities requirement known as MREL (Minimum Required Eligible Liabilities) which applies to all entities operating in Europe, not only those the G-SIIs. MREL and TLAC are discussed further in the Capital section of this report.

The medium-and long-term debt issuances that are considered to be MREL/TLAC eligible are preferred and subordinated debt. The ability of senior bonds to be MREL/TLAC eligible instruments depends on the insolvency legislation in the country of domicile of the issuer. For example, in Spain, recent legislation has created a new instrument category known as senior non-preferred, an instrument which Banco Santander has been a pioneering issuer in. In other countries, such as the UK or the United States, subordination is structural and is achieved by issuing ordinary senior debt via the entity's Holding company. Contractual subordination is also possible where a clause is included in the contract stating that the issuance is subordinate to certain liabilities.

1.2.2. Evolution of liquidity in 2017

The main aspects of liquidity in 2017 can be summarised as follows:

i) Basic liquidity ratios remain at comfortable levels.

ii) We are continuing to achieve regulatory ratios ahead of schedule.

iii) Moderate use of encumbered assets in funding operations.

i. Basic liquidity ratios remain at comfortable levels

The table shows the evolution of the basic monitoring liquidity metrics at the Group level over the last few years:

GRUPO SANTANDER MONITORING METRICS

	2017	2016	2015
Net loans / net assets	75%	75%	75%
Net loan-to-deposit ratio (LTD)	109%	114%	116%
Customer deposits and medium- and long-term funding / net loans	115%	114%	114%
Short-term wholesale funding / net liabilities	2%	3%	2%
Structural liquidity surplus / net liabilities	15%	14%	14%

As at end-December 2017, Grupo Santander recorded:

- A stable credit to net assets ratio (total assets minus trading derivatives and inter-bank balances) of 75%, in line with recent years. This high level in comparison with European competitors reflects the retail nature of Grupo Santander's balance sheet.

- Net loan-to-deposit ratio (LTD) of 109%, very comfortably within the target range (below 120%). This stability shows a balanced growth between assets and liabilities.

- The ratio of customer deposits plus medium- and long-term funding to lending was 115% at the end of 2017.

- Limited recourse to short-term wholesale funding. The ratio was around 2%, in line with previous years.

- Lastly, the Group's structural surplus (i.e. the excess of structural funding sources - deposits, medium- and long-term funding and capital - as a percentage of structural liquidity needs - fixed assets and loans-) rose in 2017, to an average of €156,927 million, higher than at the end of the previous year.

As at 31 December 2017, the consolidated structural surplus stood at €163,957 million. This consists of fixed-income assets (€162,586 million), equities (€22,958 million), partly offset by short-term wholesale funding (-€20,999 million) and net interbank and central bank deposits (-€587 million). In relative terms, the total volume was equivalent to 15% of the Group's net liabilities, in line with December 2016.

Having discussed the principal liquidity ratios at Group level, the following table sets out the ratios for for Santander's main units as at end 2017:

MAIN UNITS AND LIQUIDITY METRICS

December 17	LTD Ratio	Deposits + M/LT funding/ Net loans
Spain	79%	160%
Popular	117%	100%
Portugal	100%	115%
Santander Consumer Finance	254%	66%
Poland	92%	111%
United Kingdom	106%	117%
Brazil	101%	122%
Mexico	87%	123%
Chile	143%	95%
Argentina	76%	134%
United States	141%	110%
Group total	**109%**	**115%**

Generally speaking, there were two **key drivers** behind the evolution of the Group's liquidity and that of its subsidiaries **in 2017** (excluding the forex effect):

1. Good performance in deposits in the main geographies where the Group operates, particularly in Spain and in the UK. This performance has helped to narrow the commercial gap, as deposit growth has more than outstripped the increase in lending.

2. Debt issuance momentum continued, especially in the European units, though more targeted in its execution due the lower balance sheet needs. In particular, issuances that are expected to be TLAC and MREL eligible have been prioritised.

In 2017, the Group as a whole has captured €51,740 million of medium- and long-term funding (calculated using year-average exchange rates).

In terms of **instruments**, medium and long-term debt instruments (senior debt, covered bonds, subordinated debt and preferred shares) showed the greatest increase, up around 15% to €37,775 million, mainly due to senior and preferred issuances. Securitisation and structured finance activity increased 6% compared to 2016, at €13,965 million.

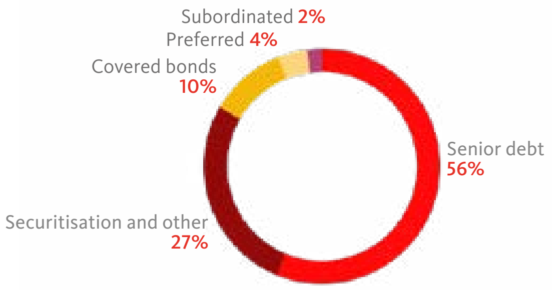
By **geography,** the largest issuers of medium- and long-term debt were Spain, the UK and Santander Consumer Finance. Santander Consumer Finance further increased its diversification this year in terms of funding sources and has accessed senior and *pfandbriefe* markets in Germany for the first time. Compared to 2016, Spain and Portugal increased the most; Spain due to the need to build MREL and TLAC eligible liability buffers, explaining the limited covered bond issuance in the year in favour of unsecured debt. In Portugal's case, as a consequence of funding needs deriving from the integration of Banco Popular Portugal into Santander Totta following Popular's resolution and subsequent sale to Santander.

The main issuers of securitisations were Santander Consumer Finance and the United States, via its consumer lending subsidiary Santander Consumer USA.

The charts below set out in greater detail their **distribution by instruments and geographic areas:**

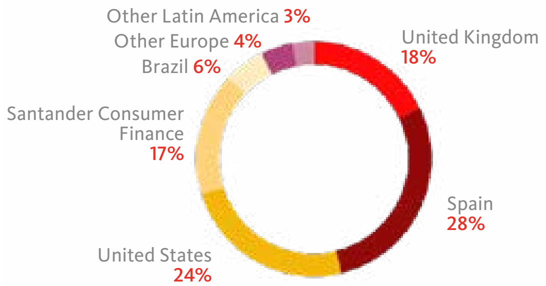
DISTRIBUTION BY INSTRUMENT

December 2017. (%)



DISTRIBUTION BY GEOGRAPHY

December 2017. (%)



The weight of covered bonds issued in the year remains in line with 2016 at 10% of total issuances. However, in contrast to last year when the main issuers were Santander and the UK, in 2017 the main issuers were Portugal and the UK.

Grupo Santander regularly holds different types of meetings with analysts, investors and shareholders in which we disclose our strategic funding plans for the coming years. Analysing the issuance activity over the course of the year in the main geographies and comparing it to the information presented at the beginning of 2017, we can conclude the following:

- Santander parent bank marketed around €3 billion of hybrid securities, in line with forecasts; roughly €10 billion of senior non-preferred, in the lower range of that disclosed to the market; and completed its funding plan with senior preferred and covered bond expectations of just over €1 billion.

- Santander Consumer Finance issued senior preferred debt in line with the amounts disclosed to the markets.

- The UK issued over €2 billion of senior debt via its holding company, in line with expectations, and less than €1 billion of hybrid debt, below forecasted amounts due to lower funding needs. The UK completed its funding plan by directly issuing around €4 billion of senior and covered bond securities.

- The United States issued around €4 billion of senior debt via its holding company, somewhat above disclosed volumes.

- In the year, using year-average exchange rates, the Group as a whole issued €19.825 billion of MREL/TLAC eligible securities, of which €16.222 billion were senior non-preferred and eligible senior debt, €2.321 billion were AT1, and €1.282 billion were subordinated debt.

In summary, Grupo Santander retained its comfortable access to the different markets in which it operates, reinforced by new issuing units and products. In 2017, we issued debt and securitisations in 14 different currencies, with participation from 22 relevant issuers in 14 countries and with an average maturity of 5 years, slightly above the previous year.

ii. Compliance with regulatory ratios ahead of schedule

Under its liquidity management model, over the last few years Grupo Santander has been managing the implementation, monitoring and compliance with the new liquidity requirements established under international financial regulations ahead of schedule.

LCR (Liquidity Coverage Ratio)

The regulatory requirement for this ratio in 2017 was set at 80%. As of 1 January 2018 the requirement increased to 100%. As a result, the Group, both at a consolidated and subsidiary level, has increased its risk appetite from 100% in 2017 to 105% in 2018.

The Group's strong short-term liquidity starting position, combined with autonomous management in all major units, enabled compliance levels of more than 100% to be maintained throughout the year, at both the consolidated and individual levels.

As at end 2017, the Group's LCR ratio stood at 133%, comfortably exceeding regulatory requirements. The following table provides detail of the LCR ratio by unit, which shows the considerable excess over requirements:

LIQUIDITY COVERAGE RATIO

	Dec 17
Santander	130%
Popular	146%
Santander Consumer Finance	201%
Portugal	123%
Poland	141%
United Kingdom	120%
United States	118%
Brazil	126%
Chile	138%
Mexico	188%
Grupo Santander	**133%**

NSFR (*Net Stable Funding Ratio*)

The final definition of the net stable funding ratio approved by the Basel Committee in October 2014, has not yet come into effect. The Basel requirement still needs to be written into the CRR, which is expected to be published in the second half of 2018. The NSFR regulatory requirements will only become binding two years after its inclusion into European Law.

However, the Group has defined a management limit of 100% at the consolidated level and for almost all of its subsidiaries.

With regards to this ratio, Santander benefits from a high weight of customer deposits, which are more stable, permanent liquidity needs deriving from commercial activity funded by medium- and long-term instruments and limited recourse to short-term funds. Taken together, this enables Santander to maintain a balanced liquidity structure, reflected in NSFR ratios greater than 100%, both at Group and individual levels as at end December 2017.

In particular, the NSFR of the parent bank was 105%, the UK 121%, Brazil 109% and the United States 110%.

In short, the liquidity models and management of the Group and its main subsidiaries have enabled them to meet both regulatory metrics well ahead of schedule.

iii. Asset Encumbrance

Lastly, it is worth highlighting Grupo Santander's moderate use of assets as collateral in the structural funding sources of the balance sheet.

In line with the guidelines established by the European Banking Authority (EBA) in 2014, the concept of asset encumbrance includes both on-balance sheet assets pledged as collateral in operations to obtain liquidity as well as those off-balance sheet assets received and re-used for a similar purpose, in addition to other assets associated with liabilities other than for funding reasons.

The following tables present the data Grupo Santander is required to report to the EBA as at end 2017.

GRUPO SANTANDER
ASSET ENCUMBRANCE

€ billion	Carrying amount of encumbered assets	Fair value of encumbered assets	Carrying amount of unencumbered assets	Fair value of unencumbered assets
Assets	**349.6**		**1,094.7**	
Credit and loans	224.9		803.9	
Equities	16.3	16.2	10.8	10.8
Debt instruments	89.8	94.4	109.6	104.9
Other assets	18.6		170.5	

GRUPO SANTANDER
ENCUMBERED RECEIVED COLLATERAL

€ billion	Fair value of encumbered collateral received or own debt securities issued	Fair value of collateral received or own debt securities issued available for encumbrance
Collateral received	**86.7**	**27.2**
Credit and loans	0.0	0.0
Equities	3.2	5.5
Debt instruments	81.6	21.7
Other collateral received	1.9	0.0
Debt instruments issued by the entity other than covered bonds and securitisations	**0.0**	**3.6**

GRUPO SANTANDER
ENCUMBERED ASSETS AND COLLATERAL RECEIVED AND ASSOCIATED LIABILITIES

€ billion	Matching liabilities, contingent liabilities or securities lent	Assets, collateral received and own debt securities issued other than covered bonds and ABSs encumbered
Total sources of encumbrance (carrying amount)	**330.7**	**436.3**

On-balance sheet encumbered assets amounted to €349.6 billion, 64% of which is accounted for by loans (mortgages, corporate, etc.). Off-balance sheet asset encumbrance stood at €86.7 billion, mainly relating to debt securities received as collateral in repo and similar operations which were then re-used. The total for the two categories was €436.3 billion of encumbered assets, giving rise to a volume of associated liabilities of €330.7 billion.

As at end 2017, total asset encumbrance in funding operations represented 28.0% of the Group's extended balance sheet under EBA criteria (total assets plus guarantees received: €1,558 billion as of end 2017). The increase in this ratio compared to the values reported in 2016 are due to the acquisition of Banco Popular in June 2017, whose balance sheet was more encumbered than the rest of Grupo Santander.

Finally, a distinction needs to be made between the different natures of the sources of encumbrance, as well as their role in the Group's funding:

- 44.5% of total asset encumbrance corresponds to collateral pledged in medium- and long-term operations (with a residual maturity of more than 1 year) to fund the commercial activity on the balance sheet. This results in a level of asset encumbrance known as "structural" at 12.5% of the extended balance sheet, using EBA criteria.

- The other 55.5% corresponds to short-term market transactions with a residual maturity of less than one year or to collateral pledged in derivative operations whose purpose of which is not to finance ordinary business activity of businesses but rather efficient short-term liquidity management.

1.3 Funding outlook for 2018

Grupo Santander starts 2018 with a comfortable liquidity position and with good prospects for the coming year. However, some risks to stability remain namely those related to funding regulation uncertainties.

With manageable debt maturities over the next few quarters, supported by the low weight of short-term funding and an issuance dynamic expected to be in line with recent years, the Group will manage each geographic area in order to optimise liquidity usage and to maintain a robust balance sheet structure in the units and in the Group as a whole.

For the Group as a whole, reduced commercial needs are envisaged as, in most cases, the increase in lending is expected tFo largely be counter-balanced out by increases in customer deposits. The greatest liquidity requirements will stem from Spain, both Banco Santander and Banco Popular, Santander Consumer Finance and from the UK.

At Group level, Santander will continue with its long term plan to issue liabilities with loss-absorbing capacity, regardless of whether they are considered to be capital instruments or not. This plan seeks to enhance the Group's current regulatory ratios efficiently, and also takes into account future regulatory requirements. Specifically, the TLAC principles and term sheet require a minimum TLAC requirement to be determined individually for each G-SII at the greater of (a) 16% of risk weighted assets as of 1 January 2019 and 18% as of 1 January 2022, and (b) 6% of the Basel III Tier 1 leverage ratio exposure measure as of 1 January 2019, and 6.75% as of 1 January 2022. Although currently TLAC is only an international agreement awaiting to be transposed into binding regulations in the different jurisdictions (CRR in the case of European G-SIIs), the Group is already incorporating and covering potential requirements into its funding plans.

On the other hand, the MREL requirement was scheduled to come into force by January 2016. However, Commission Delegated Regulation (EU) No. 2016/1450 of 23 May 2016 (the "MREL RTS") gave discretion to resolution authorities to determine appropriate transitional periods to each institution. Under the current proposal of the European Commission to implement TLAC requirements into European regulation, institutions such as Banco Santander would continue to be subject to an institution-specific MREL requirement (i.e., a Pillar II add-on MREL Requirement), which may be higher than the requirement of the TLAC standard (which would be implemented as a Pillar I MREL requirement for G-SIIs). In this sense, we expect Grupo Santander's MREL requirement to be communicated to us by the Single Resolution Board ("SRB") during 2018/2019, based on the current regulation (BRRD). (See 1.6 under Capital Management and Adequacy Solvency Ratios).

Given this focus, Santander plans to issue between €2 billion and €3 billion of hybrid instruments in 2018, and between €7 billion and €10 billion of senior non-preferred; Santander Consumer Finance between €4 billion and €6 billion of senior debt and will continue to develop its *pfandbriefe* programme in Germany; UK expects to issue between €6 billion and €8 billion of senior debt, both via the Holding company and directly via the bank and will complete its funding programme with between €2 billion and €4 billion of covered bonds; and finally, the United States plans to issue between €1 billion and €2 billion during the year.

The Group's units, especially Santander Consumer Finance and the US via Santander Consumer USA, have budgeted for securitisations whose execution will depend on loan origination in line with the business plan.

Within this general picture, several of the Group's units took advantage of the positive market conditions at the beginning of 2018, issuing close to €7 billion in January and the first few days of February.

CAPITAL MANAGEMENT AND ADEQUACY. SOLVENCY RATIOS

The fully loaded CET1 ratio was 10.84% at the end of 2017 (+29 b.p.), in line with our goal of surpassing 11% in 2018
The fully loaded capital ratio was 14.48%, (+61 b.p.) in the year
In July, following the acquisition of Banco Popular and in order to recover the capital ratio levels prior to the purchase, the Group carried out a capital increase of €7,072 million
Active capital management continues to be strengthened across the Group

Grupo Santander's capital management and adequacy seeks to guarantee solvency and maximise profitability, ensuring compliance with the Group's internal objectives as well as regulatory requirements. It is a key strategic tool for taking decisions at the local and corporate levels and enables us to set a common framework of actions, defining and standardising capital management criteria, policies, functions, metrics and processes.

The function of the Group's capital is carried out at two levels:

- **Regulatory capital**: regulatory management stems from an analysis of the capital base, the solvency ratios under the prevailing regulatory criteria and the scenarios used for capital planning. The objective is to make the capital structure as efficient as possible both in terms of cost as well as compliance with the regulatory requirements. Active capital management includes strategies to use and assign capital efficiently to businesses as well as securitisations, asset sales, issuances of capital instruments (preferred shares, subordinated debt) and capital hybrids.
- **Economic capital**: the economic capital model aims to guarantee that the Group adequately assigns its capital to all risks to which it is exposed as a result of its activity and risk appetite. Its purpose is to optimise value creation for the Group and its business units.

  The real economic measurement of capital needed for an activity, together with its return, guarantees value creation optimisation by selecting those activities that maximise the return on capital. This is carried out under different economic scenarios, both expected as well as unlikely but plausible, and with the solvency level decided by Grupo Santander.

Capital

The Group considers the following capital concepts:

Regulatory capital

- **Capital requirements:** the minimum volume of own funds required by the regulator to ensure the solvency of the entity, depending on its credit, market and operational risks.
- **Eligible capital:** the volume of own funds considered eligible by the regulator to meet capital requirements. The main elements are accounting capital and reserves.

Economic capital

- **Self-imposed capital requirement:** the minimum volume of own funds required by the Group to absorb unexpected losses resulting from current exposure to the risks assumed by the entity at a particular level of probability (this may include other risks in addition to those considered in regulatory capital).
- **Available capital:** the volume of own funds considered eligible by the entity under its management criteria to meet its capital requirements.

Cost of capital

The minimum return required by investors (shareholders) as remuneration for the opportunity cost and risk assumed by investing in the entity's capital. The cost of capital represents a "cut-off rate" or "minimum return" to be achieved, enabling analysis of the activity of business units and evaluation of their efficiency.

Leverage ratio

This is a regulatory metric that monitors the soundness and robustness of a financial institution by comparing the size of the entity to its capital. This ratio is calculated as the ratio between Tier 1 divided by the leverage exposure, that takes into account the size of the balance sheet with adjustments for derivatives, funding of securities operations and off-balance sheet items.

Return on risk adjusted capital (RoRAC)

This is the return (net of tax) on economic capital required internally. Therefore, an increase in economic capital decreases the RoRAC. For this reason, the Bank requires transactions or business involving higher capital consumption to deliver higher returns.

This considers the risk of the investment, and is therefore a risk adjusted measurement of returns.

Using the RoRAC enables the Bank to manage its business more effectively, assess the real returns on its business - adjusted for the risk assumed - and to be more efficient in its business decisions.

Return on risk-weighted assets (RoRWA)

This is the return (net of tax) on risk-weighted assets for a particular business.

The Bank uses RoRWA to establish regulatory capital allocation strategies, guaranteeing that the maximum return is achieved.

Value creation

The profit generated in excess of the cost of economic capital. The Bank creates value when risk adjusted returns (measured by RoRAC) exceed its cost of capital, and destroys value when the reverse occurs. This measures risk adjusted returns in absolute terms (monetary units), complementing the RoRAC approach.

Expected loss

This is the loss due to insolvency that the entity will suffer on average over an economic cycle. Expected loss considers insolvencies to be a cost that can be reduced by appropriate selection of loans.

1.1 Priorities and main activities in the Group's capital management

The Group's most notable capital management activities are:

- Establishing solvency objectives and the capital contributions aligned with the minimum regulatory requirements and internal policies, in order to guarantee a solid level of capital, coherent with the Group's risk profile, and an efficient use of capital to maximise shareholder value.
- Developing a capital plan to meet the objectives coherent with the strategic plan. Capital planning is an essential part of executing the three-year strategic plan.
- Assessing capital adequacy in order to ensure that the capital plan is coherent with the Group's risk profile and with its risk appetite framework also in stress scenarios.
- Developing the annual capital budget as part of the Group's budgetary process.
- Monitoring and controlling budget execution and drawing up action plans to correct any deviation from the budget.
- Calculating capital metrics.
- Drawing up internal capital reports, as well as reports for the supervisory authorities and for the market.

The main measures taken in 2017 are set out below:

Issuances of financial instruments with the legal nature of capital

During the year, Banco Santander issued two contingent convertible bonds (CoCos) of €750 million and €1,000 million to strengthen its AT1 capital.

As regards subordinated debt, in the first half of the year Banco Santander's issuances totalled €1,150 million. These issuances bolstered the total capital ratio as they count towards Tier 2 funds.

In December, Banco Santander issued €981 million of contingently amortisable perpetual bonds (Loyalty Bonds) for certain customers of the Group affected by the resolution of Banco Popular, with no impact on the Group's capital ratios. This issuance is TLAC/MREL eligible (see section 1.6.)

In July, following the acquisition of Banco Popular and in order to recover the ratio levels prior to the purchase, Banco Santander announced a capital increase for a nominal amount of €729,116,327.50, through the issuance and circulation of 1,458,232,745 new ordinary shares of the same class and series as those currently in circulation and with preferred subscription rights for shareholders. The new shares were issued at a nominal value of €0.50 per share plus a premium of €4.35 per share (total value €4.85 per share) and the total effective amount of the capital increase (including the nominal value and issuance premium) was €7,072,428,813.25.

Dividend policy*

During 2017, the Group maintained cash payments for most of its quarterly remunerations, with the aim of distributing €0.22 charged to the year's earnings in four dividends, three of them in cash of €0.06 each one and one scrip dividend (Santander Dividendo Elección) of €0.04 per share. We also communicated our intention for 2017 and successive years to offer a cash pay-out of between 30% and 40% of the Group's profit and for shareholder remuneration to be line with the growth in earnings.

The objectives set for 2017 were met (cash pay-out of 40% of profit and an increase in the cash dividend per share of 9%).

Strengthen active capital management culture

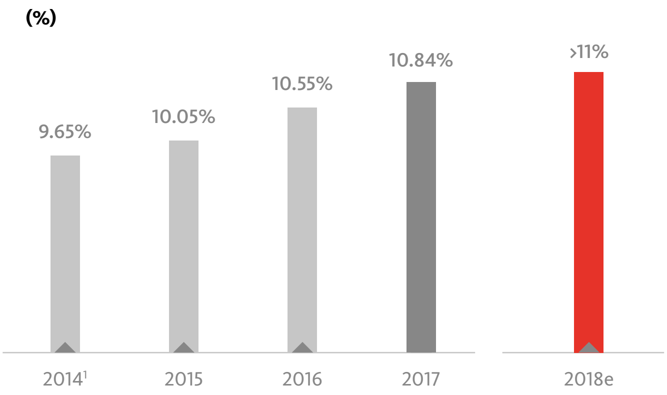
Grupo Santander continued to work towards having a fully loaded CET1 in excess of 11% in 2018.

The continuous improvement in the capital ratios reflects the Group's profitable growth strategy and a culture of active management of capital at all levels of the organisation. Of note:

- The dedicated capital management teams were strengthened, and there was greater coordination between the Corporate Centre and local teams.
- All countries and business units developed their individual capital plans focused on having businesses that maximise the return on capital.
- A higher weight of capital in incentives. To this end, certain aspects related to capital and its profitability are taken into account in the variable pay of senior executives:
    - Among the metrics taken into account are the fully loaded CET1, the contribution of capital and the return on risk weighted assets (RoRWA).
    - Among the qualitative aspects contemplated are adequate management of regulatory changes in capital, effective capital management in business decisions, progress in the capital plan towards the set goals and effective capital allocation.

We are developing in parallel a programme of measures to continuously improve the infrastructure, processes and methodologies that support all aspects related to capital in order to further strengthen active capital management, respond more agilely to the numerous and increasing regulatory requirements and conduct all activities associated within this sphere more efficiently.

FULLY-LOADED CET1



(*) Subject to the final dividend against the 2017 results being approved at the Bank's annual shareholders' meeting.

1.2 Evolution of capital ratios in 2017

The phased-in ratios are calculated by applying the Basel III transitory schedules, while the fully-loaded ratios are calculated without applying any schedule (i.e. with the final regulations).

In fully-loaded terms, the CET1 ratio at the end of 2017 was 10.84% (+29 b.p.) which puts us well within reach of the declared objective of more than 11% in 2018.

The total fully-loaded capital ratio was 14.48%, having increased 61 b.p. during the year.

ELIGIBLE CAPITAL (FULLY-LOADED)*

(€ million)

			Change		
	31.12.17	31.12.16	Amount	%	31.12.15
Capital stock and reserves	111,362	101,437	9,925	9.8	98,193
Attributable profit	6,619	6,204	415	6.7	5,966
Dividends	(2,998)	(2,469)	(529)	21.4	(2,268)
Other retained earnings	(23,108)	(16,116)	(6,992)	43.4	(15,448)
Minority interests	7,228	6,784	443	6.5	6,148
Goodwill and intangible assets	(28,537)	(28,405)	(132)	0.5	(28,254)
Other deductions	(5,004)	(5,368)	365	(6.8)	(5,633)
Core CET1	**65,563**	**62,068**	**3,495**	**5.6**	**58,705**
Preferred shares and other T1 eligibles	7,730	5,767	1,964	34.1	5,504
Tier 1	**73,293**	**67,834**	**5,458**	**8.0**	**64,209**
Generic funds and eligible T2 instruments	14,295	13,749	546	4.0	11,996
Eligible capital	**87,588**	**81,584**	**6,004**	**7.4**	**76,205**
Risk-weighted assets	605,064	588,088	16,976	2.9	583,917
CET1 capital ratio	**10.84**	**10.55**	**0.29**		**10.05**
T1 capital ratio	**12.11**	**11.53**	**0.58**		**11.00**
Total capital ratio	**14.48**	**13.87**	**0.61**		**13.05**

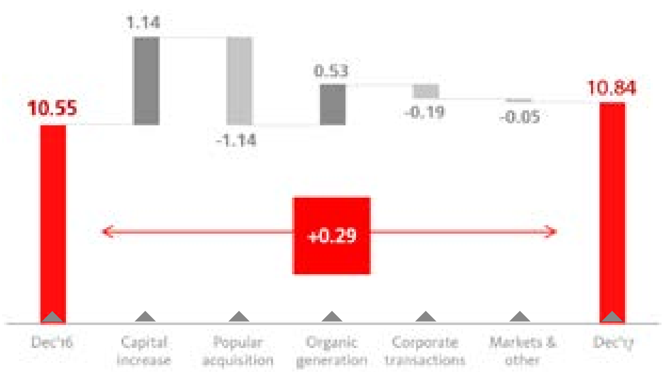
(*).- 31.12.17 including Popular.

The following table compares the CET 1, Tier 1 and total capital in accordance with phased-in and fully-loaded methodologies

MAIN CAPITAL AND SOLVENCY RATIOS

	Fully-loaded		Phased-in	
	Dec'17	Dec'16	Dec'17	Dec'16
Common equity (CET1)	65,563	62,068	74,173	73,709
Tier1	73,293	67,834	77,283	73,709
Eligible capital	87,588	81,584	90,706	86,337
Risk-weighted assets	605,064	588,089	605,064	588,088
CET1 capital ratio	10.84%	10.55%	12.26%	12.53%
T1 capital ratio	12.11%	11.53%	12.77%	12.53%
Total capital ratio	14.48%	13.87%	14.99%	14.68%
Leverage ratio	5.02%	4.98%	5.28%	5.40%

FL CET1 PERFORMANCE
(%)

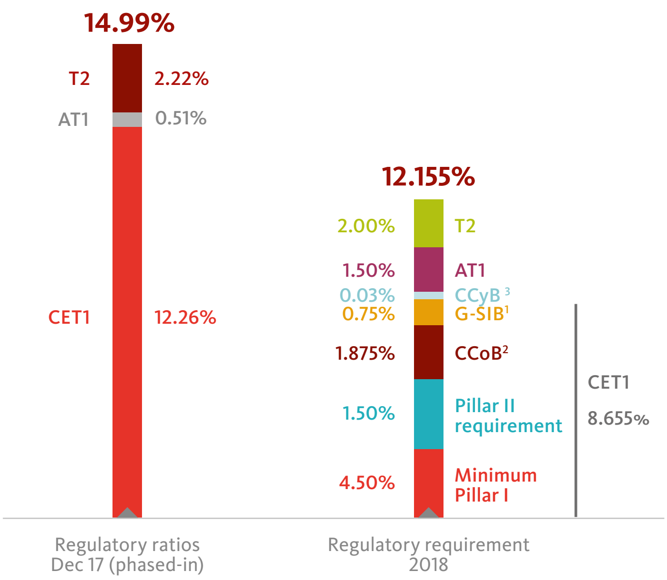


The 29 b.p. increase in the year is principally due to profit and risk weighted assets management, resulting in an organic generation of 53 b.p. in the year. In addition to this organic increase, there were deductions of 19 b.p. due to perimeter impacts (SAM and Allfunds transactions and the increased stake in SC USA) and 5 b.p. relating to various impacts, such as the Available for Sale portfolio valuation among others. The consolidation of Popular's risk weighted assets had a negative 114 b.p. impact on the CET1 ratio. However the Group increased capital in July and the net of the two operations was neutral in capital terms.

As regards the leverage ratio, there were no significant changes in 2017. Tier 1 capital was stable and the leverage exposure registered the usual movements of balance sheet volumes from business activity and from exchange rate changes.

From a qualitative point of view, Grupo Santander has solid capital ratios, in alignment with its business model, balance sheet structure and risk profile.

With regards to the regulatory ratios, Banco Santander exceeds the 2018 minimum regulatory requirements by 284 b.p., taking into account the surplus and shortfall in AT1 and T2 respectively.



1. Global systemically important banks (G-SIB) buffer
2. Capital conservation buffer
3. Countercyclical buffer

1.3 Economic capital

The economic capital is the capital needed to support all the risks of our activity with a certain level of solvency. It is measured using an internally developed model. In our case, the solvency level is determined by the objective long-term rating of "A" (two notches above the Kingdom of Spain's rating), which represents a confidence level of 99.95% (higher than the regulatory level of 99.90%) to calculate the necessary capital.

Santander's economic capital model incorporates in its measurement all significant risks incurred by the Group in its activity (concentration risk, structural interest rate risk, business risk, pensions risk and others that are beyond the scope of regulatory Pillar I). Furthermore, economic capital incorporates the diversification effect which in Grupo Santander's case is key, due to the multinational nature of its activity covering many businesses, in order to appropriately determine and understand the risk profile and solvency of a group with global activity such as Santander.

The fact that Santander's business activity is spread across various countries via a structure of separate legal entities, with a variety of client and product segments, exposed to different types of risks, means that Grupo Santander's results are less vulnerable to adverse situations in one of the particular markets, portfolios, client types or risks. The economic cycles, despite the current high level of economic globalisation, are not the same nor are the different geographies affected with the same intensity. In this way, groups with a global presence have more stable results and are more resistant to the eventual market or portfolio crises, which translates to lower risk. In other words, Grupo Santander's risk and the associated economic capital of the group as a whole are less than the sum of the individual parts.

Unlike with regulatory criteria, Grupo Santander considers certain intangible assets, such as DTAs, goodwill and software, to retain value, even in the hypothetical case of resolution given the geographic structure of Grupo Santander's subsidiaries. As such, the asset is valued and its unexpected loss and capital impact are estimated.

Economic capital is a key tool for internal management and development of the Group's strategy, both from the standpoint of assessing solvency as well as risk management of portfolios and businesses.

From the solvency standpoint, Grupo Santander uses its economic model, in the context of the Basel Pillar II, for the internal capital adequacy assessment process (ICAAP). The business evolution and capital needs are planned under a central scenario and alternative stress scenarios. This ensures the Group meets its solvency objectives to be ensured even in adverse scenarios.

The metrics derived from economic capital enable the risk-return objectives to be assessed, the price of operations to be set based on risk and the economic viability of projects, units and business lines to be evaluated, with the overriding objective of maximising the generation of shareholder value.

As a homogeneous risk measure, economic capital can be used to explain the distribution of risk throughout the Group, reflecting comparable activities and different types of risk in a single metric.

The economic capital requirement at the end of 2017 amounted to €72,144 million which, compared to an available economic capital base of €99,080 million, implies a capital surplus of €26,936 million.

AVAILABLE ECONOMIC CAPITAL

(€ million)

	2017	2016
Net capital and issue premiums	59,098	52,196
Reserves and retained profits	55,862	52,967
Valuation adjustments	(23,108)	(16,116)
Non-controlling interests	7,228	6,784
Base economic capital available	**99,080**	**95,831**
Economic capital required	72,144	72,632
Capital supluss	26,936	23,199

The main difference compared to regulatory CET1 lies in the treatment of goodwill, other intangible assets and DTAs which we consider as additional capital requirements rather than a deduction from available capital.

The following chart sums up the Group's economic capital needs at the end of 2017, geographic area and types of risk:

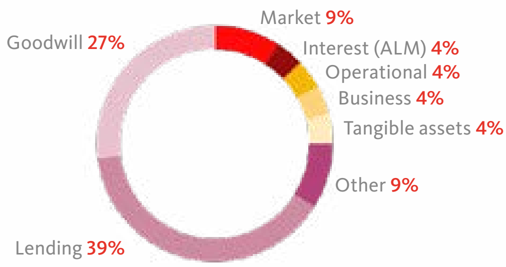
The distribution of economic capital among the main business areas reflects the diversified nature of the Group's business and risk. Continental Europe represents 49% of the capital, Latin America including Brazil 23%, the UK 14% and the US 13%.

Outside the operating areas, the main risks the Corporate Centre assumes are goodwill and the risk derived from the exposure to structural exchange rate risk (risk derived from maintaining stakes in subsidiaries abroad denominated in currencies other than the euro).

The benefit of diversification included in the economic capital model, including both the intra-risk diversification (similar to geographic diversification) as well as inter-risks, amounted to approximately 30%.

DISTRIBUTION OF ECONOMIC CAPITAL NEEDS BY TYPE OF RISK

December 2017. (%)



DISTRIBUTION OF ECONOMIC CAPITAL NEEDS BY GEOGRAPHIC AREA AND TYPE OF RISK

December 2017. (€ million)

€ million

Grupo Santander
Total requirements: 72,144

Corporate Activities 24,754	Continental Europe 23,300	United Kingdom 6,777	Latin America 10,997	United States 6,317
All risks:	**All risks:**	**All risks:**	**All risks:**	**All risks:**
Goodwill: 77%	Credit: 55%	Credit: 58%	Credit: 66%	Credit: 60%
Market: 12%	Market: 13%	Pensions:: 20%	Interest (ALM): 10%	Operational: 10%
DTA: 10%	Operational: 8%	Operational: 8%	Business: 7%	Tangible assets: 8%
Other: 1%	Interest (ALM): 8%	Business: 6%	Operational: 6%	Intangible assets: 6%
	Other: 16%	Other: 8%	Other: 11%	Business: 6%
				Other: 10%

1.3.1. RoRAC and value creation

Grupo Santander has been using RoRAC methodology 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 for segments, portfolios and customers, in order to facilitate optimum allocation of capital.
- Measure management of the Group's units through budgetary monitoring of capital consumption and RoRAC.
- Analyse and set prices for taking decisions on operations (admission) and customers (monitoring).

The RoRAC methodology enables the return on operations, customers, portfolios and businesses to be compared on a like-for-like basis, identifying those that obtain a risk-adjusted return higher than the cost of the Group's capital, thus aligning risk and business in order to maximise value creation, which is the ultimate goal of the Group's senior management.

Grupo Santander also regularly assesses the level and evolution of value creation (VC) and the risk-adjusted return (RoRAC) of the Group and its main business units. The VC is the profit generated above the cost of economic capital (EC) employed, and is calculated as follows:

Value creation = recurring profit – (average economic capital x cost of capital)

The profit used is obtained from making the necessary adjustments to the accounting profit so as to extract only the recurring result that each unit generates in its year of activity.

The minimum return on capital that a transaction must obtain is determined by the cost of capital, which is the minimum remuneration required by shareholders. This is calculated by adding to the risk-free return the premium that shareholders require to invest in Grupo Santander. This premium depends essentially on the degree of volatility in Banco Santander's share price with respect to the market's performance. The Group's cost of capital in 2017 was 8.60% (compared to 9.37% in 2016).

As well as reviewing the cost of capital annually, the Group's internal management also estimates a cost of capital for each business unit, taking into account each market's specific features, under the philosophy of subsidiaries autonomous in capital and liquidity, in order to evaluate whether each business is capable of generating value individually.

If an operation or portfolio obtains a positive return, it contributes to the Group's profits, but it only creates shareholder value when that return exceeds the cost of capital.

The following chart shows the value creation and RoRAC at the end of 2017 of the Group's main business areas:

RoRAC AND VALUE CREATION
(€ million)

	Dec-17		Dec-16	
Main segments	**RoRAC**	**Value creation**	**RoRAC**	**Value creation**
Continental Europe	19.7%	2,110	17.3%	1,426
United Kingdom	19.3%	764	20.2%	825
Latin America	41.8%	4,049	33.1%	2,879
United States	8.9%	22	9.2%	-13
Total business units	**23.9%**	**6,946**	**20.7%**	**5,117**

1.4 Capital planning and stress tests

Capital stress test exercises are a key tool in the dynamic evaluation of risks and the solvency of banks.

It is a forward-looking evaluation based on macroeconomic as well as idiosyncratic scenarios that are unlikely but plausible. Thus, robust planning models are required, capable of transferring the effects defined in the projected scenarios to different elements that influence the bank's solvency.

The ultimate aim of capital stress exercises is to make a complete assessment of the risks and solvency of banks, which enables possible capital requirements to be determined in the event they are needed because of banks' failure to meet their regulatory and internal capital objectives.

Internally, Grupo Santander has a defined capital stress and planning process not only to respond to various regulatory exercises but also as a key tool integrated into the Bank's management and strategy.

The objective of the internal capital stress and planning process is to ensure sufficient current and future capital, including in unlikely but plausible economic scenarios. Based on the Group's initial situation (defined by its financial statements, its capital base, risk parameters and regulatory ratios), the envisaged results are estimated for different business environments (including severe recessions as well as expected macroeconomic environments), and the Group's solvency ratios are obtained projected usually over a three-year period.

The planning process offers a comprehensive view of the Group's capital for the analysed time period and in each of the defined scenarios. The analysis incorporates the regulatory capital, economic capital and available capital metrics.

The structure in place is detailed in the following chart:

1 Macroeconomic scenarios	→ **Central** and **recession** → **Idiosyncratic:** based on specific risks facing the entity → **Multi-year** horizon
2 Forecasts of balance sheet and income statement	→ Projection of **volumes.** Business **strategy** → **Margins** and **funding costs** → Operating **fees** and **expenses** → **Market** shocks and **operational** losses → Credit losses and **provisions**. PIT LGD and PD models
3 Forecasts of capital requirements	→ **Consistent** with projected **balance sheet** → **Risk parameters** (PD, LGD and EAD)
4 Solvency analysis	→ Available **capital base.** Profits and dividends → **Regulatory and legislative impacts** → **Capital and solvency ratios** → **Compliance** with capital **objectives**
5 Action plan	→ In the event of failure to comply with internal objectives or regulatory requirements

The structure presented facilitates attainment of the ultimate objective of capital planning, by turning it into an important strategic element for Grupo Santander which:

- Ensures current and future solvency, including in adverse economic scenarios.
- Ensures comprehensive capital management and incorporates an analysis of specific effects, facilitating their integration into the Group's strategic planning.
- Enables a more efficient use of capital.
- 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, under a framework that ensures that the governance is suitable and that all the elements that configure it are subject to adequate levels of questioning, review and analysis.

One of the key elements in capital planning and stress analysis exercises, due to its particular importance in projecting the income statement under defined adverse scenarios, consists of calculating the provisions that will be needed under these scenarios, mainly those that are produced to cover losses on credit portfolios. Specifically, in order to calculate loan-loss provisions, Grupo Santander uses a methodology that ensures at all times the level of provisions covers all loan losses projected by its internal models of expected loss, based on Exposure at Default (EAD), Probability of Default (PD) and Loss Given Default (LGD parameters).

This methodology is widely accepted and is similar to that used in the 2016 European Banking Authority (EBA) stress test, as well as in 2011 and 2014 and in the stress test on the Spanish banking industry in 2012.

Lastly, the capital planning and stress analysis process culminates with the analysis of solvency under different scenarios and over a defined time period, in order to assess capital sufficiency and ensure the Group meets its internally defined capital objectives as well as all regulatory requirements.

In the event that the capital objectives set are not met, an action plan will be drawn up which sets out the necessary measures to be able to attain the desired minimum capital. These measures are analysed and quantified as part of the internal exercises although it is not necessary to utilise them as the minimum capital thresholds are exceeded.

This internal process of stress and capital planning is carried out transversally throughout the Group, not only at the consolidated level, but also locally in the different units that comprise the Group, and which use the stress process and capital planning as an internal management tool and in response to their local regulatory requirements.

Grupo Santander has undergone six stress tests since the economic crisis in 2008, in which its strength and solvency has been demonstrated in the most extreme and severe macroeconomic scenarios. All of them showed that, thanks mainly to its business model and geographic diversification, Banco Santander would still be capable of generating profits for its shareholders and meeting the most demanding regulatory requirements.

In the first of them (CEBS 2010), Grupo Santander was the bank with the least impact on its solvency ratio, except for those banks that do not distribute dividends. In the second test, conducted 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 one with the highest level of profits.

In the stress exercises carried out by OIiver Wyman for Spanish Banks in 2012 (top down and then bottom up), Banco Santander again demonstrated its strength to face the most extreme scenarios with full solvency. It was the only bank that improved its core capital ratio, with an excess of capital over the minimum of more than €25 billion.

In the stress exercise conducted by the European Central Bank in 2014, in co-operation with the EBA, the Group was the bank with the least impact in the adverse scenario among its international competitors (capital surplus of around €20 billion above the minimum requirement).

The 2016 stress exercise, unlike previous ones, did not incorporate a minimum level of capital. It used the results as an additional variable within the Supervisory Review and Evaluation Process (SREP). Grupo Santander was the bank with the least capital destroyed among its peers. Its fully loaded CET1 capital ratio declined 199 b.p. (compared to an average fall of 335 b.p.).

The results of the various stress tests showed that the Group's business model, based on retail banking and geographic diversification, enables it to robustly confront the severest international crisis scenarios.

As well as the regulatory stress tests, Grupo Santander has conducted internal stress tests every year since 2008, within its capital self-evaluation process (Pilar II). In all of them, the Group's capacity to confront the most difficult exercises, both at the global level as well as in the countries in which it operates, has been demonstrated.

EBA transparency exercise 2017
In 2017, the European Banking Authority carried out a transparency exercise and published information on risk weighted assets (RWA), capital, solvency and details of sovereign positions at the end of 2016 and June 2017 for 132 banks in 25 European countries. The purpose of the exercise was to foster transparency and knowledge of European banks' capital and solvency, contributing to market discipline and to the European Union's financial stability. It is important to point out that the results did not include Grupo Santander's capital increase following the acquisition of Grupo Banco Popular, though Popular's RWAs were included. Including the capital increase, the CET1 ratio would have been 10.72%.

This report accompanied the November 2017 report on the risks and vulnerabilities of EU banks. The report concluded that banks have strengthened their positions, underpinned by a benign macroeconomic and financial environment, a better capital position and enhanced asset quality, as well as a slight increase in profitability. However, a greater effort is needed regarding management of non-performing loans and the long-term sustainability of business models remains a challenge. The importance of maintaining robust technological infrastructures and operational strength are also priorities.

1.5 Recovery and Resolution Plans and Special Situations Management Framework

This section summarises the main advances in the sphere of the Group's crisis management. Specifically, the main principles developed regarding Recovery Plans, Resolution Plans and the management framework governing special situations.

1.5.1. Recovery Plans

Context. The eighth version of the Corporate Recovery Plan was prepared in 2017. Its most important part sets out the measures that Banco Santander would have at its disposal to survive a very severe crisis on its own.

Two of the most important objectives are, first, to test the feasibility, effectiveness and credibility of the recovery measures identified and, second, the degree of suitability of the recovery indicators and their respective thresholds that if surpassed entail activating the scaling of decision-making in order to cope with stress situations.

With this end, the Corporate Plan sets out different macroeconomic and/or financial crisis scenarios in which idiosyncratic and/or systemic events important for the Group which could entail activating the Plan are envisaged. Moreover, the Plan has been designed with the premise that, if activated, there would be no extraordinary public aid, in accordance with article 5.3 of the BRRD.

It is important to point out that the Plan should not be interpreted as an instrument independent of the rest of the structural mechanisms established to measure, manage and supervise the risk assumed by Grupo Santander. The Plan is integrated with the following tools, among others: the Risk Appetite Framework (RAF); the Risk Appetite Statement (RAS); the Risk Identification Assessment (RIA), the Business Continuity Management System (BCMS) and the internal processes for assessing the sufficiency of capital and liquidity (ICAAP and ILAAP). The Plan is also integrated into the Group's strategic plans.

Evolution in 2017. We continued the improvement work in line with the European regulator's requirements and expectations and the industry's best practices. Specifically, the following were included: (i) in the Strategic Analysis chapter, greater detail and granularity regarding internal and external interdependencies; (ii) in the Governance section, the advances made in conducting stress simulation exercises , defining macroeconomic and political risk Early Warning Indicators (EWIs), which are regularly monitored at the corporate level for the Group's main countries were reflected and, and describing the development, review and approval processes of the corporate and local plans; (iii) the Scenarios section incorporates two systemic scenarios (global and local), specifically designed for recovery as their objective is to break the red threshold of, at least, one indicator which would entail potential activation of the Corporate Plan. There is also an analysis of the potential reputational implications in the idiosyncratic and local-systemic scenarios; (iv) in the Measures section, the feasibility analysis was completed for each measure with greater granularity and detail regarding the assumptions and hypotheses behind calibrating the recovery capacity as well as the necessary preparatory measures to execute them on time and credibly.

The main **conclusions** extracted from analysing the contents of the 2017 Corporate Plan confirm that:

- There are no material interdependencies between the Group's different countries.
- The measures available ensure an ample recovery capacity in all the scenarios raised in the Plan. Moreover, the Group's geographic diversification model is a point in its favour from the recovery perspective.
- Each subsidiary has sufficient capacity to emerge by its own means from a recovery situation, which increases the strength of the Group's model, based on subsidiaries that are autonomous in terms of capital and liquidity.
- None of the subsidiaries, in the event of serious financial problems or solvency, can be considered as sufficiently relevant to surpass the severest levels established for the recovery indicators and which could result in activating the Corporate Plan.
- The Group has sufficient mitigation mechanisms to minimise the negative economic impact from potential damage to its reputation in different stress scenario.

All of these factors underscore that the Group's model and geographic diversification strategy, based on a model of subsidiaries autonomous in liquidity and capital, continues to be strong from a recovery perspective.

Regulation and governance. The Plan was developed in accordance with the current EU regulation[1]. The Plan also follows the non-binding recommendations made by international bodies such as the Financial Stability Board (FSB[2]).

As in previous versions, the Group's Plan was presented in September to the Single Supervisory Body. As of then the EBA has six months to make formal considerations.

The Group's Plan comprises both the Corporate Plan (which corresponds to Banco Santander) as well as local plans for its main countries (UK, Brazil, Mexico, US, Germany, Argentina, Chile, Poland and Portugal), which are annexed to the Corporate Plan. It is important to mention that, except for Chile, all countries have to draw up a local plan as a local regulatory requirement as well as the corporate requirement to do so.

The Board of Banco Santander approves the Corporate Plan, though the content and relevant figures are previously presented and discussed in the Bank's main management and control committees (Capital Committee, Global ALCO and the Risk Supervision, Regulation and Compliance Committee). The Local Plans are approved by the corresponding local bodies and always in coordination with Grupo Santander, as they must form part of the Group Plan (as they are annexed to the Corporate Plan).

1.5.2. Resolution plans

Grupo Santander continues to cooperate with the relevant authorities in preparing resolution plans, providing all the information they request.

The authorities that form part of the Crisis Management Group (CMG) maintained their decision on the strategy to follow for the resolution of Grupo Santander: the Multiple Point of Entry (MPE)[3].

This strategy is based on the legal and business structure with which Grupo Santander operates, organised into nine "Resolution Groups" which can be resolved independently without involving other parts of the Group.

In March 2017, the Single Resolution Board (SRB) communicated the preferred resolution strategy as well as the priorities of work for improving the Group's resolvability.

The Group continued to advance in the projects to improve its resolvability, defining four lines of action:

1) Ensure the Group has a sufficient buffer of instruments with loss absorption capacity.

The Bank issued €13 billion of senior non-preferred debt in 2017 which absorbs losses before any senior debt.

In addition, in order to avoid legal uncertainties when executing a bail-in, all MREL/TLAC issuance contracts include a clause where the holder recognises the capacity of the resolution authority bail-in said instrument.

Lastly, and again to avoid any type of legal uncertainty when bailing-in issuances, the issuing companies have been merged with the parent company so that as of 2018 the direct issuer is the parent company[4].

2) Ensure that there are information systems that can quickly provide high quality necessary information in the event of resolution.

In 2017, we worked on automating the information on liabilities that could be the object of a bail-in in the event of resolution.

Furthermore, we are working on automating the rest of the information that is delivered to the resolution authority and used for drawing up the Resolution Plan.

1. Directive 2014/59/EU (Directive of the European Union on crisis management); prevailing regulation of the European Banking Authority in matters of recovery plans (EBA/RTS/2014/11; EBA/GL/2014/06; EBA/GL/2015/02); recommendations of the European Banking Authority to the European Commission on key business lines and critical functions (EBA/op/2015/05); regulation of the European Banking Authority pending approval (EBA/CP/2015/01 on ITS templates for recovery plans); regulation of the European Banking Authority not directly related with recovery, but with significant implications in this sphere (EBA/GL/2015/03 on factors triggering early intervention measures); as well as Spanish regulations: Law 11/2015, on recovery and resolution of credit institutions and investment service companies and Royal Decree 1012/2015 which develops this Law.
2. FSB Elements key for effective resolution systems for financial institutions (15 October 2014, updating of the first publication in October 2011), guidelines for identifying critical functions and shared critical services (15 July 2013) and guidelines on elements triggering recovery and crisis scenarios (July 15 2013).
3. Except for what has been stated, the drawing up of resolution plans in the US corresponds to the individual entities. In December 2015, Grupo Santander delivered the third version of its local resolution plans, although the FRB and the FDIC said it must not submit plans for 2016 and 2017 as they were in the process of supplying comments on the previous plans and beginning to give a guide for the plans to be delivered in 2018..
4. Except for two issuers of structured debt, which at December 2016 accounted for €2 billion out of €25 billion total issuance.

Both process are expected to be automated during the first quarter of 2018.

Projects were also launched to have data repositories on:

1. Legal entities that form part of Grupo Santander
2. Critical suppliers.
3. Critical infrastructure.
4. Financial contracts in accordance with article 71.7 of the BRRD

3) Guarantee operational continuity in resolution situations
The operational continuity clauses were reinforced in the contracts with internal suppliers and the clauses to be included in external supplier contracts are being analysed.

A survey of the main market infrastructures on which Grupo Santander depends was launched in order to understand their policies in the event that one of the member entities of this infrastructure were to enter into resolution.

Lastly, contingency plans are expected to be developed in 2018 to cover an infrastructure which ceases providing service in the event of resolution.

4) Foster a culture of resolvability in the Group
Progress was made in involving senior management by raising questions regarding the resolvability of Grupo Santander to the Board and the creation of a Steering Committee specialised in resolution issues.

Advances are expected to be made in 2018 in developing tools that help to identify the potential obstacles to resolution and assess the impact of management decisions on the Bank's resolvability.

More emphasis will be placed on training throughout the organisation in these issues in order to generate greater awareness.

1.5.3. Special Situations Management Framework

As regards governance in crisis situations, the Special Situations Management Framework was formally approved in 2016, both in the corporation as well as in the Group's main countries.

This framework has a holistic nature, resulting from its application to those special events or situations of any type in which there is an exceptional situation, different from that expected or from those which arise from ordinary businesses management, and which could compromise the development of activity or give rise to a serious deterioration of the entity's or the Group's financial situation, as it would mean a significant distancing from the risk appetite and defined limits.

The main elements of this framework are:

1. It defines a series of common crisis indicators.

2. It defines a traffic light code on the basis of the degree of deterioration or risk of deterioration of the financial situation consistent with the limits used in daily business as usual management.

3. It defines a Crisis Manager Director who coordinates the response to a crisis situation.

4. It identifies personnel in charge of alerting and escalating crisis events.

5. It creates a high level Crisis Committee backed by a Technical Crisis Committee.

In 2017, progress was made in implementing the framework in order to attain a homogeneous level of development in the Group's main subsidiaries and promote adherence of new countries.

Moreover, progress was also made in developing instruments to facilitate rapid and effective crisis management (e.g. automation of communications in special situations, having specific rooms prepared for crisis management, etc) and in strengthening the awareness and training of employees and the Group's governance bodies involved in the escalation and management of this type of situation, mainly by preparing and conducting war games.

1.6 Total Loss Absorbing Capacity (TLAC) y Minimum Required Eligible Liabilities (MREL)

On 9 November 2015, the FSB published its final principles and term sheet containing an international standard to enhance the loss absorbing capacity of G-SIIs.

The final standard consists of an elaboration of the principles on loss absorbing and recapitalisation capacity of G-SIIs in resolution and a term sheet setting out a proposal for the implementation of these proposals in the form of an internationally agreed standard on total loss absorbing capacity ("TLAC") for G-SIIs. Once implemented in the relevant jurisdictions, these principles and terms will form a new minimum TLAC standard for G-SIIs, and in the case of G-SIIs with more than one resolution group, each resolution group within the G-SII. The FSB will undertake a review of the technical implementation of the TLAC principles and term sheet by the end of 2019.

The TLAC principles and term sheet require a minimum TLAC requirement to be determined individually for each G-SII at the greater of (a) 16% of risk weighted assets as of 1 January 2019 and 18% as of 1 January 2022, and (b) 6% of the Basel III Tier 1 leverage ratio exposure measure as of 1 January 2019, and 6.75% as of 1 January 2022.

Furthermore, BRRD provides that Member States shall ensure that institutions meet, at all times, a minimum requirement for own funds and eligible liabilities ("MREL"). The MREL shall be calculated as the amount of own funds and eligible liabilities expressed as a percentage of the total liabilities and own funds of the institution. The MREL requirement was scheduled to come into force by January 2016. However, resolution authorities were given discretion to determine appropriate transitional periods to each institution.

The European Commission committed to review the existing MREL rules with a view to provide full consistency with the TLAC standard. The European Commission's proposals dated 23 November 2016 to amend BRRD and CRR aimed to implement the TLAC standard and to integrate the TLAC requirement into the general MREL rules thereby avoiding duplication from the application of two parallel requirements. As mentioned above, although TLAC and MREL pursue the same regulatory objective, there are, nevertheless, some differences between them in the way they are constructed.

The European Commission is proposing to integrate the TLAC standard into the existing MREL rules and to ensure that both requirements are met with largely similar instruments, with the exception of the subordination requirement, which will be institution-specific and determined by the resolution authority. Under these proposals, institutions such as Banco Santander would continue to be subject to an institution-specific MREL requirement (i.e., a Pillar II add-on MREL Requirement), which may be higher than the requirement of the TLAC standard (which would be implemented as a Pillar I MREL requirement for G-SIIs).

The European Commission's proposals require the introduction of limited adjustments to the existing MREL rules ensuring technical consistency with the structure of any requirements for G-SIIs. In particular, technical amendments to the existing rules on MREL are needed to align them with the TLAC standard regarding, inter alia, the denominators used for measuring loss-absorbing capacity, the interaction with capital buffer requirements, disclosure of risks to investors, and their application in relation to different resolution strategies. Implementation of the TLAC/MREL Requirements is expected to be phased-in from 1 January 2019 (a 16% minimum TLAC requirement) to 1 January 2022 (an 18% minimum TLAC requirement).

Additionally, the European Commission's Proposals dated 23 November 2016 include a proposal for a European Directive amending BRRD that would create a new asset class of non-preferred senior debt that should only be bailed-in after capital instruments but before other senior liabilities. On 27 December 2017, Directive 2017/2399 of the European Parliament and of the Council of 12 December 2017 amending Directive 2014/59/EU as regards the ranking of unsecured debt instruments in insolvency hierarchy, was published in the Official Journal of the European Union. Before that, Royal Decree-law 11/2017, of 23 June, on urgent measures in financial matters created in Spain the new category of senior non-preferred debt.

The final texts are expected to be approved in 2018 and come into force in 2019.

During 2018/2019 we expect the relevant authorities to inform us for the first time of the MREL requirement for the Group on the basis of the prevailing legislation (BRRD).

From 2019, the minimum requirement established in the CRR will apply to us, though the resolution authority will be able to set higher levels based on resolvability considerations.

DESCRIPTION OF BUSINESSES

In 2017 Grupo Santander maintained the same general criteria applied in 2016, as well as the business segments, with the following exceptions:

- In the second quarter of 2016, and in order to make it comparable with the same period of 2015, the contribution to the Single Resolution Fund (SRF) of €120 million net was reclassified to "Net capital gains and provisions" from "Other operating results." In the fourth quarter, this reclassification was reversed. In the information presented here, and in order to facilitate the quarterly comparison, the contribution to the SRF is recorded in "Other operating results". This change affects the composition of the consolidated Group accounts, Spain, Santander Consumer Finance and Portugal, but not the attributable profit.
- Assigning to the various countries and global segments the capital gains and non-recurring provisions that were being presented in the Corporate Centre. They relate to the second and fourth quarters of 2016 and affect the attributable profit of the units of Spain (-€216 million), Santander Consumer Finance (+€25 million), Poland (+€29 million), United Kingdom (-€30 million), United States (-€32 million) and, as a counterpart of all of them, the Corporate Centre itself (+€231 million). The Group's total attributable profit does not change.
- Annual adjustment of the perimeter of the Global Customer Relationship Model between Retail Banking and Santander Global Corporate Banking. This change has no impact on the geographic businesses.

The financial statements of each business unit have been drawn up by aggregating the Group's basic operating units. The information relates to both the accounting data of the units integrated 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:

Geographic businesses. The operating units are segmented by geographical areas. This coincides with the Group's first level of management and reflects Santander's positioning in the world's three main currency areas (euro, sterling and dollar). The segments reported on are:

- **Continental Europe**. This covers all businesses in the area. 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 the businesses developed by the Group's various units and branches in the country.
- **Latin America**. This embraces all the Group's financial activities conducted via its banks and subsidiaries in the region. The financial statements of Brazil, Mexico and Chile are set out.
- **United States.** Includes the holding Santander Holdings USA (SHUSA) and its subsidiaries Santander Bank, Banco Santander Puerto Rico, Santander Consumer USA, Banco Santander International, Santander Investment Securities and the New York branch.

Global businesses. The activity of the operating units is distributed by the type of business: Retail Banking, Santander Global Corporate Banking and Spain Real Estate Activity.

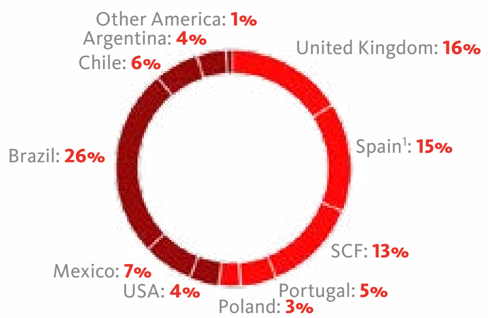
- **Retail Banking**. This covers all customer banking businesses, including consumer finance, except those of corporate banking, which are managed through the Global Customer Relationship Model. The results of the hedging positions in each country are also included, conducted within the sphere of each one's Assets and Liabilities Committee.
- **Santander Global Corporate Banking (SGCB)**. This business reflects the revenues from global corporate banking, investment banking and markets worldwide including treasuries managed globally (always after the appropriate distribution with commercial banking customers), as well as equities business.

The acquired perimeter of Banco Popular is temporarily presented separately.

In addition to these operating units, which report by geographic area and by businesses, the Group continues to maintain the area of **Corporate Centre.** This area incorporates the centralised activities relating to equity stakes in financial companies, financial management of the structural exchange rate position, assumed within the sphere of the Group's Assets and Liabilities Committee, as well as management of liquidity and of shareholders' equity via issues.

As the Group's holding entity, this area manages all capital and reserves and allocations of capital and liquidity with the rest of businesses. 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.

DISTRIBUTION OF UNDERLYING ATTRIBUTABLE PROFIT BY GEOGRAPHICAL BUSINESS*
2017



(1) Including Popular: 3%

(*) As a percentage of operating areas excluding Corporate Centre and Real Estate Activity in Spain

The figures of the Group's various units have been drawn up in accordance with these criteria, and so do not coincide individually with those published by each unit.

NET OPERATING INCOME

(€ million)	2017	2016	Change amount	%	% excl. FX
Continental Europe	**6,338**	**6,025**	**313**	**5.2**	**4.9**
o/w: Spain	2,434	2,311	123	5.3	5.3
Santander Consumer Finance	2,506	2,357	148	6.3	6.2
Poland	814	735	79	10.8	8.1
Portugal	595	620	(25)	(4.0)	(4.0)
United Kingdom	**2,855**	**2,850**	**6**	**0.2**	**7.4**
Latin America	**13,779**	**11,073**	**2,706**	**24.4**	**20.6**
o/w: Brazil	9,193	6,845	2,348	34.3	26.0
Mexico	2,078	1,928	150	7.8	11.2
Chile	1,498	1,435	63	4.4	2.1
USA	**3,761**	**4,334**	**(573)**	**(13.2)**	**(11.6)**
Operating areas	**26,734**	**24,282**	**2,452**	**10.1**	**9.7**
Corporate Centre	(1,696)	(1,516)	(180)	11.9	11.9
Total Group (Excl. Popular)	25,038	22,766	2,272	10.0	9.5
Popular	**436**	**(0)**	**436**		
Total Group	**25,473**	**22,766**	**2,708**	**11.9**	**11.4**

ATTRIBUTABLE PROFIT TO THE GROUP

(€ million)	2017	2016	Change amount	%	% excl. FX
Continental Europe*	**2,953**	**2,599**	**354**	**13.6**	**13.4**
o/w: Spain*	1,180	1,022	157	15.4	15.4
Santander Consumer Finance*	1,254	1,093	161	14.7	14.6
Poland*	300	272	28	10.4	7.7
Portugal	440	399	41	10.2	10.2
United Kingdom*	**1,498**	**1,681**	**(183)**	**(10.9)**	**(4.4)**
Latin America	**4,284**	**3,386**	**898**	**26.5**	**24.0**
o/w: Brazil	2,544	1,786	758	42.5	33.7
Mexico	710	629	81	12.9	16.5
Chile	586	513	72	14.1	11.7
USA*	**408**	**395**	**13**	**3.2**	**5.2**
Operating areas*	**9,143**	**8,060**	**1,082**	**13.4**	**14.1**
Corporate Centre*	(1,889)	(1,439)	(450)	31.3	31.3
Total Group (Excl. Popular)*	7,253	6,621	632	9.5	10.3
Popular*	**263**	**(0)**	**263**		
Total Group*	**7,516**	**6,621**	**895**	**13.5**	**14.3**
Net capital gains and provisions	(897)	(417)	(480)	115.2	117.0
Total Group	**6,619**	**6,204**	**415**	**6.7**	**7.4**

(*) In the units, underlying attributable profit (excluding net capital gains and provisions)

GROSS LOANS EXCLUDING REPOS

(€ million)	2017	2016	Change amount	%	% excl. FX
Continental Europe	**307,340**	**302,564**	**4,776**	**1.6**	**1.6**
o/w: Spain	148,585	150,960	(2,375)	(1.6)	(1.6)
Santander Consumer Finance	92,431	87,742	4,688	5.3	6.2
Poland	22,974	20,697	2,277	11.0	5.1
Portugal	31,296	29,030	2,266	7.8	7.8
United Kingdom	**235,783**	**242,510**	**(6,727)**	**(2.8)**	**0.8**
Latin America	**151,542**	**159,134**	**(7,593)**	**(4.8)**	**6.7**
o/w: Brazil	74,341	80,306	(5,965)	(7.4)	7.2
Mexico	26,962	28,017	(1,055)	(3.8)	4.6
Chile	38,249	38,800	(551)	(1.4)	2.7
USA	**75,389**	**89,638**	**(14,249)**	**(15.9)**	**(4.3)**
Operating areas	**770,054**	**793,847**	**(23,793)**	**(3.0)**	**1.7**
Total Group (Excl. Popular)	774,443	798,312	(23,869)	(3.0)	1.7
Popular	**79,533**		**79,533**		
Total Group	**853,976**	**798,312**	**55,664**	**7.0**	**12.1**

FUNDS (DEPOSITS EXCLUDING REPOS + MUTUAL FUNDS)

(€ million)	2017	2016	Change amount	%	% excl. FX
Continental Europe	**352,726**	**322,606**	**30,120**	**9.3**	**9.0**
o/w: Spain	251,196	224,798	26,398	11.7	11.7
Santander Consumer Finance	35,398	35,052	346	1.0	1.7
Poland	27,803	25,898	1,905	7.4	1.7
Portugal	32,213	31,438	775	2.5	2.5
United Kingdom	**210,305**	**210,611**	**(306)**	**(0.1)**	**3.5**
Latin America	**193,264**	**187,516**	**5,749**	**3.1**	**16.4**
o/w: Brazil	106,959	99,771	7,188	7.2	24.2
Mexico	35,548	36,438	(890)	(2.4)	6.0
Chile	33,104	34,559	(1,455)	(4.2)	(0.2)
USA	**59,329**	**74,166**	**(14,837)**	**(20.0)**	**(9.0)**
Operating areas	**815,624**	**794,899**	**20,725**	**2.6**	**7.6**
Total Group (Excl. Popular)	815,849	795,757	20,092	2.5	7.5
Popular	**74,286**		**74,286**		
Total Group	**890,135**	**795,757**	**94,378**	**11.9**	**17.3**

CONTINENTAL EUROPE (Excl. POPULAR)

(€ million)

Income statement	2017	2016	Change amount	%	% excl. FX
Net interest income	8,267	8,161	107	1.3	1.0
Net fee income	3,882	3,497	385	11.0	10.7
Gains (losses) on financial transactions	625	818	(192)	(23.5)	(23.7)
Other operating income	379	330	48	14.6	15.4
Gross income	**13,154**	**12,806**	**348**	**2.7**	**2.5**
Operating expenses	(6,815)	(6,781)	(35)	0.5	0.3
General administrative expenses	(6,343)	(6,342)	(1)	0.0	(0.2)
Personnel	(3,277)	(3,257)	(20)	0.6	0.4
Other general administrative expenses	(3,066)	(3,085)	19	(0.6)	(0.8)
Depreciation and amortisation	(472)	(439)	(34)	7.7	7.3
Net operating income	**6,338**	**6,025**	**313**	**5.2**	**4.9**
Net loan-loss provisions	(995)	(1,342)	348	(25.9)	(26.1)
Other income	(726)	(671)	(55)	8.2	7.9
Underlying profit before taxes	**4,617**	**4,012**	**605**	**15.1**	**14.7**
Tax on profit	(1,283)	(1,083)	(200)	18.4	18.1
Underlying profit from continuing operations	**3,334**	**2,929**	**406**	**13.9**	**13.5**
Net profit from discontinued operations	—	—	—	—	—
Underlying consolidated profit	**3,334**	**2,929**	**406**	**13.9**	**13.5**
Minority interests	381	330	51	15.5	14.4
Underlying attributable profit to the Group	**2,953**	**2,599**	**354**	**13.6**	**13.4**
Net capital gains and provisions*	(85)	(169)	84	(49.5)	(49.3)
Attributable profit to the Group	**2,868**	**2,430**	**438**	**18.0**	**17.7**

In 2017, integration costs in Germany In 2016, capital gains from the disposal of the stake in VISA Europe.

Balance sheet	2017	2016	Change amount	%	% excl. FX
Customer loans	307,339	297,214	10,125	3.4	3.5
Cash, central banks and credit institutions	114,658	77,232	37,426	48.5	49.0
Debt securities	82,893	80,639	2,254	2.8	2.5
o/w: available for sale	*56,820*	*54,474*	*2,346*	*4.3*	*3.9*
Other financial assets	38,234	40,689	(2,455)	(6.0)	(6.0)
Other assets	26,300	24,360	1,940	8.0	8.6
Total assets	**569,424**	**520,134**	**49,290**	**9.5**	**9.6**
Customer deposits	289,605	269,934	19,671	7.3	7.0
Central banks and credit institutions	135,901	105,152	30,749	29.2	30.2
Debt securities issued	50,704	53,064	(2,360)	(4.4)	(4.0)
Other financial liabilities	43,558	49,042	(5,485)	(11.2)	(11.2)
Other liabilities	13,713	9,452	4,261	45.1	44.7
Total liabilities	**533,480**	**486,644**	**46,836**	**9.6**	**9.7**
Total equity	**35,944**	**33,490**	**2,454**	**7.3**	**7.4**
Other managed and marketed customer funds	**85,557**	**73,624**	**11,933**	**16.2**	**16.1**
Mutual funds	64,401	54,010	10,390	19.2	18.9
Pension funds	11,566	11,298	268	2.4	2.4
Managed portfolios	9,590	8,316	1,274	15.3	16.8
Pro memoria:					
Loans excluding repos	307,340	302,564	4,776	1.6	1.6
Funds (customer deposits excluding repos + mutual funds)	352,726	322,606	30,120	9.3	9.0

Ratios (%) and operating means	2017	2016	Change amount	%
Underlying RoTE	9.83	8.51	1.32	
Efficiency ratio (with amortisations)	51.8	52.9	(1.1)	
NPL ratio	4.50	5.92	(1.42)	
NPL coverage	58.0	60.0	(2.0)	
Number of employees	56,640	57,259	(619)	(1.1)
Number of branches	4,538	4,805	(267)	(5.6)

CONTINENTAL EUROPE*

2017 highlights

€2,868 M
Attributable profit

Sustained economic recovery with GDP growth
Santander continued to improve customer loyalty and grow number of digital customers
Higher business volumes and lower NPL ratios, with the consequent fall in the cost of credit
Underlying profit rose 13% to €2,953 million, increasing in all units

* Changes in constant currency

Strategy

In an environment of particularly low interest rates, the Bank continued to focus on improving customer loyalty, gaining market share, controlling costs and enhancing credit quality. We also continued to enhance the customer experience and boost efficiency via the digital transformation, streamlining processes and marketing innovative products.

As a result, the number of loyal customers rose 18%, driven by both individuals (+20%) as well as SMEs and companies (+8%). The greater loyalty fuelled growth in fee income (+11% excluding acquisitions). The digital strategy increased the number of these customers by 11% (big rises in many countries).

2017 was also an important year in terms of inorganic growth. Of note was the incorporation of Banco Popular, the 50% acquisition of Santander Asset Management and the agreement to acquire the retail business and private banking of Deutsche Bank in Poland, which will become effective in 2018 after receiving the necessary authorisations. Banco Popular's acquisition made Banco Santander Totta the largest private sector bank in Portugal and enabled Banco Santander to recover the leadership in Spain.

Activity (figures excluding Popular)

Lending rose 2%, with all units growing except Spain (-1.6%) due to institutional balances. Of note was Portugal whose loans had declined in previous years, but at the end of 2017 and thanks to the increase in the institutional segment, recorded growth of 8%. Poland's increased 5% due to SMEs, and SCF's 6%, spurred by auto finance.

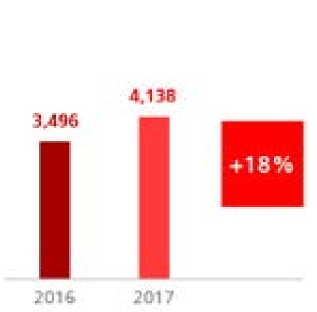
Funds increased 9%. Deposits and mutual funds rose in all units.

Results (figures excluding Popular)

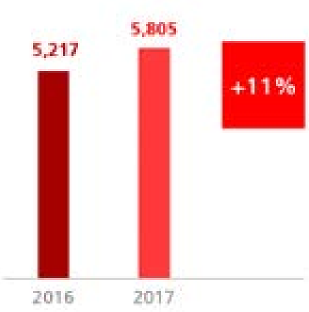
Continental Europe posted a profit of €2,868 million (+18%). The drivers were fee income (+11%), reflecting the greater customer loyalty, and a 26% fall in loan-loss provisions. The improvement was due to a dynamic that can be seen in the core units and which reflects the better NPL ratios and lower cost of credit. Net interest income was flat, affected by interest rates at historic lows.

All units increased their underlying profit and at double-digit rates in Spain, SCF and Portugal, to a lesser extent in Poland, affected by higher tax and regulatory impacts.

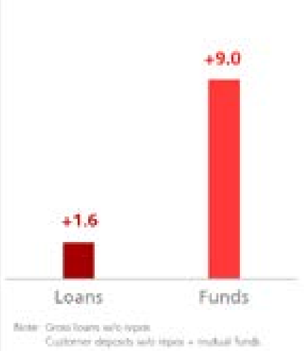
LOYAL CUSTOMERS
Thousands



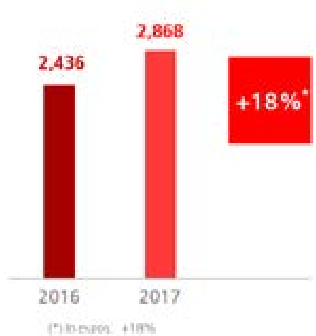
DIGITAL CUSTOMERS
Thousands



ACTIVITY PERFORMANCE
% change 2017 / 2016 (excl. FX)



ATTRIBUTABLE PROFIT
Constant € million



SPAIN (Excl. POPULAR)

(€ million)

Income statement	2017	2016	Change amount	%
Net interest income	2,909	3,077	(169)	(5.5)
Net fee income	2,067	1,781	287	16.1
Gains (losses) on financial transactions	429	595	(167)	(28.0)
Other operating income	289	155	135	87.0
Gross income	**5,694**	**5,608**	**86**	**1.5**
Operating expenses	(3,259)	(3,297)	37	(1.1)
General administrative expenses	(3,080)	(3,156)	77	(2.4)
Personnel	(1,597)	(1,632)	35	(2.1)
Other general administrative expenses	(1,482)	(1,524)	42	(2.7)
Depreciation and amortisation	(180)	(140)	(39)	28.1
Net operating income	**2,434**	**2,311**	**123**	**5.3**
Net loan-loss provisions	(513)	(585)	72	(12.3)
Other income	(207)	(267)	60	(22.6)
Underlying profit before taxes	**1,714**	**1,459**	**255**	**17.5**
Tax on profit	(518)	(416)	(102)	24.4
Underlying profit from continuing operations	**1,197**	**1,043**	**153**	**14.7**
Net profit from discontinued operations	—	—	—	—
Underlying consolidated profit	**1,197**	**1,043**	**153**	**14.7**
Minority interests	17	21	(4)	(18.2)
Underlying attributable profit to the Group	1,180	1,022	157	15.4
Net capital gains and provisions*	—	(216)	216	(100.0)
Attributable profit to the Group	**1,180**	**806**	**374**	**46.4**

(*) In 2016, capital gains from the disposal of the stake in VISA Europe and restructuring costs.

Balance sheet	2017	2016	Change amount	%
Customer loans	153,632	152,850	782	0.5
Cash, central banks and credit institutions	89,585	54,207	35,378	65.3
Debt securities	61,836	58,084	3,752	6.5
o/w: available for sale	*42,780*	*38,727*	*4,054*	*10.5*
Other financial assets	35,391	37,741	(2,350)	(6.2)
Other assets	10,354	9,473	881	9.3
Total assets	**350,798**	**312,354**	**38,444**	**12.3**
Customer deposits	193,639	176,779	16,860	9.5
Central banks and credit institutions	79,146	52,071	27,075	52.0
Debt securities issued	16,713	20,863	(4,150)	(19.9)
Other financial liabilities	41,168	46,951	(5,784)	(12.3)
Other liabilities	7,883	4,186	3,697	88.3
Total liabilities	**338,549**	**300,850**	**37,699**	**12.5**
Total equity	**12,249**	**11,504**	**744**	**6.5**
Other managed and marketed customer funds	**77,221**	**66,649**	**10,572**	**15.9**
Mutual funds	58,438	49,357	9,080	18.4
Pension funds	10,563	10,359	203	2.0
Managed portfolios	8,221	6,932	1,288	18.6
Pro memoria:				
Loans excluding repos	148,585	150,960	(2,375)	(1.6)
Funds (customer deposits excluding repos + mutual funds)	251,196	224,798	26,398	11.7

Ratios (%) and operating means	2017	2016	Change amount	%
Underlying RoTE	10.11	8.88	1.22	
Efficiency ratio (with amortisations)	57.2	58.8	(1.5)	
NPL ratio	4.72	5.41	(0.69)	
NPL coverage	45.9	48.3	(2.4)	
Number of employees	22,916	23,017	(101)	(0.4)
Number of branches	2,843	2,911	(68)	(2.3)

SPAIN*

2017 highlights

€1,180 M
Attributable profit

Our loyalty and customer-focused strategy produced a 42% rise in loyal customers, enhanced satisfaction and gains in market share
Ongoing digital transformation of the customer relationship model, strengthening digital capacities in all channels, and launch of *Digilosofía*. Growth of 15% in digital customers and leadership in the mobile phone payments market
Attributable profit increased 46%, thanks to growth in gross income spurred by fee income, lower costs and reduced loan-loss provisions

* Excl. Popular

Strategy

Our commercial strategy is mainly focused on reinforcing customer loyalty and experience, through the digital transformation.

The number of loyal customers increased 54%, underpinned by the *1l2l3* strategy and the new means of payment strategy, and with market share gains in all the main products (mortgages and companies).

The most notable developments included:

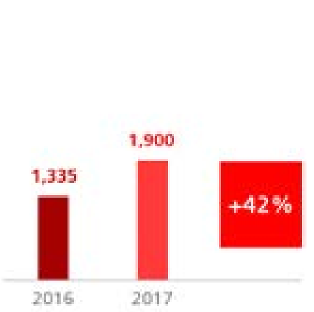
- Within the *1*|*2*|*3* strategy, we completed the commercial offer with the launch of the *Smart* account for millenial customers and the 100% digital and no-fee *Zero* account, which already has more than 2.6 million customers.
- We bolstered transactions with record sales in cards, with more than 1.4 million units issued and an over 50% increase in the turnover of credit.

Of note in companies was growth in business with SMEs, with market share gains, enhanced customer quality and a greater focus on value-added and short-term products. This resulted in a gain of 38 b.p. in lending, with international business increasing 16% and the commercial portfolio 12%.

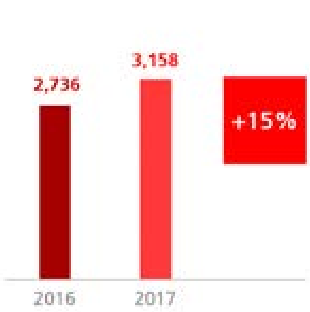
We remained very committed to the Bank's digital transformation. In this context, the launch of *Digilosofia* enables us to add value to our digital capacities, with significant advances on the transformation process:

- We reached 3.2 million digital customers (+15%) and grew mobile phone customers by 40%.
- We are market leaders in mobile payments, with a market share of around 60% and pioneers in the launching of an international payments solution based on distributed ledger technology.
- Continued improvement in key processes such as the opening of accounts, granting loans, insurance and international payments. Remote channels give us the possibility to contract all our products online. Sales through digital channels account for 25% of the total.
- Launch of a new website and app for both individuals and companies, with new solutions such as the *Confirming* app that facilitates treasury management for customers and non-customers with just three clicks and the *Bansacar* app.

LOYAL CUSTOMERS
Thousands

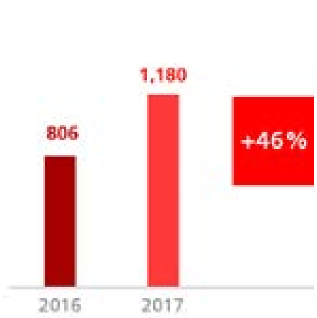


DIGITAL CUSTOMERS
Thousands



ACTIVITY PERFORMANCE
% change 2017 / 2016

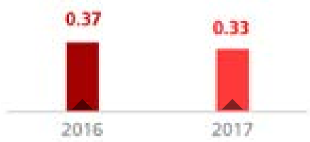
ATTRIBUTABLE PROFIT
€ million



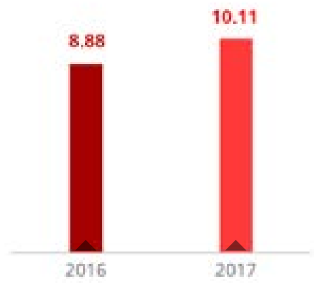
NPL RATIO
%

COVERAGE RATIO
%

COST OF CREDIT
%



UNDERLYING RoTE
%



- We remain the leader in quality in our contact centre.
- By the end of the year, 500 branches of the *SmartRed* network had undergone a digital transformation: digitally integrated, intelligent, simple and accessible.
- *The Banker* recognised Santander Espanha as the Best Bank in Spain and the Best Private Bank.

Activity

- Solid commercial dynamics with excellent performance of loans. New lending rose 13%, with all segments doing well, mainly individuals (+24%) and SMEs (+13%).
- Mortgages surged 33% and the commercial portfolio 12%, with activity in all segments.
- Commercial and retail banking lending increased and was particularly positive to SMEs and companies which rose €1,600 million. The growth in consumer credit, SMEs and other products neutralised the lower mortgage balances.
- Solid structure of funding and liquidity in funds, bolstered by sustained growth in customer funds (+12%). Time deposits gave way to demand deposits (+19%).

Mutual funds rose 18%, spurred by positive and sustained net inflows every month.

Results

Attributable profit was 46% higher at €1,180 million due to the positive evolution in fee income, containment of costs and reduced needs for provisions, which offset the pressure on net interest income and gains on financial transactions.

- Net interest income continued to be impacted by low interest rates, the repricing of loans and competitive pressure in prices.
- Fee income rose 16%, notably that from means of payment and customer transactions as well as from wholesale banking. Gross income inched up 2%.
- Operating expenses were 1% lower, after absorbing the costs related to the launch of Openbank, the perimeter impact from integrating a firm which manages POS terminals and IT amortisation. This was thanks to the efficiency plans of previous years. The cost-to-income efficiency was 57%.
- Provisions continued to normalise and the cost of credit to decline (to 0.33%).

Sustained improvement in the risk profile. The NPL ratio fell to 4.72%, 70 bp less than in 2016.

Strategy in 2018

Secure our leadership in Spain, following the acquisition of Popular and combining the best of both banks
Strengthen our competitive advantage as the reference bank in SMEs with high value-added products, while remaining the leader in wholesale banking and large companies
Increase customer loyalty, maintaining the 1l2l3 strategy as the driver to enhance the customer relation and satisfaction
Continue to advance in the digital transformation
Maintain sustainable profitability with a model based on advanced risk management, capital planning and liquidity management

SANTANDER CONSUMER FINANCE

(€ million)

Income statement	2017	2016	Change amount	%	% excl. FX
Net interest income	3,571	3,391	180	5.3	5.2
Net fee income	878	862	16	1.9	1.8
Gains (losses) on financial transactions	3	(14)	17	—	—
Other operating income	32	23	9	41.0	45.8
Gross income	**4,484**	**4,262**	**222**	**5.2**	**5.1**
Operating expenses	(1,978)	(1,904)	(74)	3.9	3.8
General administrative expenses	(1,798)	(1,719)	(79)	4.6	4.5
Personnel	(848)	(810)	(38)	4.7	4.6
Other general administrative expenses	(951)	(910)	(41)	4.5	4.4
Depreciation and amortisation	(180)	(185)	6	(3.0)	(3.1)
Net operating income	**2,506**	**2,357**	**148**	**6.3**	**6.2**
Net loan-loss provisions	(266)	(387)	121	(31.4)	(31.5)
Other income	(157)	(168)	11	(6.4)	(6.5)
Underlying profit before taxes	**2,083**	**1,803**	**280**	**15.5**	**15.4**
Tax on profit	(588)	(521)	(67)	12.9	12.8
Underlying profit from continuing operations	**1,495**	**1,282**	**213**	**16.6**	**16.5**
Net profit from discontinued operations	—	—	—	—	—
Underlying consolidated profit	**1,495**	**1,282**	**213**	**16.6**	**16.5**
Minority interests	241	189	53	27.9	27.5
Underlying attributable profit to the Group	**1,254**	**1,093**	**161**	**14.7**	**14.6**
Net capital gains and provisions*	(85)	25	(111)	—	—
Attributable profit to the Group	**1,168**	**1,119**	**50**	**4.5**	**4.4**

(*) In 2017, integration costs in Germany. In 2016, capital gains from the disposal of the stake in VISA Europe.

Balance sheet	2017	2016	Change amount	%	% excl. FX
Customer loans	90,091	85,180	4,911	5.8	6.7
Cash, central banks and credit institutions	4,895	7,144	(2,249)	(31.5)	(30.3)
Debt securities	3,220	3,927	(707)	(18.0)	(17.1)
o/w: available for sale	*3,220*	*3,823*	*(603)*	*(15.8)*	*(14.9)*
Other financial assets	22	38	(17)	(43.5)	(41.8)
Other assets	3,508	3,333	175	5.2	5.7
Total assets	**101,735**	**99,622**	**2,113**	**2.1**	**3.0**
Customer deposits	35,443	35,050	393	1.1	1.8
Central banks and credit institutions	23,342	23,373	(31)	(0.1)	0.9
Debt securities issued	28,694	27,892	801	2.9	4.0
Other financial liabilities	996	870	126	14.5	14.4
Other liabilities	3,637	3,280	356	10.9	11.3
Total liabilities	**92,112**	**90,466**	**1,646**	**1.8**	**2.7**
Total equity	**9,623**	**9,156**	**467**	**5.1**	**6.3**
Other managed and marketed customer funds	**8**	**7**	**0**	**4.9**	**4.9**
Mutual funds	2	2	(0)	(13.4)	(13.4)
Pension funds	6	6	1	10.6	10.6
Managed portfolios	—	—	—	—	—
Pro memoria:					
Loans excluding repos	92,431	87,742	4,688	5.3	6.2
Funds (customer deposits excluding repos + mutual funds)	35,398	35,052	346	1.0	1.7

Ratios (%) and operating means	2017	2016	Change amount	%	% excl. FX
Underlying RoTE	16.44	14.83	1.60		
Efficiency ratio (with amortisations)	44.1	44.7	(0.6)		
NPL ratio	2.50	2.68	(0.18)		
NPL coverage	101.4	109.1	(7.7)		
Number of employees	15,131	14,928	203	1.4	
Number of branches	546	567	(21)	(3.7)	

SANTANDER CONSUMER FINANCE*

2017 highlights

€1,168 M
Attributable profit

SCF is Europe's consumer finance market leader
Main management focuses: boost auto finance, consumer credit and digital channels
New lending rose in all countries and underlying profit increased 15%, growing for the eighth year running. Including non-recurring results in both years, attributable profit rose 4%
High profitability, with RoTE at around 16% and RoRWA above 2%. Furthermore, the year ended with a cost of credit at an historic low

* Changes in constant currency

Strategy

SCF is Europe's consumer finance market leader, with a presence in 14 countries and more than 130,000 associated points-of-sale (auto dealers and shops). It also has a significant number of finance agreements with auto and motorbike manufacturers and retail distribution groups.

In 2017, SCF continued to gain market share, underpinned by a solid business model: highly diversified by geography with a critical mass in key products, more efficient than competitors and a risk control and recovery system that enables high credit quality to be maintained.

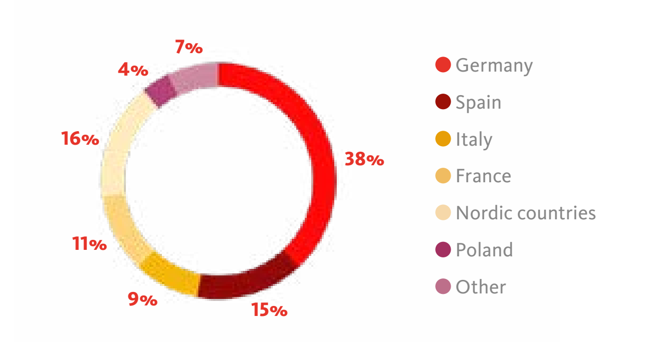
Management focused on:

- Improving the efficiency of capital, in a competitive environment characterised by the entry of new competitors, an excess of liquidity in markets and low GDP growth.
- Management of the agreements with Banque PSA Finance (BPF) completed in 2016 (joint ventures in 11 countries).
- Increasing auto finance and consumer credit, extending agreements with the main dealers.
- Strengthen digital channels.

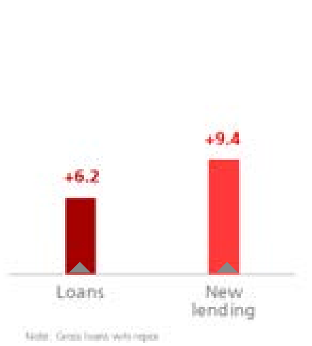
Activity

- We continued to sign and develop new agreements, both with retail distributors as well as producers, seeking to help them in the commercial transformation process and thus increase the value proposition for the final client.
- Lending rose 6%, with new loans growing 9%, spurred by auto finance (+11%). Almost all country units grew their business: over 70% of lending is in countries with the highest rating and Germany and the Nordic countries account for more than 50% of the portfolio.
- Customer deposits rose 2%, growth that distinguishes us from our competitors. The volume of wholesale funding captured in 2017 amounted to €11,692 million, via senior issues, securities and other long-term issues.
- Deposits and medium- and long-term issuances-securitisations placed in the market covered 70% of net loans.

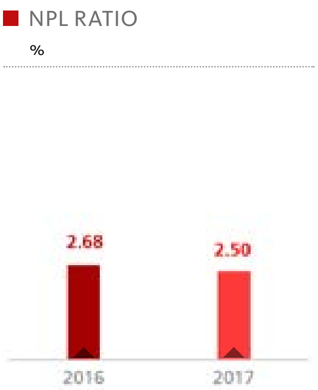
CUSTOMER LOANS BY GEOGRAPHIC AREA
December 2017

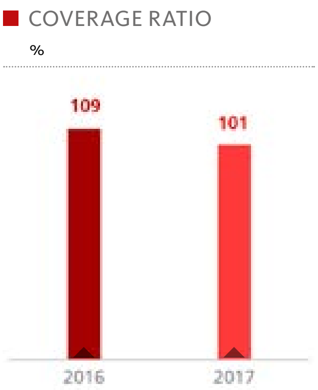


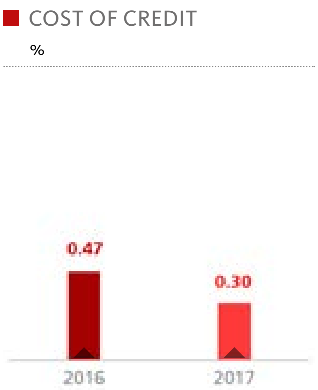
ACTIVITY PERFORMANCE
% change 2017 / 2016 (excl. FX)

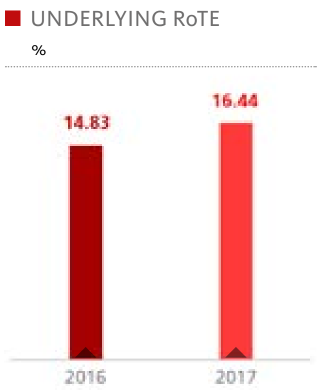


ATTRIBUTABLE PROFIT
Constant € million









Results

Attributable profit was 4% higher at €1,168 million, due to two factors:

- The current interest rate environment, very positive for consumer business, both in revenues and provisions.
- The low level of the cost of credit.

Looking more closely at the P&L statement:

- Gross income increased, mainly due to net interest income (80% of revenues) which rose 5%.
- Operating expenses were 4% higher, in line with business, and the cost-to-income ratio was around 44%, slightly better than in 2016.
- Loan-loss provisions declined 32%, producing a strong reduction in the cost of credit (to 0.30% from 0.47%), which is a very low level for consumer business. This was made possible by the good performance of credit risk and the positive impact of the sale of portfolios and certain release of provisions. The NPL ratio fell 18 b.p. to 2.50% and coverage was 101%.
- Attributable profit was hit by the €85 million charge net of taxes, mainly for the cost of integrating the commercial networks in Germany.

Of note was underlying attributable profit in Poland (+35%), Spain (+16%) and Italy (+12%).

In short, solid organic dynamics and well executed agreements, which provide a high potential for further growth in 2018, market share gains and continued high profitability and efficiency.

Strategy in 2018

Maintain our leadership position in new auto finance and grow in that for used cars, generating value-added for the producers
Proactive management of brand agreements and development of digital projects
Accompany our partners in their transformation plans, both in digitalisation of the purchasing process and financing of vehicles, as well as in other strategic projects
Reorganise business in Germany under the same brand, with greater efficiency and a better and more complete customer attention
Drive digitalisation via cooperation with fintechs and signing agreements with the main retailers

POLAND

(€ million)

Income statement	2017	2016	Change amount	%	% excl. FX
Net interest income	928	834	95	11.4	8.6
Net fee income	443	400	43	10.8	8.1
Gains (losses) on financial transactions	52	83	(32)	(38.2)	(39.7)
Other operating income	(3)	(2)	(1)	39.8	36.4
Gross income	**1,419**	**1,314**	**105**	**8.0**	**5.4**
Operating expenses	(605)	(579)	(26)	4.5	1.9
General administrative expenses	(548)	(521)	(26)	5.1	2.5
Personnel	(319)	(303)	(16)	5.4	2.9
Other general administrative expenses	(229)	(219)	(10)	4.6	2.0
Depreciation and amortisation	(58)	(58)	0	(0.8)	(3.2)
Net operating income	**814**	**735**	**79**	**10.8**	**8.1**
Net loan-loss provisions	(137)	(145)	8	(5.2)	(7.5)
Other income	(96)	(83)	(14)	16.8	13.9
Underlying profit before taxes	**581**	**508**	**73**	**14.3**	**11.6**
Tax on profit	(148)	(121)	(27)	22.7	19.8
Underlying profit from continuing operations	**432**	**387**	**45**	**11.7**	**9.0**
Net profit from discontinued operations	—	—	—	—	—
Underlying consolidated profit	**432**	**387**	**45**	**11.7**	**9.0**
Minority interests	132	115	17	14.8	12.1
Underlying attributable profit to the Group	300	272	28	10.4	7.7
Net capital gains and provisions*	—	29	(29)	(100.0)	(100.0)
Attributable profit to the Group	**300**	**301**	**(1)**	**(0.4)**	**(2.8)**

(*) In 2016, capital gains from the disposal of the stake in VISA Europe and some regulatory impacts

Balance sheet	2017	2016	Change amount	%	% excl. FX
Customer loans	22,220	19,979	2,240	11.2	5.3
Cash, central banks and credit institutions	1,661	2,021	(360)	(17.8)	(22.2)
Debt securities	6,786	6,301	484	7.7	2.0
o/w: available for sale	*5,959*	*5,774*	*184*	*3.2*	*(2.3)*
Other financial assets	491	537	(46)	(8.5)	(13.3)
Other assets	1,014	941	73	7.8	2.1
Total assets	**32,171**	**29,779**	**2,392**	**8.0**	**2.3**
Customer deposits	24,255	22,780	1,475	6.5	0.8
Central banks and credit institutions	952	824	128	15.5	9.4
Debt securities issued	821	504	317	62.8	54.2
Other financial liabilities	523	511	12	2.3	(3.1)
Other liabilities	684	917	(233)	(25.4)	(29.3)
Total liabilities	**27,235**	**25,537**	**1,698**	**6.7**	**1.0**
Total equity	**4,936**	**4,243**	**694**	**16.4**	**10.2**
Other managed and marketed customer funds	**4,007**	**3,202**	**805**	**25.2**	**18.5**
Mutual funds	3,900	3,118	782	25.1	18.5
Pension funds	—	—	—	—	—
Managed portfolios	108	84	24	28.4	21.7
Pro memoria:					
Loans excluding repos	22,974	20,697	2,277	11.0	5.1
Funds (customer deposits excluding repos + mutual funds)	27,803	25,898	1,905	7.4	1.7

Ratios (%) and operating means	2017	2016	Change amount	%	% excl. FX
Underlying RoTE	11.56	11.57	(0.00)		
Efficiency ratio (with amortisations)	42.6	44.1	(1.4)		
NPL ratio	4.57	5.42	(0.85)		
NPL coverage	68.2	61.0	7.2		
Number of employees	11,572	12,001	(429)	(3.6)	
Number of branches	576	658	(82)	(12.5)	

POLAND

2017 highlights

€300 M
Attributable profit

Bank Zachodni continued to be the reference bank in mobile and online banking
Focused on growth in mortgages, SMEs, leasing and companies
Attributable profit dropped 3%, impacted by capital gains of VISA Europe in 2016. Underlying profit before tax rose 12% driven by higher revenues, cost control and lower cost of credit
Management of spreads and activity in a low interest rate environment was reflected in solid commercial revenues (net interest income and fee income)
Agreement with Deutsche Bank, A.G. to acquire the retail and private banking business of Deutsche Bank Polska, S.A. The transaction is expected to be closed in the fourth quarter of 2018, once all the regulatory authorisations have been received

* Changes in constant currency

Strategy

The Bank maintained its objective of being the bank of first choice for customers.

Due to the changes in the macroeconomic environment, the 2017-2019 strategy was updated and took into account the current and envisaged challenges that might arise in the external environment, as well as the Group's development objectives and other relevant factors.

The strategy promotes a customer-centred culture, underpinned by the digital transformation and the continuous improvement in the business model and in the range of products.

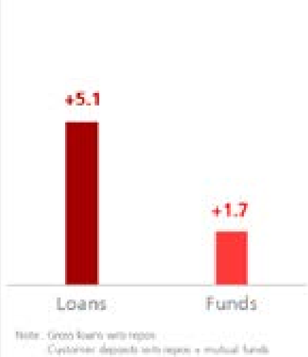
Among the Bank's main actions in 2017 were:

- We installed new CRM tools in order to keep on responding to and anticipating our customers' expectations and needs.
- Particular interest in all products being simple and easy to understand, with transparent conditions and prices, incentives and benefits based on the strength of the customer relation.
- The *As I Want it Account* was launched at the end of August, enabling customers to decide which products and services they need and how to pay for them. This account is for new as well as existing customers. By the end of the year, 335,000 accounts had been opened.
- On 14 December 2017, the Bank announced the agreement to acquire Core Deutsche Bank Polska & DB Securities. The transaction is expected to be closed during the fourth quarter of 2018, once all the regulatory and corporate authorisations have been received. Core DB Polska contributes gross loans of PLN 18,200 million, customer deposits of PLN 10,400 million and managed assets of PLN 6,900 million (all data as of June 2017). It's worth mentioning that the acquired balances did not include mortgages in foreign currency.

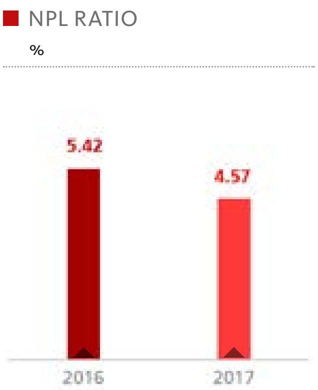
LOYAL CUSTOMERS
Thousands

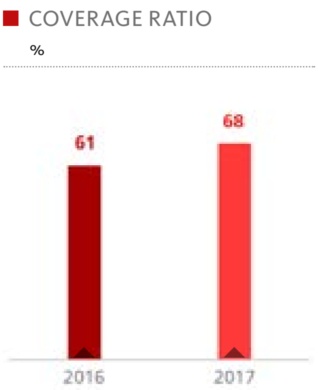
DIGITAL CUSTOMERS
Thousands

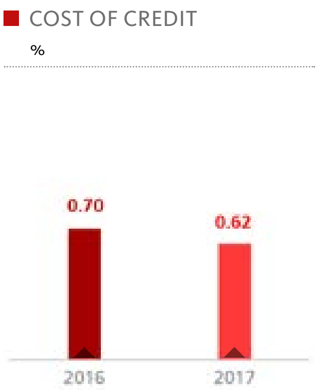
ACTIVITY PERFORMANCE
% change 2017 / 2016 (excl. FX)

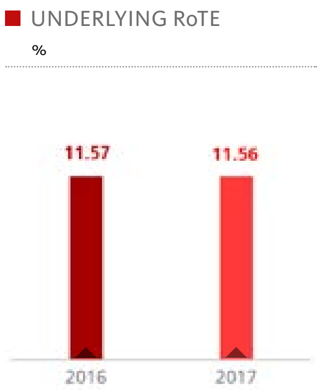


ATTRIBUTABLE PROFIT
Constant € million









All of this resulted in the following recognitions:

- BZ WBK was named the Best Bank in Poland for the third year running in the *Euromoney Awards for Excellence,* one of the most prestigious categories of the financial sector. This award highlights the Bank's excellent results and the rolling out of its digital transformation programme. Bank Zachodni WBK also received the Best Bank award for SMEs in Poland.

- Bank Zachodni WBK was also recognised in 2017 as one of the best places to work (TOP Employer 2017). This prize recognises the creation of a cordial work environment, the focus on talent and career and employment development.

Activity

Loans rose 5%, underpinned by companies (+7%, with SMEs rising 11%) and individuals (+3%).

Customer funds increased 2% in 2017, reflecting the profitability strategy in place: demand deposits rose 8% and mutual funds 18%, while time deposits dropped 16%.

This evolution maintained our solid funding structure (net loan-to-deposit ratio of 92%).

Results

Attributable profit was 3% lower at €300 million, mainly due to the recording of capital gains from the disposal of VISA Europe recorded in 2016 and some regulatory impacts.

Excluding these impacts, underlying profit before tax increased 12%, with good performance of the recurring lines:

- Excellent net interest income (+9%), spurred by higher volumes and fee income (+8%). Gross income grew at a slower pace (+5%), due to lower gains on financial transactions from the sale of ALCO portfolios.

- Operating expenses rose 2%, mainly due to higher personnel costs (+3%). Amortisations, on the other hand, fell 3%.

- Loan-loss provisions were down 8%, thanks to the significant improvement in credit quality. The NPL ratio dropped to 4.57% from 5.42% in 2016 and the cost of credit was 0.62% (0.70% in 2016).

Strategy in 2018

Make Bank Zachodni WBK the reference bank for customers, gaining their confidence and loyalty
Grow faster than our competitors, supported by digitalisation
Keep on being the country's most profitable bank
Carry out the necessary measures to close the operation with Core Deutsche Bank Polska according to schedule and continue with its integration

PORTUGAL (Excl. POPULAR)

(€ million)

Income statement	2017	2016	Change amount	%
Net interest income	697	733	(36)	(4.9)
Net fee income	341	314	27	8.7
Gains (losses) on financial transactions	84	112	(28)	(25.4)
Other operating income	24	51	(27)	(53.2)
Gross income	**1,145**	**1,209**	**(64)**	**(5.3)**
Operating expenses	(550)	(589)	39	(6.7)
General administrative expenses	(512)	(551)	39	(7.1)
Personnel	(326)	(339)	13	(3.9)
Other general administrative expenses	(186)	(212)	26	(12.3)
Depreciation and amortisation	(38)	(38)	(0)	0.3
Net operating income	**595**	**620**	**(25)**	**(4.0)**
Net loan-loss provisions	12	(54)	66	—
Other income	(35)	(34)	(1)	3.0
Underlying profit before taxes	**573**	**533**	**40**	**7.5**
Tax on profit	(130)	(131)	1	(0.4)
Underlying profit from continuing operations	**442**	**402**	**41**	**10.1**
Net profit from discontinued operations	—	—	—	—
Underlying consolidated profit	**442**	**402**	**41**	**10.1**
Minority interests	2	2	(0)	(5.0)
Underlying attributable profit to the Group	440	399	41	10.2
Net capital gains and provisions	—	—	—	—
Attributable profit to the Group	**440**	**399**	**41**	**10.2**

Balance sheet	2017	2016	Change amount	%
Customer loans	30,210	27,328	2,882	10.5
Cash, central banks and credit institutions	4,517	2,459	2,058	83.7
Debt securities	10,018	11,622	(1,604)	(13.8)
o/w: available for sale	*4,066*	*5,683*	*(1,617)*	*(28.5)*
Other financial assets	1,602	1,667	(65)	(3.9)
Other assets	1,855	1,745	111	6.4
Total assets	**48,202**	**44,820**	**3,382**	**7.5**
Customer deposits	30,269	30,002	267	0.9
Central banks and credit institutions	8,452	6,743	1,710	25.4
Debt securities issued	4,477	3,805	672	17.7
Other financial liabilities	327	349	(22)	(6.2)
Other liabilities	1,008	590	418	70.9
Total liabilities	**44,534**	**41,489**	**3,045**	**7.3**
Total equity	**3,668**	**3,331**	**337**	**10.1**
Other managed and marketed customer funds	**3,423**	**2,770**	**652**	**23.6**
Mutual funds	1,944	1,435	508	35.4
Pension funds	998	933	64	6.9
Managed portfolios	482	402	80	19.9
Pro memoria:				
Loans excluding repos	31,296	29,030	2,266	7.8
Funds (customer deposits excluding repos + mutual funds)	32,213	31,438	775	2.5

Ratios (%) and operating means	2017	2016	Change amount	%
Underlying RoTE	12.70	13.03	(0.34)	
Efficiency ratio (with amortisations)	48.0	48.7	(0.7)	
NPL ratio	5.71	8.81	(3.10)	
NPL coverage	59.1	63.7	(4.6)	
Number of employees	5,895	6,306	(411)	(6.5)
Number of branches	563	657	(94)	(14.3)

PORTUGAL*

2017 highlights

€440 M
Attributable profit

The strategy to transform the commercial model, distinguished by the *1/2/3 World* and development of new digital platforms, spurred growth in loyal and digital customers (+8% and +11%, respectively)
Market share of new lending to companies was 17%. In mortgages, the market share of new loans stood above 20%
Attributable profit rose 10%, reflecting lower operating expenses and provisions
Following the acquisition of Banco Popular Portugal, Santander Totta is the country's largest private sector bank in terms of assets and loans in domestic activity

* Excl. Popular

Strategy

Commercial activity remained focused on exploiting the country's growth trend. This was reflected in the market share gain in business with individuals and companies, growth in transactions and rise in the number of loyal and digital customers (+8% and +11%, respectively).

In individuals, the activity continued to be underpinned by the *1/2/3 World* which evolved very well in the number of accounts, credit cards and protection insurance.

In companies, the main focus was still on developing new digital platforms such as the new *Santander Totta Empresas* app.

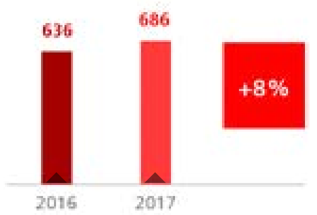
The Bank placed in September ten-year mortgage bonds for €1.0 billion. This was the first issuance with this maturity in Portugal since 2010.

In 2017, *Euromoney* and *Global Finance* recognised Santander Totta as the best bank in Portugal and *The Banker* magazine named it Bank of the Year. It was also ranked the most reputable banking brand in Portugal by the consultancy *Onstrategy*.

Activity

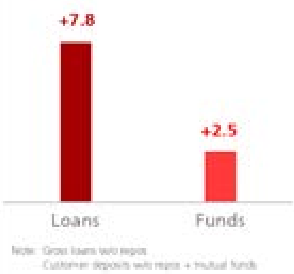
- Total lending rose 8%, benefitting from a corporate operation in the third quarter. New mortgage business remained very dynamic and the Bank continued to record market shares of more than 20%. Likewise, in companies, the market share in lending was around 17%.
- Funds amounted to €32,213 million (+2%). Deposits and mutual funds increased 1% and 35%, respectively. Also, the funding cost improved and dropped from 0.35% in 2016 to 0.19%.
- The capital ratio remained very solid (fully loaded CET1 of 16.4%, well above the minimum requirement).
- S&P upgraded the Bank to BBB-, Moody's confirmed its rating after the acquisition of Banco Popular and DBRS upgraded the Bank to A (low). Fitch also improved its rating to BBB+. Santander Totta's ratings are the best in the Portuguese banking system

LOYAL CUSTOMERS
Thousands

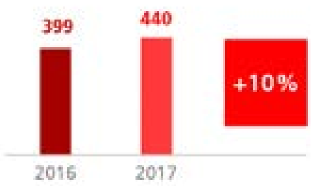


DIGITAL CUSTOMERS
Thousands

ACTIVITY PERFORMANCE
% change 2017 / 2016



ATTRIBUTABLE PROFIT
Constant € million



NPL RATIO

%

COVERAGE RATIO

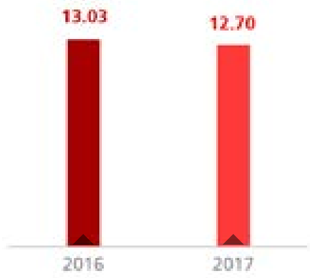
%

COST OF CREDIT

%

UNDERLYING RoTE

%



Results

Attributable profit was 10% higher at €440 million, driven by lower operating expenses and provisions. In gross income, the good performance of fee income did not offset the lower net interest income and gains on financial transactions.

- Net interest income fell 5% as the positive impact of the lower cost of deposits did not offset the drop in revenue from loans and securities, due to the low interest rate environment and the reduced share of the public debt portfolio in the Bank's balance sheet.

- Fee income amounted to €341 million, up 9% and reflecting the greater customer loyalty and transactions. Gains on financial transactions, on the other hand, fell 25%, due to lower results from the sale of portfolios.

- Operating expenses were 7% lower, thanks to the optimisation plans of the last few years. This reduction, combined with the evolution of revenues, improved the efficiency ratio to 48%.

- Loan-loss provisions declined and closed the year with a small release of provisions. This reflected the excellent evolution of the NPL ratio, which improved notably to 5.71%, well below the peak of 10.46% in June 2016 following Banif's integration.

Strategy in 2018

Integrate Banco Popular Portugal, improving efficiency
Strengthen our position as the best private sector bank in Portugal on a higher market share
Growth in lending, driven by companies, and in funds, mainly off-balance-sheet
Deepen our digital transformation and streamline processes, increasing loyalty and cross selling

POPULAR

(€ million)

Income statement	2017*
Net interest income	1,003
Net fee income	288
Gains (losses) on financial transactions	1
Other operating income	17
Gross income	**1,309**
Operating expenses	(873)
General administrative expenses	(781)
Personnel	(421)
Other general administrative expenses	(360)
Depreciation and amortisation	(92)
Net operating income	**436**
Net loan-loss provisions	(114)
Other income	(20)
Underlying profit before taxes	**302**
Tax on profit	(39)
Underlying profit from continuing operations	**263**
Net profit from discontinued operations	—
Underlying consolidated profit	**263**
Minority interests	0
Underlying attributable profit to the Group	**263**
Net capital gains and provisions**	(300)
Attributable profit to the Group	**(37)**

Balance sheet	
Customer loans	75,516
Cash, central banks and credit institutions	14,025
Debt securities	17,457
o/w: available for sale	*16,171*
Other financial assets	1,709
Other assets	18,246
Total assets	**126,953**
Customer deposits	64,960
Central banks and credit institutions	37,279
Debt securities issued	10,661
Other financial liabilities	2,460
Other liabilities	3,666
Total liabilities	**119,026**
Total equity	**7,927**
Other managed and marketed customer funds	**16,409**
Mutual funds	9,619
Pension funds	4,600
Managed portfolios and insurance premiums	2,190
Pro memoria:	
Gross customer loans excluding repos	79,533
Funds (customer deposits excluding repos + mutual funds)	74,286

(*) Results consolidated into Grupo Santander as of 7 June 2017.

(**) Restructuring costs.

BANCO POPULAR

2017 highlights

-€37 M
Attributable profit

Banco Santander announced on 7 June its acquisition of Banco Popular, an operation that bolstered our position as the leading bank in Spain
Since then we have focused on recovering commercial activity and offering the best service to Popular's customers who already benefit from a larger network of ATMs throughout Spain
Deposits have increased 15% since the purchase and loans remained stable in the fourth quarter when new lending grew
Popular posted a loss of €37 million, due to the extraordinary charge of €300 million for the integration process. Excluding this, underlying profit was €263 million

Strategy and Activity

Significant progress has been made in the management of Popular since its incorporation into Grupo Santander, in accordance with the initial plan envisaged and meeting the commitment made to the market and to our shareholders:

- We began to integrate Popular, capturing cost synergies and moving toward optimum efficiency levels.
- The agreement to sell the portfolio of foreclosed properties to Blackstone, doubtful loans and other related assets reduced the exposure to the real estate sector.
- In December we agreed to sell TotalBank, based in Florida. This transaction is scheduled to be completed by the end of 2018, with a positive impact on the Group's CET1 ratio of five b.p.
- The Portuguese subsidiary of Banco Popular was sold to Santander Totta. This is an intragroup transaction and therefore, it has no impact on the consolidated results. The integration of Popular's business will strengthen Santander Totta making it the largest private sector bank in the country.
- Lastly, a commercial action was successfully launched for retail customers who were shareholders of Banco Popular, 78% of whom subscribed to the offer of loyalty bonds.

As regards activity, customer deposits, both current and time, have risen significantly since the beginning of June, underscoring the recovery of market confidence. The stock of loans stabilised in the last few months, aided by the rise in new lending in the fourth quarter thanks to Popular's notable position in the SMEs segment. This trend, although positive, is not yet sufficient to recover the balances prior to the acquisition.

Results

Banco Popular made a loss since 7 June of €37 million, due to integration costs of €300 million. Excluding this, underlying profit was €263 million.

Gross income was €1,309 million. Net interest income was affected by interest rate pressure (Euribor at historical lows). The fourth quarter was also hit by ALCO portfolios and the €63 million contribution to the Deposit Guarantee Fund.

Operating expenses were €873 million and loan-loss provisions amounted to €114 million.

Strategy in 2018

Make progress in meeting the goals announced at the time of the acquisition
Optimise Popular's structure, improving its efficiency ratio. Cost savings will be gradually reflected in the P&L statement as the year advances
Continue to analyse the best alternatives for joint ventures and non-core businesses that continue on the balance sheet, so that they fit into Banco Santander's business model
Increase customer loyalty and satisfaction, in accordance with the transformation process taking place in all the Group's units

UNITED KINGDOM

(€ million)

Income statement	2017	2016	Change amount	%	% excl. FX
Net interest income	4,363	4,405	(42)	(0.9)	6.2
Net fee income	1,003	1,032	(29)	(2.8)	4.3
Gains (losses) on financial transactions	282	319	(37)	(11.5)	(5.1)
Other operating income	68	61	7	11.1	19.2
Gross income	**5,716**	**5,816**	**(100)**	**(1.7)**	**5.4**
Operating expenses	(2,861)	(2,967)	106	(3.6)	3.4
General administrative expenses	(2,513)	(2,656)	143	(5.4)	1.5
Personnel	(1,358)	(1,418)	61	(4.3)	2.6
Other general administrative expenses	(1,156)	(1,238)	82	(6.6)	0.1
Depreciation and amortisation	(348)	(311)	(37)	11.9	20.0
Net operating income	**2,855**	**2,850**	**6**	**0.2**	**7.4**
Net loan-loss provisions	(205)	(58)	(146)	251.3	276.7
Other income	(466)	(339)	(127)	37.5	47.4
Underlying profit before taxes	**2,184**	**2,452**	**(268)**	**(10.9)**	**(4.5)**
Tax on profit	(662)	(736)	75	(10.1)	(3.6)
Underlying profit from continuing operations	**1,523**	**1,716**	**(193)**	**(11.3)**	**(4.8)**
Net profit from discontinued operations	—	—	—	—	—
Underlying consolidated profit	**1,523**	**1,716**	**(193)**	**(11.3)**	**(4.8)**
Minority interests	25	35	(11)	(30.3)	(25.3)
Underlying attributable profit to the Group	1,498	1,681	(183)	(10.9)	(4.4)
Net capital gains and provisions*	—	(30)	30	(100.0)	(100.0)
Attributable profit to the Group	**1,498**	**1,651**	**(153)**	**(9.2)**	**(2.7)**

(*) In 2016, capital gains from the disposal of the stake in VISA Europe, restructuring costs and PPI.

Balance sheet	2017	2016	Change amount	%	% excl. FX
Customer loans	243,617	251,250	(7,634)	(3.0)	0.5
Cash, central banks and credit institutions	56,762	36,643	20,118	54.9	60.5
Debt securities	26,188	28,045	(1,857)	(6.6)	(3.2)
o/w: available for sale	*9,887*	*12,204*	*(2,318)*	*(19.0)*	*(16.1)*
Other financial assets	24,690	26,819	(2,130)	(7.9)	(4.6)
Other assets	9,974	12,202	(2,228)	(18.3)	(15.3)
Total assets	**361,230**	**354,960**	**6,270**	**1.8**	**5.5**
Customer deposits	230,504	212,113	18,391	8.7	12.6
Central banks and credit institutions	27,833	21,590	6,243	28.9	33.6
Debt securities issued	61,112	71,108	(9,996)	(14.1)	(10.9)
Other financial liabilities	21,167	27,913	(6,746)	(24.2)	(21.4)
Other liabilities	4,310	5,221	(911)	(17.4)	(14.5)
Total liabilities	**344,926**	**337,945**	**6,981**	**2.1**	**5.8**
Total equity	**16,304**	**17,014**	**(711)**	**(4.2)**	**(0.7)**
Other managed and marketed customer funds	**8,657**	**8,564**	**93**	**1.1**	**4.7**
Mutual funds	8,543	8,447	96	1.1	4.8
Pension funds	—	—	—	—	—
Managed portfolios	114	118	(3)	(2.8)	0.7
Pro memoria:					
Loans excluding repos	235,783	242,510	(6,727)	(2.8)	0.8
Funds (customer deposits excluding repos + mutual funds)	210,305	210,611	(306)	(0.1)	3.5

Ratios (%) and operating means	2017	2016	Change amount	%
Underlying RoTE	10.26	10.56	(0.30)	
Efficiency ratio (with amortisations)	50.1	51.0	(1.0)	
NPL ratio	1.33	1.41	(0.08)	
NPL coverage	32.0	32.9	(0.9)	
Number of employees	25,971	25,688	283	1.1
Number of branches	808	844	(36)	(4.3)

UNITED KINGDOM*

2017 highlights

€1,498 M
Attributable profit

The strategic and operational advances underpinned solid results despite the changeable macroeconomic environment
Good business evolution: growth in retail current account balances, mortgages, and corporate loans and deposits of UK companies, excluding commercial real estate (CRE)
Digital transformation continued to support operational efficiency and improved customer experience
Attributable profit slightly lower than in 2016, due to higher loan-loss provisions in GCB and software write-offs. Net operating income was 7% higher with strong net interest income and fee income growth

* Changes in constant currency

Strategy

We remained focused on growing customer loyalty, operational and digital excellence and steady and sustainable profit growth, while being the best bank for our people and the communities in which we operate.

- We continued to benefit from the *1|2|3 World* which now has 5.4 million customers, up 275,000 in the year. Retail current account balances rose by £2,500 million, maintaining a good pace of growth.

- We continued to develop our digital proposition. Digital customers continued to increase by around 10% and we gained an average of 1,400 new active mobile banking users per day. In 2017, 47% of our mortgages were retained online, 38% of current account openings and 51% of credit cards were via digital channels.

- The number of loyal retail customers continued to grow, up 5%, although at a slower pace with customers consolidating their savings into our *1|2|3* current account. Loyal SME and corporate customers increased 5%, driven by improving customer satisfaction and our international proposition.

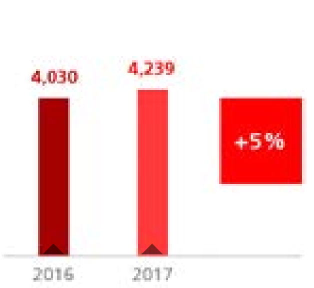
- As published by the Financial Research Survey (FRS), retail customer satisfaction was broadly in line with our three highest performing peers as at December 2017.

This performance was achieved despite a very competitive UK banking environment, and one which faces major regulatory changes. Open Banking and PSD II (Payment Services Directive) will influence customer interaction and potentially the competitive landscape.

The implementation of our wide ring-fence structure is progressing well and we are on track to comply with the Banking Reform Act before the 1 January 2019 deadline.

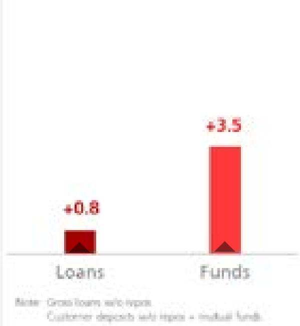
Consequently, and as reaffirmed at our 2017 Group Strategy Update, we are well positioned to deliver on our strategic priorities for 2018.

LOYAL CUSTOMERS
Thousands



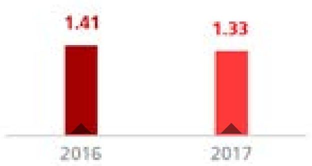
DIGITAL CUSTOMERS
Thousands

ACTIVITY PERFORMANCE
% change 2017 / 2016 (excl. FX)

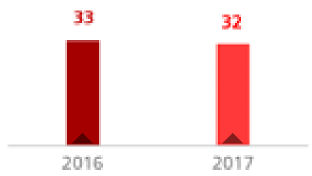


ATTRIBUTABLE PROFIT
Constant € million

NPL RATIO
%

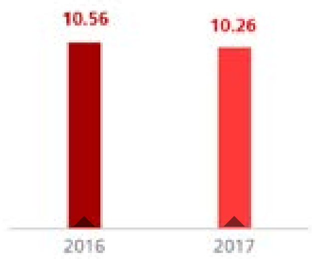


COVERAGE RATIO
%



COST OF CREDIT
%

UNDERLYING RoTE
%



Activity

- Lending was 1% higher. Residential mortgages rose by £600 million and loans to UK trading companies increased by £800 million, up 4% year on year, offset by the reduction of our CRE lending that declined £900 million.
- Customer deposits excluding repos rose 3%, underpinned by retail current accounts, other retail products and corporate deposits, and partly offset by the decrease in savings balances.
- Santander UK focuses on maintaining a strong balance sheet and a low risk profile, as was demonstrated in the 2017 PRA stress test results. Once again, we had the lowest stressed CET1 drawdown of all the participating UK banks.

Results

Attributable profit for the year fell 3%, adversely impacted by the single GCB loan that went into non-performance. Excluding this, the business was strong.

- Net interest income rose 6%, driven by the improvement in retail liability spreads from the changes made to the *1I2I3 World* terms. This was partially offset by the pressure on new lending spreads.
- Fee income increased 4%, with higher transaction fees in Retail Banking and international and digital payment fees in Commercial Banking.
- Operating expenses were up 3%, under control despite inflationary pressures and banking reform costs of £81 million. Higher investment costs in business growth and enhancements to our digital channels were partly offset by improved operational efficiency.

Credit quality remained solid in all loan portfolios, supported by good risk management and the low interest rate environment. The NPL ratio was 1.33% at the end of the year (1.41% in 2016).

Underlying RoTE was unchanged at 10%.

Strategy in 2018

Ongoing focus on customer loyalty as the key driver of business growth
Leverage our Investment Hub and NEO CRM platforms, and improve cross-border customer relationships via international trade corridors
Prioritise operational and digital excellence in order to offer the best customer experience
Increase our profits in a predictable way, while maintaining a strong balance sheet

LATIN AMERICA

(€ million)

Income statement	2017	2016	Change amount	%	% excl. FX
Net interest income	15,944	13,346	2,598	19.5	15.8
Net fee income	5,490	4,581	909	19.8	16.7
Gains (losses) on financial transactions	1,012	806	206	25.5	26.5
Other operating income	27	32	(5)	(14.4)	(27.6)
Gross income	**22,473**	**18,764**	**3,709**	**19.8**	**16.4**
Operating expenses	(8,694)	(7,692)	(1,002)	13.0	10.3
General administrative expenses	(7,877)	(7,007)	(870)	12.4	9.7
Personnel	(4,366)	(3,886)	(480)	12.4	9.5
Other general administrative expenses	(3,511)	(3,121)	(390)	12.5	10.0
Depreciation and amortisation	(817)	(685)	(132)	19.3	15.8
Net operating income	**13,779**	**11,073**	**2,706**	**24.4**	**20.6**
Net loan-loss provisions	(4,973)	(4,911)	(62)	1.3	(2.6)
Other income	(1,329)	(785)	(544)	69.3	60.6
Underlying profit before taxes	**7,477**	**5,377**	**2,100**	**39.1**	**36.2**
Tax on profit	(2,380)	(1,363)	(1,017)	74.6	70.8
Underlying profit from continuing operations	**5,097**	**4,014**	**1,083**	**27.0**	**24.5**
Net profit from discontinued operations	—	—	—	—	—
Underlying consolidated profit	**5,097**	**4,014**	**1,083**	**27.0**	**24.5**
Minority interests	814	628	185	29.5	26.9
Underlying attributable profit to the Group	4,284	3,386	898	26.5	24.0
Net capital gains and provisions	—	—	—	—	—
Attributable profit to the Group	**4,284**	**3,386**	**898**	**26.5**	**24.0**

Balance sheet	2017	2016	Change amount	%	% excl. FX
Customer loans	146,133	152,187	(6,054)	(4.0)	7.6
Cash, central banks and credit institutions	55,934	67,400	(11,466)	(17.0)	(5.3)
Debt securities	57,364	63,314	(5,951)	(9.4)	2.5
o/w: available for sale	*32,475*	*29,219*	*3,256*	*11.1*	*24.5*
Other financial assets	14,226	18,696	(4,470)	(23.9)	(15.4)
Other assets	17,160	19,171	(2,011)	(10.5)	2.0
Total assets	**290,818**	**320,768**	**(29,951)**	**(9.3)**	**2.2**
Customer deposits	141,543	143,747	(2,205)	(1.5)	11.2
Central banks and credit institutions	39,212	47,585	(8,373)	(17.6)	(7.6)
Debt securities issued	34,434	47,436	(13,001)	(27.4)	(18.5)
Other financial liabilities	36,084	41,395	(5,311)	(12.8)	(1.4)
Other liabilities	10,994	11,291	(297)	(2.6)	10.3
Total liabilities	**262,267**	**291,454**	**(29,186)**	**(10.0)**	**1.4**
Total equity	**28,550**	**29,315**	**(764)**	**(2.6)**	**10.1**
Other managed and marketed customer funds	**80,779**	**81,482**	**(703)**	**(0.9)**	**12.7**
Mutual funds	74,482	75,002	(520)	(0.7)	13.1
Pension funds	—	—	—	—	—
Managed portfolios	6,297	6,480	(182)	(2.8)	7.7
Pro memoria:					
Loans excluding repos	151,542	159,134	(7,593)	(4.8)	6.7
Funds (customer deposits excluding repos + mutual funds)	193,264	187,516	5,749	3.1	16.4

Ratios (%) and operating means	2017	2016	Change amount	%	% excl. FX
Underlying RoTE	18.04	15.56	2.48		
Efficiency ratio (with amortisations)	38.7	41.0	(2.3)		
NPL ratio	4.50	4.81	(0.31)		
NPL coverage	84.8	87.3	(2.5)		
Number of employees	88,713	86,312	2,401	2.8	
Number of branches	5,891	5,818	73	1.3	

LATIN AMERICA*

2017 highlights

€4,284 M
Attributable profit

Economic growth throughout the region, with stabilisation and recovery in Argentina and Brazil, respectively, and slight downturns in Chile and Mexico
Innovation measures, streamlining processes and commercial actions produced a 16% rise in loyal customers and more than three million digital customers (+33%)
Lending and funds increased
Excluding the forex impact, attributable profit rose 24% and at double-digit rates in the main units

* Changes in constant currency

Strategy

Among the most notable developments were significant investments in operating systems and digital infrastructure in order to streamline processes and enhance the customer experience, loyalty, transactions and the number of digital customers. The measures taken are set out in each unit.

The number of loyal customers rose 16% (+16% individuals and +15% companies), and in all units. Digital customers rose by 3 million (+32%).

Activity

Lending excluding the forex impact was up 7%. Of note was Brazil and Argentina. Santander gained market share in both cases. Mexico, on the other hand, opted for more selective growth and in Chile the medium-high income and SME segments remained the priorities, while the mass consumer market began to recover.

Funds increased 16%, due to growth in both deposits as well as mutual funds.

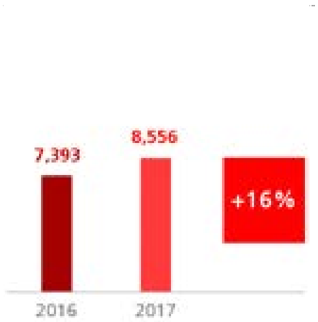
Results

Attributable profit was 24% higher at €4,284 million, driven by revenues, particularly net interest income, reflecting the growth in volumes and management of spreads in an environment with varied interest rates. Brazil significantly reduced its Selic rate and Mexico increased its official interest rates. Fee income rose 17%, the result of greater loyalty. Operating expenses increased to a lesser extent (+10%), which improved the cost-to-income ratio by 2 p.p. to 39%.

Loan-loss provisions dropped slightly (3%). The cost of credit improved thanks to larger business volumes.

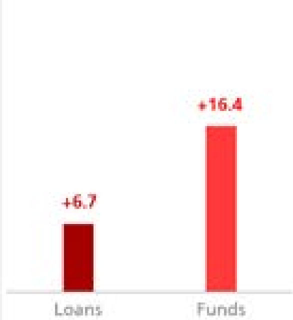
Profit increased in six of the seven units, most notably in Brazil (+34%), the largest contributor to Group earnings.

LOYAL CUSTOMERS
Thousands



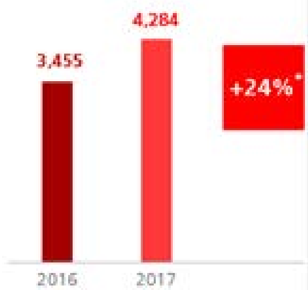
DIGITAL CUSTOMERS
Thousands

ACTIVITY PERFORMANCE
% change 2017 / 2016 (excl. FX)



Note: Gross loans w/o repos.
Customer deposits w/o repos + mutual funds

ATTRIBUTABLE PROFIT
Constant € million



(*) In euros: +27%

BRAZIL

(€ million)

Income statement	2017	2016	Change amount	%	% excl. FX
Net interest income	10,078	8,062	2,016	25.0	17.3
Net fee income	3,640	2,940	700	23.8	16.2
Gains (losses) on financial transactions	510	238	272	114.2	100.9
Other operating income	46	80	(34)	(42.6)	(46.2)
Gross income	**14,273**	**11,321**	**2,953**	**26.1**	**18.3**
Operating expenses	(5,080)	(4,475)	(605)	13.5	6.5
General administrative expenses	(4,571)	(4,046)	(525)	13.0	6.0
Personnel	(2,565)	(2,253)	(312)	13.9	6.8
Other general administrative expenses	(2,006)	(1,793)	(213)	11.9	4.9
Depreciation and amortisation	(509)	(429)	(80)	18.7	11.4
Net operating income	**9,193**	**6,845**	**2,348**	**34.3**	**26.0**
Net loan-loss provisions	(3,395)	(3,377)	(18)	0.5	(5.7)
Other income	(1,186)	(696)	(489)	70.3	59.7
Underlying profit before taxes	**4,612**	**2,772**	**1,840**	**66.4**	**56.1**
Tax on profit	(1,725)	(773)	(953)	123.2	109.4
Underlying profit from continuing operations	**2,887**	**1,999**	**888**	**44.4**	**35.5**
Net profit from discontinued operations	—	—	—	—	—
Underlying consolidated profit	**2,887**	**1,999**	**888**	**44.4**	**35.5**
Minority interests	343	213	130	60.7	50.8
Underlying attributable profit to the Group	2,544	1,786	758	42.5	33.7
Net capital gains and provisions	—	—	—	—	—
Attributable profit to the Group	**2,544**	**1,786**	**758**	**42.5**	**33.7**

Balance sheet	2017	2016	Change amount	%	% excl. FX
Customer loans	70,454	75,474	(5,020)	(6.7)	8.1
Cash, central banks and credit institutions	34,920	41,352	(6,432)	(15.6)	(2.2)
Debt securities	38,693	42,513	(3,820)	(9.0)	5.4
o/w: available for sale	*21,321*	*16,275*	*5,046*	*31.0*	*51.7*
Other financial assets	5,798	8,486	(2,688)	(31.7)	(20.9)
Other assets	11,825	13,677	(1,852)	(13.5)	0.1
Total assets	**161,690**	**181,502**	**(19,812)**	**(10.9)**	**3.2**
Customer deposits	70,074	72,478	(2,404)	(3.3)	12.0
Central banks and credit institutions	23,591	27,226	(3,635)	(13.4)	0.3
Debt securities issued	20,056	31,679	(11,623)	(36.7)	(26.7)
Other financial liabilities	23,783	24,974	(1,191)	(4.8)	10.3
Other liabilities	7,536	7,561	(25)	(0.3)	15.4
Total liabilities	**145,040**	**163,917**	**(18,878)**	**(11.5)**	**2.5**
Total equity	**16,650**	**17,584**	**(934)**	**(5.3)**	**9.7**
Other managed and marketed customer funds	**58,479**	**59,631**	**(1,152)**	**(1.9)**	**13.6**
Mutual funds	54,779	55,733	(954)	(1.7)	13.8
Pension funds	—	—	—	—	—
Managed portfolios	3,700	3,898	(198)	(5.1)	9.9
Pro memoria:					
Loans excluding repos	74,341	80,306	(5,965)	(7.4)	7.2
Funds (customer deposits excluding repos + mutual funds)	106,959	99,771	7,188	7.2	24.2

Ratios (%) and operating means	2017	2016	Change amount	%
Underlying RoTE	16.91	13.84	3.07	
Efficiency ratio (with amortisations)	35.6	39.5	(3.9)	
NPL ratio	5.29	5.90	(0.61)	
NPL coverage	92.6	93.1	(0.5)	
Number of employees	47,135	46,728	407	0.9
Number of branches	3,465	3,431	34	1.0

BRAZIL

2017 highlights

€2,544 M
Attributable profit

The expansion of commercial businesses and the greater operational efficiency underpinned the recurring revenue growth, well above the average of our competitors. Net interest income and fee income registered double-digit growth.
Good risk management: credit growth with profitable gain in market share and a reduction in the cost of credit.
Continued good evolution of profitability. Attributable profit of €2,544 million (+34%) and RoTE of 17%, reflecting a more productive, efficient and customer-focused business model, with solid organic growth

* Changes in constant currency

Strategy

Santander Brazil attained historically noteworthy results in 2017, better than that of its main competitors, with a dynamic of strong business acceleration, agility in innovations and services and greater operational efficiency. This was combined with advances in enhancing the internal culture: we are today an organisation more aligned with offering customers the best experience and, on this basis, growing in a sustained and profitable way.

The year's main actions included:

- In cards, continued strong growth in revenues (+23%), increasing our market share. Marketing of the *Santander/AAdvantage®* credit cards continued to be well received and *Santander Way* maintained the best evaluations in the market (4.8 stars in the Apple Store and 4.6 in Google Play).

  We continued the intense agenda of innovative associations and solutions for customers: in the fourth quarter we launched *Santander Pass,* a bracelet and sticker with NFC (near field communication) technology a contactless payment system; in Mastercard and Dafiti we started identity check mobile tests, a method that authenticates online payments with the use of biometrics (digital fingerprint or face recognition); and we announced the commercial agreement with Smiles to market the *Santander Smiles* cards, which give customers exclusive advantages for accumulating miles.

- We implemented the *full acquirencia* model and launched the option to buy or rent the point of sale (POS). Turnover surged 31% (three times higher than the market) which produced a gain of 168 b.p. in market share to 11.5%.

- Payroll credit increased 58% and we launched the *consignado 100% digital*.

- In mortgages, we cut interest rates, offering the best rate for customers, which helped boost new lending to individuals by 88%, well above the market.

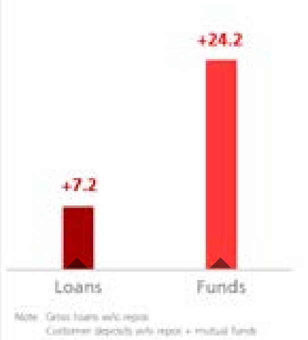
- In consumer finance, we held our leadership and increased our market share in lending to 23% (+310 b.p.). The digital tool *+Negocios* continued to support business expansion with growth of 60% in simulations of vehicle purchases. We also launched the digital platform *+Vezes,* focused on the goods and services segment (CDC) and attained close to 175,000 simulations a month.

- In SMEs, we increased our market share in loans (+241 b.p.) to 11%. In GCB, we improved customer attention with a model closer to the client and were recognised in Brazil as leaders in ECM, financial advice for project finance and in the currency market. We were also recognised as the Best Treasury in Brazil and among the best in research in Brazil and Latin America.

LOYAL CUSTOMERS
Thousands

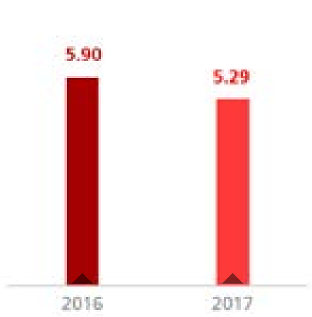
DIGITAL CUSTOMERS
Thousands

ACTIVITY PERFORMANCE
% change 2017 / 2016 (excl. FX)

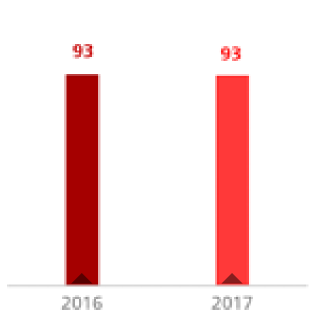


ATTRIBUTABLE PROFIT
Constant € million

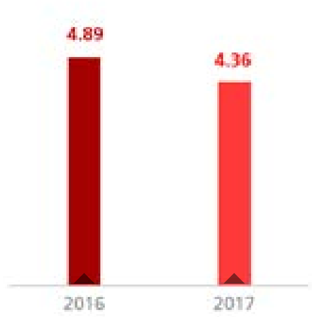
NPL RATIO
%



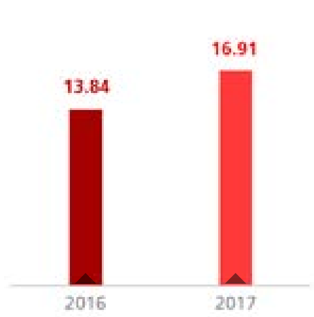
COVERAGE RATIO
%



COST OF CREDIT
%



UNDERLYING RoTE
%



- On the liabilities side, we launched *Santander One,* a digital financial advice tool that attained more than eight million logins in the fourth quarter.

- In line with the digital strategy, we put on *Black Week,* promoting special product conditions both for customers and non-customers. As well as strong growth in e-commerce sales, the campaign attained a record in the contracting of new cards and in personal loans (almost doubling growth in both cases).

All of this produced significant recognitions: Bank of the Year in Brazil from *The Banker* and Best Bank in Brazil, Best Bank in Latin America, Best Bank for Transformation in Latin America and Best Bank in the World for SMEs from *Euromoney.* We were also classified for the second year running as one of the best companies to work for in the Great Place to Work ranking.

We continued to increase our customer base in a sustainable way during the year: loyal customers (+14%) and digital ones (+34%).

On sustainability, Santander continues to hold an outstanding position in the *Prospera Santander Microcredit Program,* with R$425 million in the loan portfolio at the end of December 2017. In higher education, we have awarded about 9,500 scholarships since 2015, actively contributing to the advancement of education in the country.

Activity

- Loans grew 7% (individuals: +18%; consumer finance: +24% and SMEs: +12%), the latter increased for the fifth quarter running.

- Funds continued to grow at double-digit rates (+24%), mainly due to time deposits and mutual funds.

Results

Attributable profit of €2,544 million (+34%). Of note:

- Rise of 17% in net interest income, mainly business with customers. Revenues from loans increased 13% due to volumes and spreads and that from funds 31%, reflecting the plan we implemented.

- Fee income rose 16% thanks to the increase in customer loyalty and greater transactions. Of note that from credit cards (+23%), current accounts (+20%) and insurance (+14%).

- Operating expenses were 7% higher, due to the business dynamic and ongoing investments. The cost-to-income ratio improved by 3.9 p.p. to 35.6%, the best level in the last five years.

- Provisions fell 6%, with a good evolution of credit quality indicators: the cost of credit was 53 b.p. lower at 4.36%, the NPL ratio dropped 61 b.p. to 5.29% and coverage was 93%.

Strategy in 2018

Customers: excellence in services so that customers find the best experience in Santander Brazil
Digital: continue to consolidate our leadership in terms of innovative products and services
Volumes: maintain profitable gains in market share, with offers adjusted to each customer profile
Profitability: keep on fostering recurrent growth in profitability, underpinned by greater activity, higher operational efficiency and advances in the digital strategy

MEXICO

(€ million)

Income statement	2017	2016	Change amount	%	% excl. FX
Net interest income	2,601	2,385	216	9.1	12.5
Net fee income	749	711	38	5.4	8.7
Gains (losses) on financial transactions	150	149	1	0.4	3.6
Other operating income	(40)	(43)	3	(6.7)	(3.8)
Gross income	**3,460**	**3,203**	**258**	**8.0**	**11.5**
Operating expenses	(1,382)	(1,274)	(108)	8.4	11.9
General administrative expenses	(1,258)	(1,168)	(90)	7.7	11.1
Personnel	(653)	(606)	(46)	7.7	11.1
Other general administrative expenses	(606)	(562)	(44)	7.8	11.2
Depreciation and amortisation	(124)	(106)	(17)	16.5	20.2
Net operating income	**2,078**	**1,928**	**150**	**7.8**	**11.2**
Net loan-loss provisions	(905)	(832)	(73)	8.8	12.3
Other income	(39)	(30)	(9)	31.1	35.2
Underlying profit before taxes	**1,134**	**1,067**	**67**	**6.3**	**9.7**
Tax on profit	(230)	(247)	17	(6.9)	(3.9)
Underlying profit from continuing operations	**904**	**820**	**85**	**10.3**	**13.8**
Net profit from discontinued operations	—	—	—	—	—
Underlying consolidated profit	**904**	**820**	**85**	**10.3**	**13.8**
Minority interests	194	191	3	1.7	5.0
Underlying attributable profit to the Group	**710**	**629**	**81**	**12.9**	**16.5**
Net capital gains and provisions	—	—	—	—	—
Attributable profit to the Group	**710**	**629**	**81**	**12.9**	**16.5**

Balance sheet	2017	2016	Change amount	%	% excl. FX
Customer loans	26,462	27,315	(853)	(3.1)	5.3
Cash, central banks and credit institutions	9,956	13,362	(3,406)	(25.5)	(19.0)
Debt securities	13,676	14,124	(447)	(3.2)	5.2
o/w: available for sale	*6,971*	*7,088*	*(117)*	*(1.6)*	*6.9*
Other financial assets	5,627	7,722	(2,094)	(27.1)	(20.8)
Other assets	2,481	2,590	(108)	(4.2)	4.1
Total assets	**58,203**	**65,112**	**(6,909)**	**(10.6)**	**(2.9)**
Customer deposits	30,392	28,910	1,482	5.1	14.2
Central banks and credit institutions	8,247	11,269	(3,022)	(26.8)	(20.5)
Debt securities issued	5,168	5,393	(225)	(4.2)	4.1
Other financial liabilities	7,680	12,648	(4,968)	(39.3)	(34.0)
Other liabilities	1,779	2,037	(258)	(12.7)	(5.1)
Total liabilities	**53,267**	**60,257**	**(6,990)**	**(11.6)**	**(3.9)**
Total equity	**4,936**	**4,855**	**81**	**1.7**	**10.5**
Other managed and marketed customer funds	**9,919**	**10,242**	**(323)**	**(3.2)**	**5.3**
Mutual funds	9,919	10,242	(323)	(3.2)	5.3
Pension funds	—	—	—	—	—
Managed portfolios	—	—	—	—	—
Pro memoria:					
Loans excluding repos	26,962	28,017	(1,055)	(3.8)	4.6
Funds (customer deposits excluding repos + mutual funds)	35,548	36,438	(890)	(2.4)	6.0

Ratios (%) and operating means	2017	2016	Change amount	%
Underlying RoTE	19.50	15.45	4.05	
Efficiency ratio (with amortisations)	39.9	39.8	0.1	
NPL ratio	2.69	2.76	(0.07)	
NPL coverage	97.5	103.8	(6.3)	
Number of employees	18,557	17,608	949	5.4
Number of branches	1,401	1,389	12	0.9

MEXICO*

2017 highlights

€710 M
Attributable profit

Strategy focused on attracting new customers with high long-term transaction loyalty and on consolidating the loyalty of current customers
Focus on commercial transformation, multi-channel innovation, digital strategy and launching new business initiatives *(Santander Plus, Santander-Aeroméxico, Select Me, SúperWallet, SúperConnect, SúperDigital and TUIIO)*
Strong growth in deposits and maintaining profitability of loans
Attributable profit rose 16%, driven by the excellent performance of net interest income (+13%)

* Changes in constant currency

Strategy

During the year and under the transformation strategy, significant investments were made in infrastructure and systems focused on improving multichanneling, deepening digital strategy, strengthening the distribution model and launching new commercial initiatives.

Also, efforts were made to attract new customers and payrolls (which resulted in market share gains), retain existing customers (churn ratio dropped 52%) and grow deposits of individual customers.

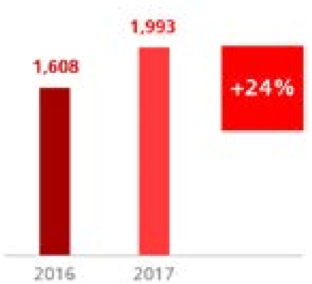
The benefits for *Santander Plus* customers were expanded with initiatives related to loans, insurance and commercial alliances with self-service companies in order to attract and make loyal a larger number of customers. More than three million customers registered, of which 52% were new.

The following actions were taken to bolster the digital strategy:

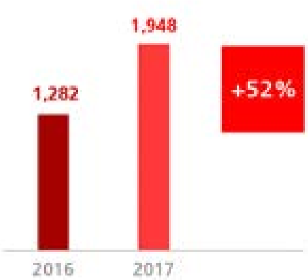
- The new *Factoría Digital* to drive digitalisation of our products.
- *Súper Wallet,* the new mobile app that enables customers to centralise management of their cards.
- *SúperConnect,* unique customer attention model in Mexico for Select customers, whose main feature is that it is fully remote.
- *SúperDigital,* where our customers can open an account from any device linked to Internet, without having to visit a branch.
- *Select Me,* a programme that supports women with solutions that facilitate their day-to-day tasks and professional development.
- *TUIIO,* a financial inclusion initiative that has its own operating model, infrastructure and brand which takes advantage of the technology to support the needs of the low income segment in Mexico and seeks to maximise the social impact on customers via a boad range of products (micro-credits, micro-insurance, international transfers, etc.)

We also continued to consolidate Santander in the SMEs market, taking advantage of our position to attract and make loyal individual customers and make us their main bank:

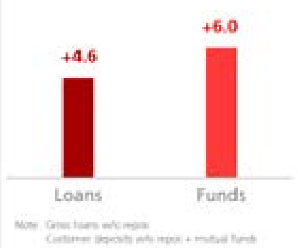
LOYAL CUSTOMERS
Thousands



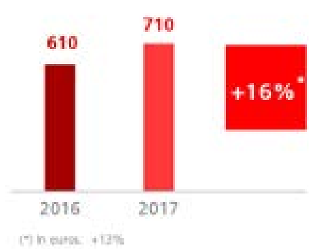
DIGITAL CUSTOMERS
Thousands

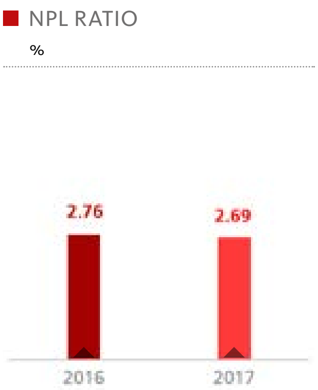


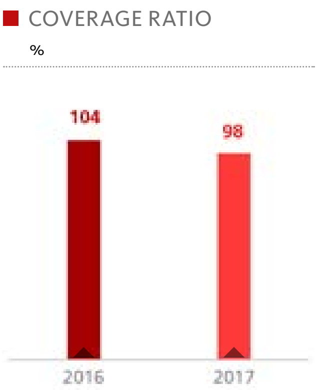
ACTIVITY PERFORMANCE
% change 2017 / 2016 (excl. FX)

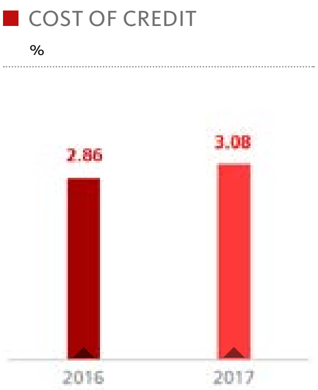


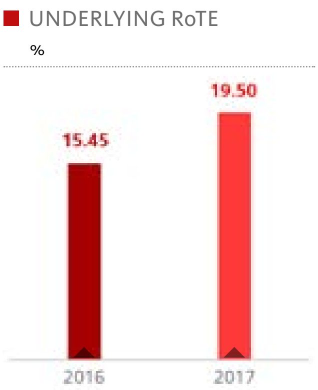
ATTRIBUTABLE PROFIT
Constant € million











- Campaigns were carried out to refinance credit lines for SMEs, focused on customers that have a good credit profile, and products were simplified.

- In Companies and Institutions, we focused on transactional loyalty and on attracting new customers via confirming. We also took actions in various productive sectors and spurred agro business.

The number of loyal customers increased 24% (individuals: +24% and SMEs: +33%) to two million. Digital customers increased 52% to 1.9 million.

Activity

Loans rose 5% and deposits excluding repos 6%.

Lending to individual customers was up 4%, as follows: consumer credit grew 8%, credit cards 6% and mortgages 1%.

Demand deposits of individual customers increased 12%, time deposits rose 38% and mutual funds 5%.

The structure of funds improved and business with SMEs, companies and institutions was strengthened. Their demand deposits rose 10% and we promoted diversification into time deposits and mutual funds, in line with the profile of customers.

Results

Attributable profit was 16% higher at €710 million.

- Gross income increased 11%. Of note was the 13% rise in net interest income, driven by growth in loans and the continued growth in deposits, together with higher interest rates since December 2015.

- Operating expenses were 12% higher, due to the investment plan to position us as the main bank of our customers. The cost-to-income ratio remained virtually stable at 40%.

Solid credit quality: the NPL ratio improved seven b.p. to 2.69%, coverage reached 98% and the cost of credit was around 3%.

Strategy in 2018

Continuing with the commercial transformation and innovation in order to be the first choice bank of our customers in Mexico
Install a new distribution model based on: strategy in micro markets, new commercial model and a new design for branches
Continue the drive in digitalisation, remote attention models, customer experience and improvements in information and analysis
Continued focus on capturing payrolls and strengthen the *Santander Plus* offer
Maintain our leadership in the services offered to corporate customers in such a way that this segment's contribution to the Bank's gross income continues to consolidate

CHILE

(€ million)

Income statement	2017	2016	Change amount	%	% excl. FX
Net interest income	1,907	1,864	43	2.3	0.1
Net fee income	391	353	39	10.9	8.6
Gains (losses) on financial transactions	213	206	7	3.6	1.4
Other operating income	12	(1)	12	—	—
Gross income	**2,523**	**2,422**	**102**	**4.2**	**2.0**
Operating expenses	(1,025)	(986)	(39)	3.9	1.7
General administrative expenses	(918)	(895)	(23)	2.5	0.3
Personnel	(574)	(558)	(16)	2.9	0.7
Other general administrative expenses	(344)	(337)	(6)	1.9	(0.3)
Depreciation and amortisation	(108)	(91)	(16)	17.9	15.4
Net operating income	**1,498**	**1,435**	**63**	**4.4**	**2.1**
Net loan-loss provisions	(462)	(514)	52	(10.1)	(12.0)
Other income	23	(27)	51	—	—
Underlying profit before taxes	**1,059**	**894**	**165**	**18.4**	**15.9**
Tax on profit	(200)	(159)	(41)	25.7	23.0
Underlying profit from continuing operations	**859**	**735**	**124**	**16.9**	**14.4**
Net profit from discontinued operations	—	—	—	—	—
Underlying consolidated profit	**859**	**735**	**124**	**16.9**	**14.4**
Minority interests	273	222	52	23.2	20.6
Underlying attributable profit to the Group	586	513	72	14.1	11.7
Net capital gains and provisions	—	—	—	—	—
Attributable profit to the Group	**586**	**513**	**72**	**14.1**	**11.7**

Balance sheet	2017	2016	Change amount	%	% excl. FX
Customer loans	37,153	37,662	(509)	(1.4)	2.7
Cash, central banks and credit institutions	4,321	5,955	(1,635)	(27.4)	(24.4)
Debt securities	4,143	5,348	(1,205)	(22.5)	(19.3)
o/w: available for sale	*3,490*	*4,787*	*(1,297)*	*(27.1)*	*(24.1)*
Other financial assets	2,789	2,474	315	12.7	17.4
Other assets	1,949	2,065	(116)	(5.6)	(1.7)
Total assets	**50,355**	**53,505**	**(3,150)**	**(5.9)**	**(2.0)**
Customer deposits	26,043	27,317	(1,274)	(4.7)	(0.7)
Central banks and credit institutions	5,491	7,172	(1,681)	(23.4)	(20.3)
Debt securities issued	8,967	10,174	(1,206)	(11.9)	(8.2)
Other financial liabilities	3,598	2,794	804	28.8	34.1
Other liabilities	1,222	1,226	(4)	(0.3)	3.8
Total liabilities	**45,321**	**48,683**	**(3,362)**	**(6.9)**	**(3.0)**
Total equity	**5,034**	**4,822**	**212**	**4.4**	**8.7**
Other managed and marketed customer funds	**9,761**	**9,903**	**(142)**	**(1.4)**	**2.6**
Mutual funds	7,163	7,321	(158)	(2.2)	1.9
Pension funds	—	—	—	—	—
Managed portfolios	2,597	2,582	16	0.6	4.8
Pro memoria:					
Loans excluding repos	38,249	38,800	(551)	(1.4)	2.7
Funds (customer deposits excluding repos + mutual funds)	33,104	34,559	(1,455)	(4.2)	(0.2)

Ratios (%) and operating means	2017	2016	Change amount	%	% excl. FX
Underlying RoTE	17.89	17.17	0.72		
Efficiency ratio (with amortisations)	40.6	40.7	(0.1)		
NPL ratio	4.96	5.05	(0.09)		
NPL coverage	58.2	59.1	(0.9)		
Number of employees	11,675	11,999	(324)	(2.7)	
Number of branches	439	435	4	0.9	

CHILE*

2017 highlights

€586 M
Attributable profit

Focus on commercial and technological innovations such as *WorkCafé,* digital onboarding and *Santander Life,* which are changing the way of doing banking in Chile
Better profitability indicators and stable credit quality in an economic downturn
The medium-high income and SME segments remained priorities, while growth began to recover in mass consumer market
Attributable profit rose 12% driven by commercial revenues, improved cost of credit and control of costs

* Changes in constant currency

Strategy

The Group aspires to be the best bank in Chile, leading digital excellence and customer experience and always committed to the Simple, Personal and Fair (SPF) culture. The Bank has focused since 2012 mainly on the segments of medium-high income individuals and SMEs.

In addition, with the digital innovations introduced this year and the better economic outlook, the Bank grew again in the mass consumer market, which had declined since 2012.

The main innovations were:

- Launch of the new *World Member Limited* credit card, focused on high income customers.

- Rolling out of the *WorkCafé* branches, a kind of co-working space backed by an advanced technological platform resulting in more productive and efficient branches. The programme was sped up in 2017, with the number rising from seven to 20 throughout the country.

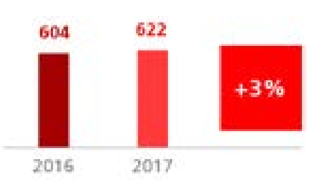
- Development of digital banking and the 2.0 app, launching various functionalities during the year including digital onboarding that enables someone to be a client via the app or digital banking in a few minutes.

- *Santander Life:* this innovative model, which recognises who has a good financial performance, was launched in December. It has led to the Bank focusing again on the mass consumer market, underpinned by a better outlook for the Chilean economy, and on technological innovations that help to reduce the risk and costs of opening new accounts.

These measures produced an increase in the number of loyal customers, in SMEs (+7%) and in individuals (+3%), as well as an increase in fee income linked to transactions. The number of digital customers rose 5%.

Santander Chile was recognised in the *Adimark Gfk* customer satisfaction survey as the best digital bank in Chile and it came first in the Digital Index, a ranking of digital brands developed by Llorente & Cuenca that measures the presence in digital environments.

LOYAL CUSTOMERS
Thousands



DIGITAL CUSTOMERS
Thousands

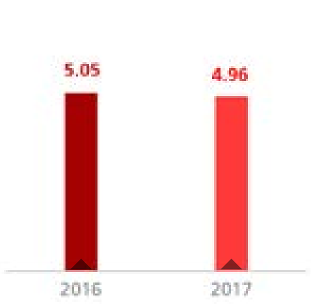
ACTIVITY PERFORMANCE
% change 2017 / 2016 (excl. FX)

Note: Gross loans w/o repos
Customer deposits w/o repos + mutual funds

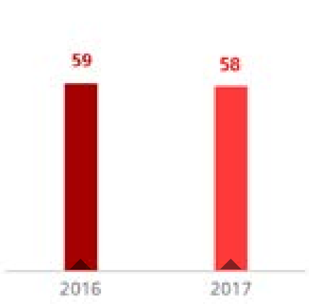
ATTRIBUTABLE PROFIT
Constant € million

(*) In euros: +14%

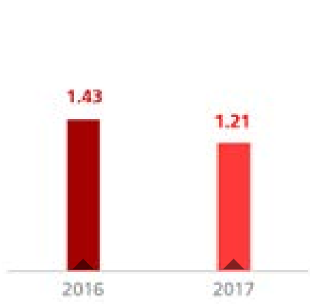
■ NPL RATIO
%



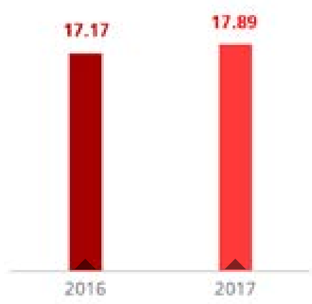
■ COVERAGE RATIO
%



■ COST OF CREDIT
%



■ UNDERLYING RoTE
%



The Banker, Euromoney and *Latin Finance* magazines also recognised Santander as the Best Bank in Chile.

Activity

Loans rose 3%, with higher growth in the segments of high income individuals (+10%) and SMEs (+5%). Mortgages grew 6% and consumer credit 4%. Commercial credit remained virtually stable, driven by SMEs and companies which offset the fall in GCB.

Customer funds remained stable, as the Bank focused on lowering the cost and mix of funds. Demand deposits grew 4% and mutual funds 2%, while time deposits declined 4%.

Results

Attributable profit was €586 million (+12%). RoTE was 17.9% (17.2% in 2016).

Of note was the 15% growth in Retail Banking profit, spurred by increased activity and fee income, lower provisions and flat costs.

- Gross income grew 2%. Net interest income remained stable due to low inflation, partly offset by the lower cost of funding. Fee income rose 9% thanks to the increase in loyal retail banking customers, growth in cash management business and advisory services for companies and GCB. Gains on financial transactions rose 1%, driven by customer activity.

- Operating expenses were up 2%, mainly due to an increase in depreciation and amortisations, the result of investments in branches and technology. Personnel expenses rose by only 1% and administrative ones were flat. The cost-to-income ratio remained at around 41%.

- Loan-loss provisions fell 12%, with a sustained improvement in the portfolio of individuals. Credit quality indicators improved. The cost of credit was 1.21% (1.43% in 2016), the NPL ratio dropped to below 5% and coverage was 58%

Strategy in 2018

Continue to enhance the quality of customer attention and the experience of our customers
Keep on transforming the *WorkCafé* branches
Boost growth among mass consumer market customers via Santander Life
Higher growth in lending and savings than our peer group, underpinned by stronger economic growth
Attain high levels of efficiency and productivity via excellence in execution and increased digitalisation

ARGENTINA*

2017 highlights

€359 M
Attributable profit

The retail banking of Citibank Argentina was fully integrated into Santander Rio at the end of August, five months after taking control

Strategy focused on increasing the penetration in the market through expanding branches and becoming a digital bank, with the focus on *Santander Select* and *Pymes Advance*

Net operating income increased 39%, driven by net interest income and fee income. Attributable profit, including the charges for Citibank integration, rose 14%

* Changes in constant currency

Strategy

The strategy remained focused on growing business with customers, paying particular attention to loyalty and profitability:

- Citibank's incorporation, together with organic growth, have made Santander Río the leading private bank in Argentina by business market share (credits + deposits).
- We also continued to transform branches (276 transformed and two digital offices).
- We launched auto finance and UVA mortgages indexed to inflation.
- The number of Santander Río app users increased 53% to 875,000. New functionalities were added including the capacity to make payments and transfers without the need for prior registry in online banking.

Loyal customers rose 20% and digital ones 30%. Some 77% of *Select* customers are loyal, of which 93% are digital.

All these efforts were recognised with several awards. The magazine *Global Finance* awarded Santander Río as Best Digital Bank and Foreign Trade in Argentina, Best Bank in Online Products and the Most Innovative Digital Bank in Latin America, *Euromoney* and *The Banker* as the Best Bank in Argentina in 2017. We were also fourth in the Great Place to Work ranking.

Activity

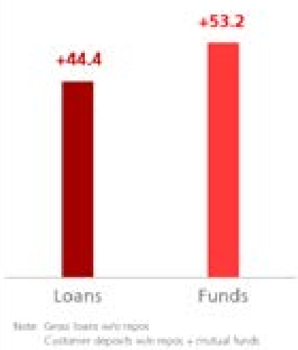
- Both loans and deposits rose 44%, about 14 p.p. and 20 p.p. of which, respectively, came from the incorporation of Citibank's retail banking. Of note was the growth in consumer credit and UVA mortgages.
- This helped us gain market share, to 10% in lending and over 11% in deposits.

Results

Attributable profit was 14% higher at €359 million and RoTE 32.0%.

- The commercial strategy, together with higher volumes and efficient management of spreads, led to a 44% rise in gross income, 58% in net interest income and 43% in fee income.
- Operating expenses rose 49%, mainly due to Citibank's incorporation. Excluding it costs grew at a slower rate than revenues despite the impact of the new salary agreement, expansion of the branch network and investments in transformation and technology. The cost to income ratio was 55.5%.
- Loan loss provisions rose in line with lending. Credit quality remained high, with a NPL ratio of 2.50%, coverage of 100% and a cost of credit of 1.85%.

ACTIVITY PERFORMANCE
% change 2017 / 2016 (excl. FX)



ATTRIBUTABLE PROFIT
Constant € million

Strategy in 2018

Maximise the profitability of business acquired from Citibank

Continue the transformation into a digital bank, improving efficiency, loyalty and satisfaction

Grow in consumer credit, mortgages, financing lines and foreign trade, as well as in businesses with the public sector

Increase customer funds significantly, especially mutual funds and investment products

URUGUAY*

2017 highlights

€103 M
Attributable profit

Santander is the country's largest private sector bank, with a strategy focused on growing in retail banking and improving efficiency and the quality of service
Lending rose in all target segments and products, mainly SMEs and consumer credit
Attributable profit increased 19%, driven by gross income that grew at almost double the rate of operating expenses

* Changes in constant currency

Strategy and Activity

The goal in 2017 was to enhance the quality of service and loyalty of our customers by launching various products and services:

- We launched *Verano Select Experience,* a new way of relating to customers, in the first quarter. This had a big impact on our *Select* customers.
- As part of the digitalisation process, we launched the *Buzonera Inteligente,* deposit terminals with immediate online deposit and cheques with scanned image that already cover 80% of the Bank's network.
- We also created the country's first banking portal specialised in mortgages and developed virtual assistance that tends to the first line of all our digital channels. In finance companies, we launched the second version of the app through which 36% of loans are already requested.
- We continued to advance in the growth strategy for digital customers whose number has already reached 176,000 (+42%). Digital penetration stood at 49%, up from 36% in 2016.
- Lending rose 2%, spurred by consumer credit and cards (+20%). Loans in pesos increased 13% and those in foreign currencies fell 3%. Total deposits dropped 4% (local currency deposits rose 16% and foreign currency ones dropped 7%), due to the outflow of non-resident deposits and the strategy of improving profitability of funds.

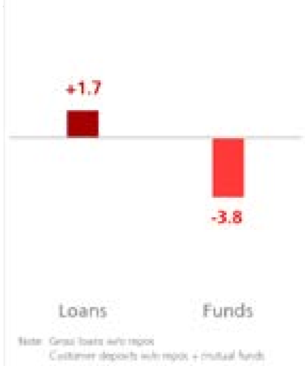
Results

Attributable profit was €103 million (+19%), driven by the stronger growth (+13%) in gross income than in costs (+7%), which remained stable in real terms.

The cost-to-income ratio improved to 48.5%, 2.9 p.p. better than in 2016.

Loan-loss provisions were up 22%. The NPL ratio was 2.84% and coverage 130%, both at controlled levels and in accordance with the greater focus on retail banking.

ACTIVITY PERFORMANCE
% change 2017 / 2016 (excl. FX)



ATTRIBUTABLE PROFIT
Constant € million

Strategy in 2018

Continue to grow in retail business
Become the leaders in the segments of individuals and SMEs, as well as in consumer credit, means of payment and transactional products
Increase customer loyalty as the source of revenue growth
Keep on improving the efficiency ratio, through the digital transformation

PERU*

2017 highlights

€40 M
Attributable profit

Strategy focused on specialised financial services for global customers, corporates and large companies.
Attributable profit rose 7%, spurred by higher revenues and release of loan-loss provisions

* Changes in constant currency

Strategy

Activity centres on corporate banking and the country's large companies, as well as providing service for the Group's global customers and helping to develop public infrastructure.

Specialised business model, which gives precedence to a close relation with customers and quality of service, while taking advantage of operational and business synergies with other Group units.

We continued to consolidate the auto finance company, which has a specialised business model that facilitates buying various brands of new vehicles via most of the dealerships.

Activity

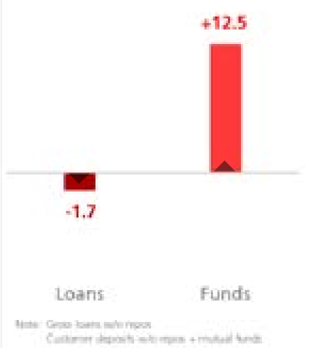
Loans fell 2% because of the slowdown in the economy and the sol's appreciation which affected the evolution of dollar balances. Deposits increased 12%, strengthening the capturing of new customers in order to diversify funding sources.

Results

Attributable profit was 7% higher at €40 million.

- Gross income grew 4%, thanks to a good performance of net interest income and gains on financial transactions.
- Operating expenses increased 5%. The efficiency ratio remained stable at around 31%.
- The very low NPL ratio (0.65%) released provisions and coverage was still high.

ACTIVITY PERFORMANCE
% change 2017 / 2016 (excl. FX)



ATTRIBUTABLE PROFIT
Constant € million

Strategy in 2018

Keep on increasing loans to companies, expanding the offer and distribution capacity and incorporating new customers from the global relationship model and corporate banking
Promote advisory services in investment banking and public infrastructure
Expand auto finance, widening the range of products, distribution channels and funding sources

COLOMBIA*

2017 highlights

€6 M
Attributable profit

Auto finance began in 2017 and a trust company (S3 Colombia) will be set up to provide custody services
Attributable profit was €6 million compared to a loss in 2016

* Changes in constant currency

Strategy

Grupo Santander in Colombia focuses on Global Corporate Banking, Large Companies and Companies. It combines local and global reach and is continuously providing more services and products for these customers. The Group concentrates on developing treasury solutions, risk coverage, basic financing, project finance, M&A, deposits, accounts and confirming, among others.

The Bank launched auto finance in 2017 with a specialised and comprehensive business model, providing service to the brand, the importer, the distributor and the final client.

In order to complete the range of services, the Colombian regulator authorised the establishment of a trust company (S3 Colombia) that will provide custody service and is pending the required authorisations.

Activity

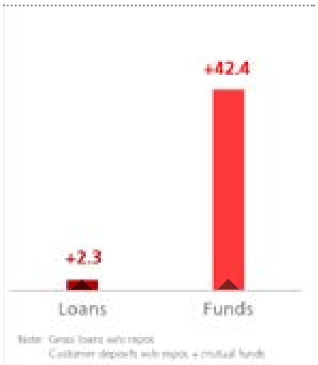
Loans stood at €582 million, 2% more than in 2016, and deposits €255 million (+42%).

Results

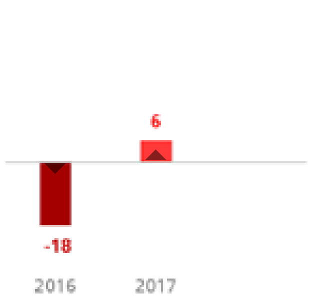
We continued to develop the Group's capacities and began to generate a profit, which was achieved in a particularly difficult environment for the financial industry because of the impact of bad loans and the fall in domestic demand.

Attributable profit amounted to €6 million compared to a loss in the previous years, mainly due to gross income, which rose 36% to €26 million and a 97% drop in loan-loss provisions.

ACTIVITY PERFORMANCE
% change 2017 / 2016 (excl. FX)



ATTRIBUTABLE PROFIT
Constant € million



Strategy in 2018

Make Banco Santander the reference for large customers, creating capacities in Treasury and in Global Transactional Banking
Consolidate Banco Santander in auto finance, reaching a critical mass
Launch S3 Colombia in the second quarter after receiving the authorisations

UNITED STATES (Excl. POPULAR)

(€ million)

Income statement	2017	2016	Change amount	%	% excl. FX
Net interest income	5,569	5,917	(348)	(5.9)	(4.1)
Net fee income	971	1,102	(131)	(11.9)	(10.2)
Gains (losses) on financial transactions	9	22	(13)	(58.0)	(57.2)
Other operating income	410	491	(82)	(16.6)	(15.0)
Gross income	**6,959**	**7,532**	**(573)**	**(7.6)**	**(5.8)**
Operating expenses	(3,198)	(3,198)	0	(0.0)	1.9
General administrative expenses	(2,875)	(2,882)	8	(0.3)	1.6
Personnel	(1,664)	(1,636)	(28)	1.7	3.7
Other general administrative expenses	(1,211)	(1,247)	36	(2.9)	(1.0)
Depreciation and amortisation	(324)	(316)	(8)	2.4	4.4
Net operating income	**3,761**	**4,334**	**(573)**	**(13.2)**	**(11.6)**
Net loan-loss provisions	(2,780)	(3,208)	428	(13.4)	(11.7)
Other income	(90)	(90)	0	(0.4)	1.5
Underlying profit before taxes	**892**	**1,036**	**(144)**	**(13.9)**	**(12.3)**
Tax on profit	(256)	(355)	99	(27.9)	(26.5)
Underlying profit from continuing operations	**636**	**681**	**(45)**	**(6.6)**	**(4.9)**
Net profit from discontinued operations	—	—	—	—	—
Underlying consolidated profit	**636**	**681**	**(45)**	**(6.6)**	**(4.9)**
Minority interests	228	286	(58)	(20.3)	(18.7)
Underlying attributable profit to the Group	**408**	**395**	**13**	**3.2**	**5.2**
Net capital gains and provisions	(76)	(32)	(43)	133.6	138.1
Attributable profit to the Group	**332**	**363**	**(30)**	**(8.4)**	**(6.7)**

(*) In 2017, tax reform, provisions for hurricanes, increased stake and other. In 2016, restatement of Santander Consumer USA.

Balance sheet	2017	2016	Change amount	%	% excl. FX
Customer loans	71,963	85,389	(13,426)	(15.7)	(4.1)
Cash, central banks and credit institutions	13,300	16,970	(3,670)	(21.6)	(10.8)
Debt securities	13,843	17,940	(4,097)	(22.8)	(12.2)
o/w: available for sale	*11,775*	*15,437*	*(3,663)*	*(23.7)*	*(13.2)*
Other financial assets	3,368	3,566	(197)	(5.5)	7.5
Other assets	11,914	13,526	(1,611)	(11.9)	0.2
Total assets	**114,388**	**137,390**	**(23,002)**	**(16.7)**	**(5.3)**
Customer deposits	51,189	64,460	(13,270)	(20.6)	(9.6)
Central banks and credit institutions	15,884	22,264	(6,380)	(28.7)	(18.8)
Debt securities issued	26,176	26,340	(164)	(0.6)	13.1
Other financial liabilities	2,503	2,907	(404)	(13.9)	(2.0)
Other liabilities	3,437	4,770	(1,333)	(27.9)	(18.0)
Total liabilities	**99,189**	**120,740**	**(21,551)**	**(17.8)**	**(6.5)**
Total equity	**15,199**	**16,650**	**(1,450)**	**(8.7)**	**3.9**
Other managed and marketed customer funds	**16,432**	**18,827**	**(2,395)**	**(12.7)**	**(0.7)**
Mutual funds	8,367	9,947	(1,580)	(15.9)	(4.3)
Pension funds	—	—	—	—	—
Managed portfolios	8,065	8,880	(815)	(9.2)	3.3
Pro memoria:					
Loans excluding repos	75,389	89,638	(14,249)	(15.9)	(4.3)
Funds (customer deposits excluding repos + mutual funds)	59,329	74,166	(14,837)	(20.0)	(9.0)

Ratios (%) and operating means	2017	2016	Change amount	%	% excl. FX
Underlying RoTE	3.12	3.11	0.01		
Efficiency ratio (with amortisations)	46.0	42.5	3.5		
NPL ratio	2.79	2.28	0.51		
NPL coverage	170.2	214.4	(44.2)		
Number of employees	17,560	17,509	51	0.3	
Number of branches	683	768	(85)	(11.1)	

UNITED STATES*

2017 highlights

€332 M
Attributable profit

Santander Holding USA passed the Federal Reserve's capital stress test and terminated its 2014 Written Agreement, enabling the Bank to operate within a normal capital cycle
Santander Bank N.A.'s underlying profit increased significantly to €275 million, (+49%), underpinned by a 53 b.p. increase in its net interest margin during the year
Santander Consumer USA maintained its high RoTE (13%) despite the shift in the mix of assets temporarily affecting results
Attributable profit in the United States declined 7%. Excluding impacts from non-recurring items in both years, underlying attributable profit rose 5%

* Excl. Popular and changes in constant currency

Strategy

Santander US includes Santander Holdings USA (the intermediate holding company – IHC) and its subsidiaries: Santander Bank, which is one of the largest banks in the northeast of the country, Santander Consumer USA, an auto finance business, the private banking unit in Miami, the broker dealer in New York and the retail bank in Puerto Rico.

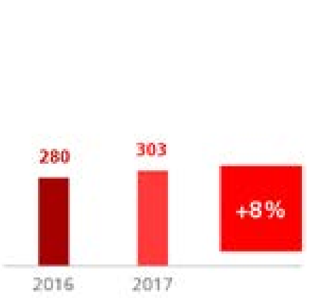
2017 was an important year for **Santander US** from a regulatory point of view. SHUSA passed the Federal Reserve's stress tests, and there were no objections to the bank's capital plan. This will allow the Bank to concentrate on improving profitability, reducing costs and optimising the country's capital structure. Accordingly, SHUSA paid its first dividend to the Group in 6 years.

At the country level, work is being done to better leverage the synergies between the different subsidiaries and structure the group more efficiently. It is an ongoing process which will permit Santander US to focus on improving its technological and financial capacities as well as its commercial offering.

Santander Bank continues to focus on improving profitability. Its NIM is now 2.7%, in line with foreign-owned peers in the United States. It has undertaken numerous initiatives to expand its digital footprint, improve customer experience, and earn customer loyalty. The impact of these initiatives was reflected in the 8% increase in loyal customers and the 5% increase in digital ones.

In **Santander Consumer USA** a new management team was put in place in the third quarter, paving the way for strengthened performance. SC USA's strategy is centred on the optimisation of the mix of assets retained on the balance sheet, improving funding costs, maximising the value of the Fiat Chrysler agreement and improving dealer experience. Santander Consumer USA continued to focus on growth in its core segment, i.e. non-prime, as well as increasing market share in the prime segment.

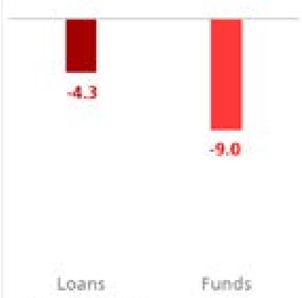
LOYAL CUSTOMERS*
Thousands



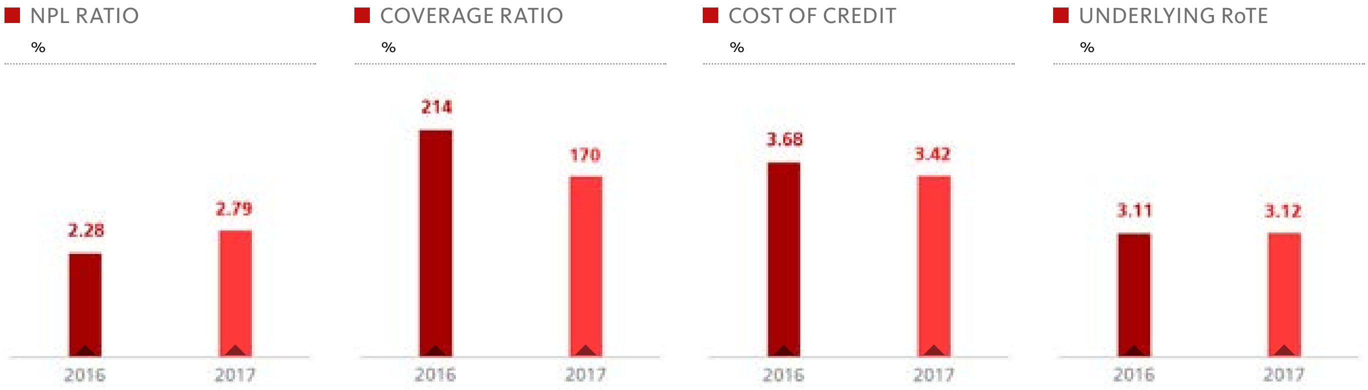
(*) Santander Bank

DIGITAL CUSTOMERS*
Thousands

ACTIVITY PERFORMANCE
% change 2017 / 2016 (excl. FX)



ATTRIBUTABLE PROFIT
Constant € million



Activity

Total lending decreased in the year. Compared to 2016, credit declined 4% due to the sale of a portfolio in Santander Consumer USA and to fewer originations in Santander Bank, together with a reduction in GCB balances as part of a disciplined pricing initiative aimed at improving profitability.

Customer funds fell 9% due to the run-off of government and GCB balances, resulting in an increased weight of core deposits in the banks funding structure. Additionally, wholesale funding balances decreased around 10% mainly due to lower funding needs from FHLB (Federal Home Loan Banks).

Results

Attributable profit was €322 million, 7% less than in 2016. Excluding impacts from non-recurring items from both years (related to hurricanes, increased stake in SC USA and the tax reform in 2017; and due to SC USA's restatement in 2016), underlying attributable profit increased 5%, benefiting from the reduced weight of minority interests.

Gross income also decreased, mainly due to lower interest income at Santander Consumer USA, affected by the change in business mix towards a lower risk profile and higher funding costs, partially mitigated by lower provisions. On the other hand, Santander Bank's gross income rose, benefitting from the increase in official interest rates and lower funding costs following balance sheet optimisation.

Costs increased due to investments at Santander Consumer USA and the Holding, while those at Santander Bank remained flat.

Provisions fell 12%, thanks to the change in the portfolio mix and the reduced volumes at Santander Consumer USA.

Santander Consumer USA maintained its high RoTE (13%) while Santander Bank's improved one percentage point over the year.

Strategy in 2018

Continue making progress in addressing Santander US' regulatory issues
Improve customer experience and loyalty with special emphasis on products and global connectivity
Continue the cost reduction initiatives, shared services integration and synergy realisation in order to improve efficiency and drive profitability
In Santander Bank, continue with the balance sheet optimisation while growing volumes and improving margins
In SC USA, maintain leading position in auto finance, ensuring an adequate risk-return profile in the non-prime segment and increasing prime originations via the Fiat Chrysler agreement

CORPORATE CENTRE

(€ million)

Income statement	2017	2016	Change amount	%
Net interest income	(851)	(739)	(111)	15.1
Net fee income	(38)	(31)	(7)	21.3
Gains (losses) on financial transactions	(227)	(243)	16	(6.6)
Other operating income	(104)	(52)	(52)	99.5
Gross income	**(1,220)**	**(1,066)**	**(154)**	**14.5**
Operating expenses	(476)	(450)	(26)	5.8
Net operating income	**(1,696)**	**(1,516)**	**(180)**	**11.9**
Net loan-loss provisions	(45)	2	(47)	—
Other income	(181)	(75)	(107)	142.8
Underlying profit before taxes	**(1,923)**	**(1,589)**	**(334)**	**21.0**
Tax on profit	32	141	(109)	(77.1)
Underlying profit from continuing operations	**(1,890)**	**(1,448)**	**(442)**	**30.5**
Net profit from discontinued operations	—	0	(0)	(100.0)
Underlying consolidated profit	**(1,890)**	**(1,448)**	**(443)**	**30.6**
Minority interests	(1)	(9)	7	(86.0)
Underlying attributable profit to the Group	(1,889)	(1,439)	(450)	31.3
Net capital gains and provisions*	(436)	(186)	(251)	134.9
Attributable profit to the Group	**(2,326)**	**(1,625)**	**(701)**	**43.1**

(*) In 2017, charge for equity stakes an intangible assets, capital gains from the disposal of the stake in Allfunds Bank and goodwill charges. In 2016, restructuring costs.

Balance sheet	2017	2016	Change amount	%
Debt securities	1,768	1,374	394	28.7
Goodwill	25,769	26,724	(955)	(3.6)
Capital assigned to Group areas	83,045	78,537	4,509	5.7
Other financial assets	7,841	9,872	(2,031)	(20.6)
Other assets	14,929	15,648	(719)	(4.6)
Total assets	**133,353**	**132,154**	**1,198**	**0.9**
Debt securities issued	35,030	30,922	4,108	13.3
Other financial liabilities	3,381	4,042	(661)	(16.4)
Other liabilities	8,092	12,422	(4,331)	(34.9)
Total liabilities	**46,502**	**47,387**	**(884)**	**(1.9)**
Total equity	**86,850**	**84,768**	**2,083**	**2.5**
Other managed and marketed customer funds	**2**	**—**	**2**	**—**
Mutual funds	2	—	2	—
Pension funds	0	—	0	—
Managed portfolios	—	—	—	—

Resources	2017	2016	Change amount	%
Number of employees	1,784	1,724	60	3.5

CORPORATE CENTRE

2017 highlights

-€2,326 M
Attributable profit*

The purpose of the Corporate Centre is to provide support and control, contributing value-added to the operating units. It also develops functions inherent in a holding related to financial and capital management
Revenues negatively affected by costs associated with exchange rate hedging, which had a positive impact on the business areas, as well as the higher volume of issues made. Recovery of taxes was also lower
In addition, a negative impact of €436 million from the net of non-recurring results mainly related with amortisation of goodwill in SC USA and the capital gain from the sale of Allfunds

* Before net capital gains and provisions: -€1,889 M

Strategy and functions

Banco Santander's Corporate Centre has support and control units that carry out functions for the Group in matters of risk, financial management, audit, technology, human resources, legal affairs, communication and marketing, among others.

It contributes value to the Group in various ways:

- It makes the Group's governance more solid, through frameworks of control and global supervision, and taking strategic decisions.
- It makes the Group's units more efficient, fostering the exchange of best practices in management of costs and economies of scale. This enables us to be one of the most efficient banks.
- By sharing the best commercial practices, launching global commercial initiatives and driving digitalisation, the Corporate Centre contributes to the Group's revenue growth.
- It also develops functions related to financial management and capital, as follows.

- **Functions developed by Financial Management:**

– Structural management of liquidity risk associated with funding the Group's recurring activity, stakes of a financial nature and management of net liquidity related to the needs of some of the business units.

This activity is carried out through diversifying the various sources of funding (issues and others), always maintaining an adequate profile (volumes, maturities and costs). The price at which these operations are conducted with other Group units is the market rate (euribor or swap) plus the premium which, in concept of liquidity, the Group supports by immobilising funds during the term of the operation.

– Interest rate risk is also actively managed in order to soften the impact of interest rate changes on net interest income, conducted via derivatives of high quality, high liquidity and low consumption of capital.

– Strategic management of the exposure to exchange rates on equity and dynamic on the countervalue of the units' results, according to the forecast of exchange rates evolution in the coming months. Net investments in equity are currently covered by €20,787 million (mainly Brazil, UK, Chile, Mexico and Poland) with different instruments (spot, forex swaps and forwards).

- **Total management of capital and reserves:**

– The capital assigned to each unit and its consolidated management is carried out at the Corporate Centre.

Results

Loss of €2,326 million, of which €436 million was non-recurring.

In year-on-year terms:

- Revenue was impacted by the costs stemming from the centralised management of the exchange rate risk and liquidity management.
- Operating expenses increased 6% in part due to the roll-out of global projects.
- Other results and provisions recorded losses of €181 million, up from €75 million in 2016. This item includes provisions at the Group level. The most notable ones in 2017 were for intangible assets (-€50 million), the cost of the government's guarantee on DTAs, as well as other provisions of a varied nature (pensions, litigation, supervisors, etc.) and equity stakes.

These items include very different kinds of provisions, as well as capital gains, capital losses and impairment of financial assets.

- The underlying loss in 2017 was €1,889 million compared to €1,439 million also negative in 2016. After including the impact of the net non-recurring positive and negative results of €436 million, the total loss was €2,326 million, up from €1,625 million in 2016.

RETAIL BANKING*

2017 highlights

€7,463 M
Attributable profit

Continued transformation of our commercial model toward one that is increasingly Simple, Personal and Fair
Focus on three priorities: customer loyalty and satisfaction, digital transformation and operational excellence
The Group had 17.3 million loyal customers at the end of 2017 and 25.4 million digital customers
The Banker chose Santander as Global Bank of the Year and Euromoney as the Best Bank in the World for SMEs for the second year running. We were also recognised as the Best Bank in Latin America in five of the countries where we operate

* Changes in constant currency

Strategy

Santander has a clear and consistent strategy of commercial transformation. The three main elements are:

1. Improve customer loyalty and satisfaction.

2. Promote the digital transformation of channels, products and services.

3. Keep on enhancing customer satisfaction and experience, improving operational excellence with new processes that are simpler, more efficient and omnichannel.

Of note were the following actions:

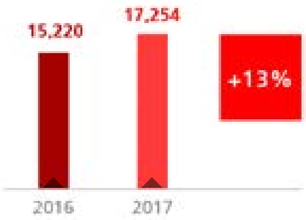
1. In **loyalty**, the 1|2|3 strategy continues to be anchored in most countries and at the end of 2017 there were 13% more loyal customers than in 2016.

RETAIL BANKING
(€ million)

Income statement	2017	2016	Change amount	%	% excl. FX
Net interest income	31,701	29,343	2,358	8.0	7.9
Net fee income	9,718	8,804	914	10.4	9.8
Gains (losses) on financial transactions	706	700	6	0.8	3.4
Other operating income	631	553	78	14.0	17.1
Gross income	**42,755**	**39,400**	**3,355**	**8.5**	**8.4**
Operating expenses	(19,374)	(18,509)	(864)	4.7	4.9
Net operating income	**23,381**	**20,890**	**2,491**	**11.9**	**11.5**
Net loan-loss provisions	(8,174)	(8,695)	521	(6.0)	(7.2)
Other income	(2,387)	(1,687)	(700)	41.5	39.8
Underlying profit before taxes	**12,820**	**10,509**	**2,312**	**22.0**	**22.7**
Tax on profit	(3,914)	(2,887)	(1,027)	35.6	36.5
Underlying profit from continuing operations	**8,906**	**7,622**	**1,284**	**16.9**	**17.5**
Net profit from discontinued operations	—	—	—	—	—
Underlying consolidated profit	**8,906**	**7,622**	**1,284**	**16.9**	**17.5**
Minority interests	1,282	1,103	179	16.2	15.9
Underlying attributable profit to the Group	7,624	6,519	1,105	17.0	17.8
Net capital gains and provisions*	(161)	(173)	12	(6.8)	(5.0)
Attributable profit to the Group	**7,463**	**6,346**	**1,117**	**17.6**	**18.4**
Pro memoria:					
Loans excluding repos	681,191	692,026	(10,836)	(1.6)	3.1
Funds (customer deposits excluding repos + mutual funds)	739,935	728,347	11,589	1.6	6.5

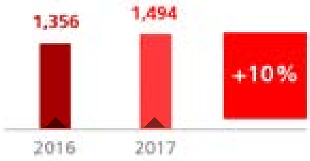
(*) In 2017, integration costs and USA tax reform. In 2016, capital gains from the disposal of the stake in VISA Europe, restructuring costs, PPI in the UK and restatement of Santander Consumer USA

LOYAL CUSTOMERS
Thousands

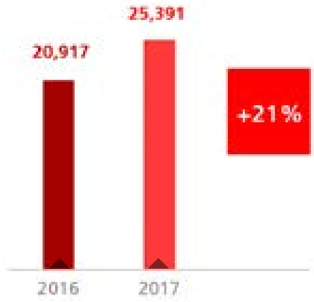


LOYAL RETAIL CUSTOMERS
Thousands

LOYAL SME & CORPORATE CUSTOMERS. Thousands



DIGITAL CUSTOMERS
Thousands



- Of note was the *1|2|3 Smart* in Spain aimed at millenials (18-31 year olds) with tailored financing products, and the 100% digital and no-fee *Zero account,* which already has more than 3 million customers; *Santander Plus* in Mexico with more than three million customers, 52% of them new; *Mundo 1|2|3* in Portugal that contributed to the growth in loyal (+8%) and digital (+11%) customers.

Cuenta 1|2|3 Smart

- Santander continued to set itself apart with the launch of innovative products tailored to customers' needs. For example, *Select Me* in Mexico, which seeks to support women in their day-to-day tasks and in their professional life, or the development of value-added services and programmes that contribute to the growth of SMEs, such as the new business model *ROF PyME* also in Mexico.

- We remain committed to the long-term growth of SMEs. Our strategy in this segment is to maintain a global initiative that we adapt in each market to local features. This produced an increase in the satisfaction levels of our customers as well as recognition in specialised international publications.

- We are registering solid growth in the cards segment, notably in Spain, where we made record sales of 1.4 million cards and increased turnover by 50%. In Brazil, credit card turnover rose 23%, gaining market share.

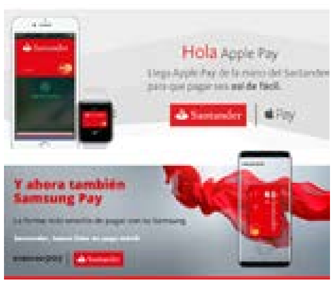
  The marketing of the cards of various loyalty programmes with airlines continued to be well received (American Airlines with *AAdvantage* card in Brazil, where activation of cards continued to be significant), *Santander Aeroméxico* in Mexico y *WorldMember Limited* in Chile).

2. In **digital strategy** the number of digital customers was 21% higher. Of note:

- The launch of Openbank, Spain's first fully digital bank, with one of the sector's most complete, flexible and agile platforms; *SuperDigital* in Brazil, independent payment platform for the youngest customers and which widens the possibilities to promote bank use; *SúperDigital* in Mexico, where our customers open an account via any device connected to internet, and the launch in Chile of the country's first 100% digital onboarding.

Openbank
Grupo Santander

- In mobile payments, we launched *Súper Wallet* in Mexico, an app that gives customers centralised management of all their cards, while in Spain we were consolidated as the leaders with a market share of around 60%.



- Other digital initiatives were the launch of *Digilosofia,* Santander's digital philosophy in Spain and improvements in our channels. In Brazil we launched *Consignado* (100% digital), contracted by mobile, *Web Casas,* a digital platform for real estate loans and *Santander Pass,* a bracelet with NFC (near field communication) a contactless payment system. In Poland, the *As I Want it Account* enables customers to decide what they need and how to pay for the products and services offered.

Digilosofía.
La filosofía digital del Santander.

3. In **operational excellence,** we are working with new processes that are simpler, more efficient and multichannel. Of note:

- In Mexico, *Dinero Creciente* was re-launched with simpler processes and competitive rates.

- In Brazil, we enlarged our team of business managers for SMEs, while promoting packets of products with personalised conditions. In order to incentivise real estate business, interest rates were lowered which led to growth of 88% in new mortgages to individuals and in the agribusiness segment 12 shops were opened (market share of 8.6%).

- In Chile, more *WorkCafé* branches, an innovative model, were opened, with co-working areas, a coffee shop and financial services. The number of these branches was stepped up, rising from seven to 20 throughout the country.

- In the UK, new digital processes were launched. Some 47% of mortgages were retained online, 38% of current account openings and 51% of credit cards were via digital channels.

- In the US, the *Apple Pay* card was launched for retail customers and *Treasury Link,* a cash management platform for commercial customers.

Santander InnoVentures incorporated to its portfolio three new financial technology companies, the UK firms Pixoneye and Curve and the US Gridspace, widening its focus toward artificial intelligence as a technology that will transform banking in the coming years. We also invested in the Mexican company ePesos to promote financial inclusion.

Results

Profit was 18% higher at €7,463 million.

Results were driven by met interest income (+8%), the good performance of fee income (+10%) in almost all units, contained costs and lower provisions.

ACTIVITY PERFORMANCE
% change 2017 / 2016 (excl. FX)

Note: Gross loans w/o repos.
Customer deposits w/o repos + mutual funds.

ATTRIBUTABLE PROFIT
Constant € million

(*) In euros: +18%

Strategy in 2018

Consolidate our culture of service: Simple, Personal and Fair
Advance in our differential value offering that gives us the global presence to improve customer satisfaction
Continue to foster the commercial transformation in order to make available to customers products, services and simpler solutions that make us stand out for operational excellence
Keep on progressing in our digital transformation in order to become the best open platform for digital financial services

SANTANDER GLOBAL CORPORATE BANKING* (GCB)

2017 highlights

€1,821 M
Attributable profit

- Improved quality of customer revenues (+2%), driven by value-added businesses and higher fee income that offset lower use of the balance sheet
- Better positioning in value-added businesses, particularly in debt and capital issues and regional transaction services via Cash Nexus. Drive in low capital consumption businesses such as export finance, agent finance and trade finance
- Continued improvement in services to retail network customers through digitalisation and tailored products
- Attributable profit up 1% and accounting for 20% of the operating areas

* Changes in constant currency

Strategy

The main activities were:

- Priority in efficient use of capital by rigorously assigning it to various businesses and greater speed in rotating the balance sheet. A private debt mobilisation team was also created to improve origination and distribution capacities, offering value-added and low capital consumption solutions to our customers.
- Leadership consolidated in Latin America, Spain and Portugal in debt and capital markets, project finance and financing via export credit agencies (ECAs). Significant growth in the M&A area in most countries, with particular focus on the Asia-Latin America corridor.
- Two new global transaction banking products developed: confirming based on purchase orders and the global receivables purchase programme. Both solutions enable customers to optimise use of working capital.

GLOBAL CORPORATE BANKING

(€ million)

Income statement	2017	2016	Change amount	%	% excl. FX
Net interest income	2,478	2,528	(50)	(2.0)	(2.5)
Net fee income	1,627	1,407	221	15.7	15.9
Gains (losses) on financial transactions	1,224	1,256	(33)	(2.6)	(1.9)
Other operating income	224	289	(66)	(22.7)	(23.9)
Gross income	**5,552**	**5,480**	**72**	**1.3**	**1.2**
Operating expenses	(1,988)	(1,917)	(71)	3.7	4.8
Net operating income	**3,564**	**3,563**	**1**	**0.0**	**(0.7)**
Net loan-loss provisions	(690)	(658)	(32)	4.9	0.8
Other income	(70)	(76)	6	(7.5)	(7.3)
Underlying profit before taxes	**2,804**	**2,829**	**(25)**	**(0.9)**	**(0.9)**
Tax on profit	(802)	(788)	(15)	1.9	2.3
Underlying profit from continuing operations	**2,002**	**2,042**	**(40)**	**(2.0)**	**(2.1)**
Net profit from discontinued operations	—	—	—	—	—
Underlying consolidated profit	**2,002**	**2,042**	**(40)**	**(2.0)**	**(2.1)**
Minority interests	181	174	7	3.8	0.9
Underlying attributable profit to the Group	1,821	1,868	(47)	(2.5)	(2.4)
Net capital gains and provisions*	—	(58)	58	(100.0)	(100.0)
Attributable profit to the Group	**1,821**	**1,809**	**12**	**0.7**	**0.8**
Pro memoria:					
Loans excluding repos	87,015	97,591	(10,576)	(10.8)	(5.4)
Funds (customer deposits excluding repos + mutual funds)	75,642	66,453	9,189	13.8	19.9

(*) In 2016, restructuring costs.

- Strengthened integration with retail banking networks and offer of value-added products to customers.

- We maintained the best efficiency levels among Banks, thanks to our customer-focused business model that combines global and local reach in risk management, capital and liquidity.

Activity

- ***Cash Management***: double-digit growth with very good results, both in transactional business as well as in funds. Nexus was consolidated in 2017 as a solid and robust solution for our customers' regional business, in order to obtain significant mandates via Santander Cash Nexus, which doubled the number of transactions and active customers, both those managed by SGCB as well as by commercial banking.

- ***Export Finance & Agency Finance:*** Santander consolidated its leadership position as one of the world's best banks by volume of managed assets. In 2017 we worked in new organisations in non-core markets where this business has a high potential.

- ***Trade & Working Capital Solutions***: strong growth, especially in confirming products and receivables, where we made significant improvements in the offer which enabled business in structured receivables to be doubled.

- Of note in ***Corporate Finance*** was the participation of Equity Capital Markets in Unicredit's capital increase and in the IPO of BR Distribuçoes. In M&A, the sole advisory role in China Merchants to acquire the terminal of Conteiner Paranaguá in Brazil and the advisory services for the Australian fund First State's acquisition of Ancora Wind Portfolio in Portugal.

- In ***Debt Capital Markets,*** Santander held its leadership position in Latin America. We were again the bank that conducted the most operations in the region, leading placements of sovereign bonds, such as that of the Argentine Republic, as well as Brazilian, Chilean, Argentinian and Mexican corporate issuances. Also of note was the solid position in Europe and the US, leading issuances in the three main currencies for companies such as Coca Cola, BASF, VW, Iberdrola, Enel, Unilever and Nestlé, among others. And also for banks such as Wells Fargo and Barclays.

- ***Syndicated corporate loans***: major role in the main operations related to M&A, including Gerdau, Chemchina / Syngenta, Reckitt Benckiser, Fresenius and Vidrala.

- In ***Structured Financing***: we are leaders in Latin America, Spain and the UK. Of note was the financing of the M6 (the largest M&A transaction on infrastructure assets in the UK), the placement of one of the largest project bonds in Europe to finance the Pedemontana-Veneta motorway, financing the largest renewable energy park in 2017 in the US (Mount Signal III, owned by Capital Dynamics) and the financing of Latin America's biggest wind farm, developed by Zuma Energía in Mexico.

RANKING IN 2017

Source	Area	Award / Ranking
Euromoney	SGCB	Best Investment Bank in Mexico and Chile
Latin Finance	SGCB	Best Infrastructure Bank 2017 in Mexico and Brazil
Global Finance	Global Debt Financing	Best Debt Bank Latam
Infrastructure Investor	Global Debt Financing	Latin America Bank of the year
Euromoney	Global Markets	Best Liquidity Provider Euro Covered Bond
MTN-I	Global Markets	2017 mtn-i Award in the Power Performer category for Senior Non-Preferred Debt Leadership
Risk Magazine	Global Markets	#2 Risk Solutions House of the Year
Market Axess	Global Markets	#1 E-Flows FRN European Corporate Bonds
Institutional Investor	Global Markets	#1 Corporate Access (Research) in Mexico
Institutional Investor	Global Markets	#1 Latin America Research Team- sector winners: Equity Strategy, Electric Utilitites, Transportation
Institutional Investor	Global Markets	#1 Equity Research in Iberian markets
TFR	Global Transaction Banking	Best Trade Bank in Latin America
Global Capital	Corporate Finance	Best Equity Capital Raising by a Listed Company: Banco Popular's € 2.5bn rights issue | 2016
Global Capital	Corporate Finance	ECM Deal of the Year in Iberia: Banco Popular's € 2.5bn rights issue | 2016
Latin Finance	Corporate Finance	Cross-Border M&A Deal of the Year: State Power Investment Corp/Pacific Hydro | 2016

- Good results in ***Markets*** activity thanks to the evolution of sales business and the larger contribution of management of books. Significant growth in Spain and the UK. Also strong growth in equities' brokerage, particularly in Spain and Portugal, Mexico and the US.

Results

Attributable profit of €1,821 million (+1%), driven by the strength and diversification of customer revenues. Gross income and attributable profit accounted for 11% and 20%, respectively, of the Group's operating areas.

Gross income increased from Corporate Finance, Global Markets and Global Transaction Banking, spurred by fee income and gains on financial transactions, mainly, and with a good performance in the UK, Continental Europe and Mexico. The positive evolution of markets more than offset the loss of DVA from contracting the Group's risk cost.

Operating expenses rose a little and provisions declined, particularly in Brazil and Spain.

GROSS INCOME BREAKDOWN

(Constant € million)

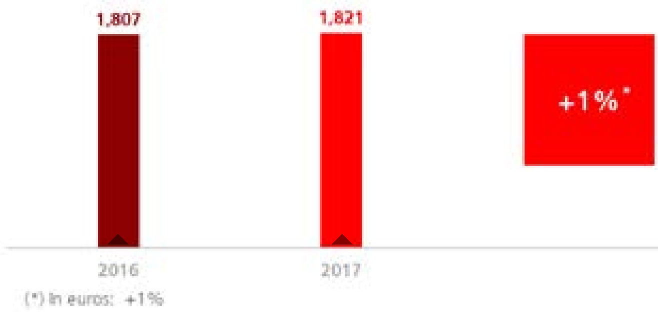
(1) Global Transaction Banking: includes the business of cash management. trade finance. basic financing and custody.

(2) Financing Solutions & Advisory: includes the units of origination and distribution of corporate loans and structured financings. bond and securitisation origination teams. corporate finance units (mergers and acquisitions. primary markets of equities. Investment solutions for corporate clients via derivatives). as well as asset based finance.

(3) Global Markets: includes the sale and distribution of fixed income and equity derivatives. interest rates and inflation; the trading and hedging of exchange rates. and short-term money markets for the Group's wholesale and retail clients; management of books associated with distribution; and brokerage of equities. and derivatives for investment and hedging solutions.

ATTRIBUTABLE PROFIT

(Constant € million)



Strategy in 2018

Capture international business flows between the countries where the Group operates, expanding the offer of high value-added products and increasing the penetration in the business of our customer franchise
Re-launch the UK and US franchises' business to accelerate their growth
Continue to develop and integrate the factory of SGCB products for customers of the commercial banking network
Maintain the low capital consumption business model, with a disciplined rotation of the balance sheet
Transform the technological and risk infrastructure in a simplified, scalable and digital platform

5

RISK MANAGEMENT REPORT

EXECUTIVE SUMMARY

Risk management and control model principles

pages 200 to 210

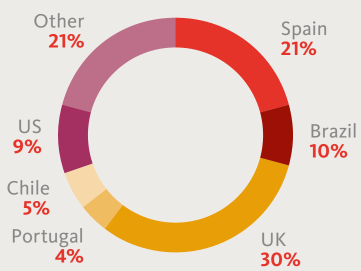
- Advanced, comprehensive management of all risks, with a forward-looking approach.
- Lines of defence that enable risk to be managed at source, controlled and monitored, in addition to an independent assessment.
- Risk culture embedded in the entire Organisation.
- A model based on autonomous subsidiaries with robust governance that separates the risk management and control functions.
- Appropriate information management and technological infrastructure.
- Risks managed by the units that generate them.

These principles, combined with a series of relevant interrelated tools and processes in the planning of the Group strategy, make for a robust control framework.

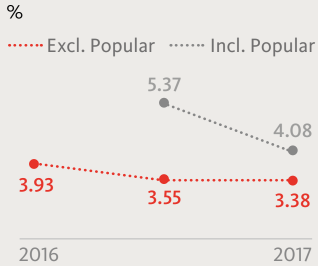
Consolidation of improvement in credit risk profile

pages 213 to 242

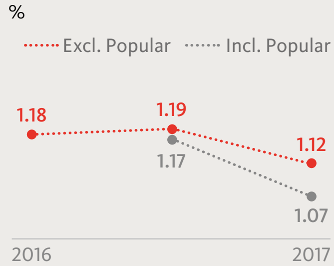
CUSTOMER CREDIT RISK BY COUNTRY



NPL RATIO



COST OF CREDIT[1]



1. Cost of credit = loan-loss provisions twelve months / average lending.

- Over 80% of risk relates to retail banking. Adequate geographic and sector diversification.
- Consolidation of the improvement trend in the Group's main credit quality indicators, which in December 2017 stood at (excl. Popular):
  - NPL ratio fell to 3.38%, decrease of 55 bp compared to year-end 2016, with noteworthy reductions in Portugal, Spain, Poland and Brazil.
  - Provisions fell to EUR 8,997 million in December, down 5.5% compared to the same period of the previous year, mainly due to SCUSA, SCF and Spain.
  - Cost of credit decreased to 1.12% (-6 bp), in line with the credit profile improvement.
  - The coverage ratio remains at approximately 71%.

Trading market risk, liquidity risk and structural risks

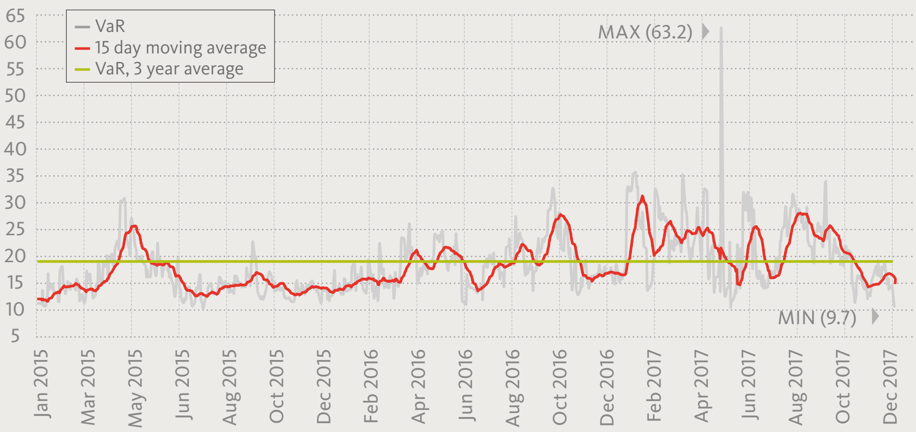
pages 243 to 263

Trading market risk

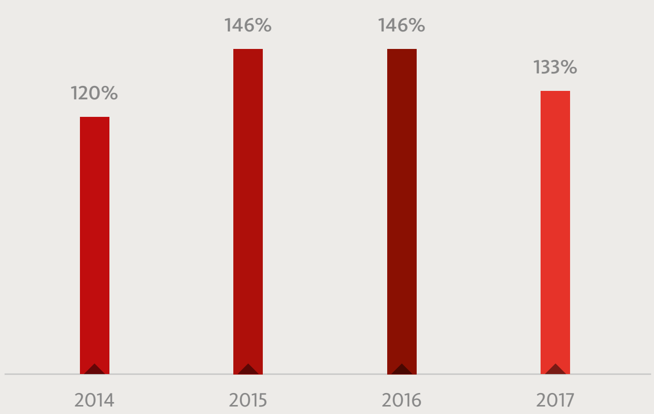
- Our core business is client facilitation driven (market making, sales/fees), along with an active management and geographically diversified model.
- An appropriate balance sheet structure reduces the impact of interest rates changes on net interest income and equity.
- Core capital ratio coverage at approximately 100% for exchange rate movements.

VAR 2015-2017 (EXCL. POPULAR)

Million euros. VaR at a 99% confidence interval over a one day horizon



SHORT-TERM LIQUIDITY COVERAGE RATIO (LCR)



Liquidity risk

- Santander has a comfortable liquidity position, based on its commercial strength and autonomous subsidiaries model, with a strong weighting of customer deposits and robust liquid asset buffers.
- The long term ratio (NSFR) maintained comfortable levels above 100% and the short term ratio (LCR) stood at 133%, complying with the regulatory requirement of 80%.
- Short and long-term liquidity metrics, and those related to encumbered assets and stress scenarios are within the risk appetite levels established for each of the Group's units.

Non-financial risks

pages 264 to 284

Operational risk

- Completion of the operational risk advanced measurement transformation project.
- Cyber risk strategy reinforcement, with the improvement of the anticipation, defence and awareness capacities.
- Development of control and critical risk methodologies to prioritise their management.

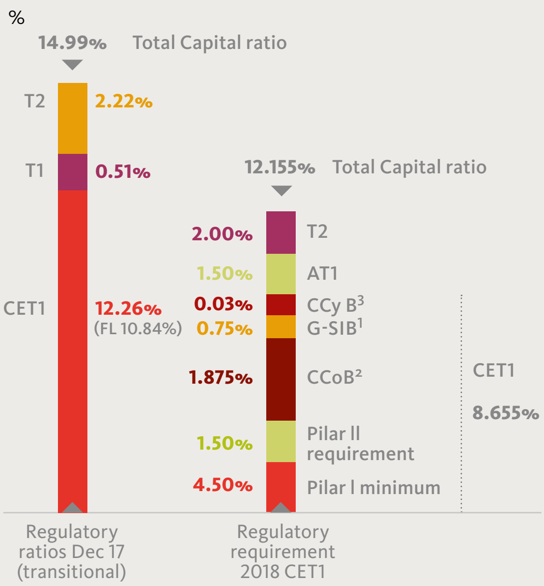
Compliance and conduct risk

- Sustainability and climate change initiatives implementation to respond to the growing interest of investors, customers and shareholders.
- Supervisor pressure increase regarding customer protection and customer complaints management.
- Challenges derived from new relevant regulations: MiFID II, GDPR, PSD II, 4th AML Directive.

Capital Risk

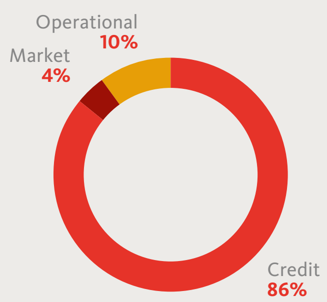
pages 288 to 290

REGULATORY CAPITAL (PHASE IN)



1. Global Systemically Important Banks buffer.
2. Conservation Capital Buffer.
3. Countercyclical Capital Buffer. Calculated with December 2017 data and required from 1 January 2018.

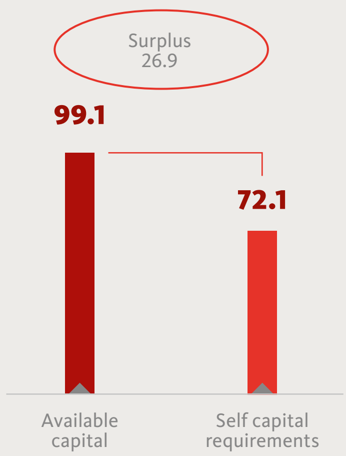
RWA* BY RISK TYPE



* Risk weighted assets

ECONOMIC CAPITAL (EXCL. POPULAR)

Billion euros



- In terms of capital risk, the Group holds a comfortable solvency position, both in terms of regulatory and economic capital.
- The breakdown of capital requirements by risk type is unchanged compared to the previous year.

A. Risk management and control model

Since its foundation in 1857, Banco Santander has had among its priorities the development of a forward-looking risk management strategy, through a sound control environment. This has enabled the Group to deal appropriately with changes in the economic, social and regulatory context in which it operates, contributing to the progress of people and businesses.

Risk management is therefore one of the key functions in ensuring that Santander remains a robust, safe and sustainable bank, that guarantees a management aligned with the interests of its employees, customers, shareholders and society.

The risk management and control model deployed by the Santander Group is based on the principles set down below, which are aligned with the Group's strategy and take into account, the regulatory and supervisory requirements, as well as the best market practices:

1. **An advanced and comprehensive risk management policy, with a forward-looking approach** that allows the Group to maintain a medium-low risk profile, through a risk appetite defined by Santander's board of directors and the identification and assessment of all risks.
2. **Lines of defence** that enable risk to be managed at source, controlled and monitored, in addition to an independent assessment.
3. **A model predicated on autonomous subsidiaries with robust governance** based on a clear committee structure that separates the risk management and control functions.
4. **Information and technological management processes** that allow all risks to be identified, developed, managed and reported at appropriate levels.
5. **A risk culture integrated throughout the Organisation**, composed by a series of attitudes, values, skills and action guidelines to deal with all risks.
6. **All risks are managed by the units that generate them.**

These principles, combined with a series of relevant interrelated tools and processes in the Group's strategy planning (risk appetite, risk identification and assessment, analysis of scenarios, risk reporting framework, budgetary processes, etc.) make up a key control framework when developing the risk profile control.

A.1. Risk map

The Santander Group has established the following first level risks in its general risk framework:

- **Credit risk:** risk of financial loss arising from the default or credit quality deterioration of a customer or other third party, to which the Santander Group has either directly provided credit or for which it has assumed a contractual obligation.
- **Market risk:** risk incurred as a result of changes in market factors that affect the value of positions in the trading book.
- **Liquidity risk:** risk that the Group does not have the liquid financial resources to meet its obligations when they fall due, or can only obtain them at high cost.
- **Structural risk:** risk arising from the management of different balance sheet items, not only in the banking book but also in relation to insurance and pension activities.
- **Capital risk:** risk of Santander Group not having an adequate amount or quality of capital to meet its internal business objectives, regulatory requirements or market expectations.
- **Operational risk:** defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This definition includes legal risk[1].
- **Conduct risk:** risk arising from practices, processes or behaviours which are not adequate or compliant with internal regulation, legal or supervisory requirements.
- **Reputational risk:** risk of current or potential negative economic impact to the Bank due to damage to the perception of the Bank on the part of employees, customers, shareholders/investors and the wider community.
- **Model risk:** risk of loss arising from inaccurate predictions, causing the Bank to make suboptimal decisions, or from a model being used inappropriately.
- **Strategic risk:** risk of loss or damage arising from strategic decisions or their poor implementation, that impact the long term interests of our key stakeholders, or from an inability to adapt to external developments.

All identified risks should be referenced to the basic risk categories mentioned above, in order to organise their management, control and related information.

A.2. Risk governance

For the proper development of the risk function, the Group has a strong governance policy, which is in place to ensure that the risk decisions taken are appropriate and efficient and that they are effectively controlled within the established risk appetite framework.

The **Group Chief Risk Officer (GCRO)** oversees this function within the Group, advises and challenges the executive line and also reports independently to the Risk Supervision, Regulation and Compliance Committee and to the board.

A.2.1. Lines of defence

Banco Santander's management and control model is based on three lines of defence.

The business functions and all support functions that generate exposure to a risk make up the first line of defence. The role of these functions is to establish a management structure for the risks that are generated as part of their activity ensuring that these remain within the approved appetite risk and the established limits.

The second line of defence is composed by the risk control function, and the compliance and conduct function. The role of these functions is to provide independent oversight and challenge the risk management activities performed by the first line of defence.

These functions are responsible for ensuring that the risks are managed in accordance with the risk appetite defined by senior management and to foster a strong risk culture across the whole Organisation. They must also provide guidance, advice and expert opinion in all key risk-related matters.

Internal audit as the third line of defence. As the last layer of control, regularly assesses policies, methods and procedures to ensure they are adequate and are being implemented effectively in the management and control of all risks.

1. Legal risk includes, but is not limited to, exposure to fines, penalties, or punitive damages resulting from supervisory actions, as well as private settlements.

The risk control, compliance and conduct and internal audit functions are sufficiently separated and independent from each other, and regarding to other functions they control or supervise for the performance of their duties, and they have access to the board of directors and/or its committees through their maximum responsibles.

A.2.2. Risk Committees structure

Ultimately, the board of directors is responsible for the risk control and management and, in particular, for setting the risk appetite for Santander Group. It can also delegate its powers to committees classed as independent control bodies or decision-making bodies. The board uses the Risk Supervision, Regulation and Compliance Committee as an independent risk control and oversight committee. The Group's Executive Committee also pays special attention to the management of all risks.

The highest risk governance bodies are described as follows:

Bodies for independent control

Risk Supervision, Regulation and Compliance Committee:
The purpose of this committee is to assist the board in matters of risk supervision and control, in the Group risk policies definition, in the relation with the supervisory authorities and in aspects of regulation and compliance, sustainability and corporate governance.

It is chaired by an independent director and is formed by external or non-executive directors, the majority of which are independent.

The functions of the Risk Supervision, Regulation and Compliance Committee are:

- Support and advise the board in defining and assessing the risk policies that affect the Group and in determining the risk propensity and risk strategy.
- Provide assistance to the board for overseeing the risk strategy implementation and its alignment with strategic commercial plans.
- Systematically review the exposures of major clients, economic sectors, geographical areas and risk types.
- Understand and assess management tools, improvement initiatives, projects progress and any other relevant activity relating to risk control over the course of time, including the internal risk model policy and its internal validation.
- Support and advise the board regarding supervisors and regulators in the various countries where the Group operates.
- Oversee compliance with the General Code of Conduct, manuals and procedures for anti-money laundering and anti-terrorism financing, and, in general, the rules of governance and the Bank's compliance programme, as well as the necessary proposals for its improvement. In particular, it is the committee's responsibility to receive information and, where necessary, issue reports on disciplinary measures for senior management.
- Supervise the Group's policy and rules of governance and compliance and, in particular, adopt the actions and measures resulting from the reports or the inspection measures of administrative supervision and control authorities.
- Monitor and assess applicable proposed regulations and regulatory initiatives, as well as analyse the possible consequences for the Group.
- Review the Corporate Social Responsibility policy, ensuring that it is oriented to the value creation of the Group, and monitoring of the strategies and practices in this matter, evaluating its compliance level.

Risk Control Committee (RCC):
This collegiate body is responsible for the effective risk control, ensuring they are managed in accordance with the risk appetite level approved by the board, permanently adopting an all-inclusive overview of all the risks included in the general risk framework. This duty implies identifying and tracking both current and potential risks, and gauging their impact on the Group's risk profile.

This committee is chaired by the Group Chief Risk Officer (GCRO) and is composed of senior management members. The risk function, which presides the committee, and the compliance and conduct, financial accounting and control, and management control functions are represented, among others. The risk function officers (CROs) of local entities take part in the committee on a regular basis to report on the risk profile of the entities and other aspects.

The Risk Control Committee reports to the Risk Supervision, Regulation and Compliance Committee and assists it in its function of supporting the board.

Decision making bodies

Executive Risk Committee (ERC):
This collegiate body is responsible for the management of all risks under the powers allocated to it by the board of directors.

The committee takes part in risk decisions at the highest level, ensuring that they are within the limits set out in the Group's risk appetite. It reports on its activity to the board or its committees whenever it is required to do so.

It is chaired by the CEO and comprises executive directors, and the Entity's senior management. The risk, finance and compliance and conduct functions, among others, are represented. The GCRO has a right to veto the decisions taken by this committee.

A.2.3. The Group's relationship with subsidiaries in risk management

Regarding the units alignment with the Corporation
The management and control model shares, in all the Group's units, basic principles via corporate frameworks. These frameworks are established by the Group's board of directors, and the local units adhere to them through their respective boards of directors, shaping the relationship between the subsidiaries and the Group, including the role played by the latter in taking important decisions by validating them.

Pursuant to these shared principles and basics, each unit adapts its risk management to its local reality, in accordance with corporate frameworks and reference documents provided by the Corporation, thus creating a recognisable and common risk management and control model in Santander Group.

One of the strengths of this model is the adoption of the best practices developed in each of the units and markets in which the Group operates. The Risk division centralises and conveys these practices.

Furthermore, the "Group-subsidiary governance model and good governance practices for subsidiaries" sets a regular interaction and functional reporting by each local CRO to the GCRO, as well as the participation of the Corporation in the process of appointing, setting targets, evaluation and remuneration of local CROs, in order to ensure risks are adequately controlled by the Group.

Regarding the structure of committees

The "Group-subsidiary governance model and good governance practices for subsidiaries" recommends that each subsidiary should have bylaw-mandated Risk Committees and other Executive Risk Committees, in line with the best corporate governance practices, consistent with those already in place in the Group.

The governance bodies of subsidiary entities are structured in accordance to local requirements, both regulatory and legal, and to the dimension and complexity of each subsidiary, being consistent with those of the parent company, as established in the internal governance framework, thereby promoting communication, reporting and effective control.

The subsidiaries management bodies have their own risk faculty model (quantitative and qualitative) and must follow the principles contained in the frameworks and reference models developed at corporate level.

Given its capacity for comprehensive (enterprise wide) and aggregated oversight of all risks, the Corporation exercises a validation and challenging role with regard to the operations and management policies of the subsidiaries, insofar as they affect the Group's risk profile.

A.3. Risk culture - Risk Pro

The Santander Way corporate culture entails a robust risk culture known as risk pro.

Risk management is underpinned by a shared culture that ensures that every employee understands and manages the risks that are part of their daily work.

Santander Group's solid risk culture is one of the main reasons the Group has been able to deal with changes in the economic cycle, new customer requirements and the rise of competitiveness, and the reason why it is considered to be an Entity that has earned the trust of its customers, employees, shareholders and society as a whole.

Against a backdrop of constant change, with new types of risk emerging and increasingly stringent regulatory requirements, Santander Group maintains an excellent level of risk management that enables it to achieve sustainable growth.

Excellence in risk management is therefore one of the strategic priorities that has shaped the Group's development. This involves prudence in risk management and building a sound internal risk management culture across the whole Organisation, which is understood and implemented by all Santander Group employees.

The risk pro culture is reinforced in all the Group's units by the following factors:

- **Employee life cycle.** From the selection and hiring phases and throughout their professional career, employees are made aware of their personal responsibility regarding risk management.

  Therefore, risk management is included in all employees' training plans. The Risk Pro Banking School, together with the other training centres for risk, help define the best strategic training lines for the Bank's professionals in accordance with Group priorities, in addition to disseminating the risk culture and developing the best talent.

  In 2017, 358,462 hours of training were given, attended by 140,527 Group employees.

  As a result, the Santander Group 2017 Global Engagement Survey concluded that 94% of employees thought that they could detect and take personal responsibility for the risks they encountered in their day-to-day work.

- **Communication.** The conduct, best practices and initiatives that exemplify the risk culture are disseminated through the different communication channels and individual actions involving the main risk managers. The Group optimised and improved its website, in which all the information required for advanced risk management is contained.

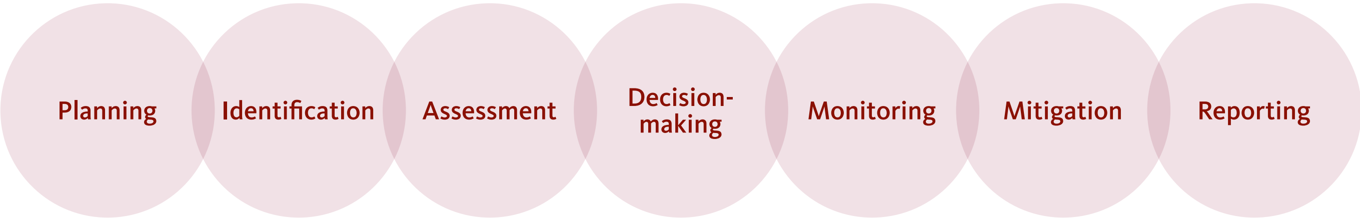
- **Risk culture assessment.** Santander Group performs a systematic and ongoing assessment of the risk culture to detect any potential areas for improvement and implement action plans. This has involved defining the global indicators used to assess the level of penetration and dissemination of the risk culture within the Group.

- **Governance.** The risk culture and risk management are underpinned by sound internal governance.

- **Advanced Risk Management (ARM).** ARM is a reflection of the importance of having a robust risk culture. For Santander Group, it is a priority aspect for its long-term goal for remaining a solid and sustainable bank.

A.4. Management processes and tools

The Santander Group has defined a series of key risk management and control processes, as shown below:



- **Planning.** Is the process of setting business objectives, which include the articulation of the types and levels of risk that the business is willing and able to accept in pursuit of these objectives.

- **Identification.** Risk identification is a key component of effective risk management and control. Every employee is responsible for identifying external and internal risks to the business in a timely manner, ensuring they are categorised according to the aforementioned risk map.

- **Assessment.** Once identified, risks must be assessed to determine their likelihood, impact and materiality under different scenarios.

- **Decision-making and Execution.** Decisions are required to manage the business's risk profile within the limits agreed in the planning phase, and to achieve business objectives. Strategy decisions are also needed to manage material and emerging risks within the functions bestowed to committees or individuals and in accordance with the powers delegated by the board of directors.

- **Monitoring performance versus Plan.** Risk management and control include monitoring business performance on a regular basis, and comparing performance against agreed plans. All plans and risk metrics should have clear alert thresholds (triggers) with defined escalation paths.

- **Mitigation (actions to address Plan deviations).** If monitoring highlights that performance has deviated, or is likely to deviate, beyond the approved ranges or thresholds, mitigating action should be considered to bring performance back to acceptable levels.

- **Reporting.** The risk reporting process includes the elaboration and submission of accurate and relevant management information, ensuring regular reporting on the business progress, and the urgent escalation of unexpected situations if required.

  It should also provide sufficient support to ensure the effectiveness of the aforementioned processes.

To develop the processes described above, Santander Group has several tools in place. These include:

Risk appetite

- **New metrics** with greater granularity and inclusion of additional metrics.
- **Consolidation** of **management and control systems** of the risk appetite framework in the Corporation and units.

Risk identification and Assessment (RIA)

- **Simplification, improvement and interaction** communities of control under new standards.
- **More robust and wider assessment** of the control environment that measures the management model implementation.

Scenario analysis

- Strengthening of the **operating and control model** in the execution of capital planning exercises.
- **Evolution of the** provisions forecast **methodology and the infraestructure** to Big Data technology, increasing the analytical and reporting capacity.

Risk Reporting Framework (RRF)

- **Structural and operational improvements** to enhance reporting of all risks at all levels.
- **Consolidation** of the **governance model** for risk information and reporting.

A.4.1. Risk appetite and structure of limits

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. For the latter, severe scenarios that could have a negative impact on the levels of capital, liquidity, profitability and/or the share price, are taken into account.

The board is responsible for annually setting and updating the risk appetite, monitoring the Bank's risk profile and ensuring consistency between both of them.

The risk appetite is set for the whole 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 local level, the boards of the subsidiaries are responsible for approving the respective risk appetite proposals once they have been validated by the Group.

The whole Organisation shares a common and unique risk appetite model. This sets out common requirements for processes, metrics, governance bodies, controls and corporate standards for its management integration, cascading down in an effective and traceable way to all management policies and limits.

Business model and fundamentals of the risk appetite

The definition and establishment of the risk appetite in the Santander Group is consistent with its risk culture and business model from the risk perspective. The main elements that define this business model and which are behind the risk appetite are:

- A general medium-low and predictable risk profile based on a diversified business model, focused on retail banking with an internationally diversified presence and with important market shares, as well as a wholesale banking business model that gives priority to customers relation in the Group's main markets.

- A stable and recurrent earnings and shareholder remuneration policy, underpinned by a sound base of capital and liquidity, as well as an effective diversification strategy in terms of sources of funding and maturities.

- An organisational structure based on subsidiaries that are legally independent and self-sufficient in capital and liquidity, minimising the use of non-operational or shell companies, and ensuring that no subsidiary has a risk profile that could jeopardise the Group's solvency.

- An independent risk function with very active involvement of senior management that guarantees a solid risk culture focused on protection, and ensuring an adequate return on capital.

- A management model that guarantees a global and inter-related view of all risks, through a corporate control and monitoring environment, with global level responsibilities: all risks, all businesses and all countries.

- A business model focused on those products that the Group knows sufficiently well and has the capacity to manage (systems, processes and resources).

- Development of its activity based on a conduct model that protects the interests of customers and shareholders.

- Adequate and sufficient availability of human resources, systems and tools that guarantee the preservation of a risk profile compatible with the risk appetite established, both at 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 risk appetite model, and that these are consistent with the evolution of the Bank's long-term results.

Corporate risk appetite principles

The following principles govern Santander Group risk appetite in all its units:

- **Board and senior management responsability.** The board is the maximum body responsible for setting the risk appetite and its regulation support, as well as supervising its compliance.

- **Enterprise Wide Risk, backtesting and challenging of the risk profile.** The risk appetite must consider all significant risks to which the Bank is exposed, facilitating an aggregate vision of the risk profile through the use of quantitative metrics and qualitative indicators. This enables the board and senior management to question and assimilate the current and forecasted risk profile in the business and strategy plans, as well as its consistency with the maximum risk limits.

- **Forward-looking view.** The risk appetite must consider the desirable risk profile for the current moment, as well as in the medium term, taking into account both the most plausible circumstances and the stress scenarios.

- **Alignment with strategic and business plans and management integration** (3 year plan, annual budget, ICAAP, ILAAP crisis recovery plans). The risk appetite is a benchmark in strategic and business planning and is integrated into management through a bottom-up and top-down approach:

  - top-down vision: the board must lead the setting of the risk appetite, vouching for the disaggregation, distribution and transfer of the aggregated limits to the management limits set at portfolio level, unit or business line.

  - bottom-up vision: the risk appetite must emanate from the board's effective interaction with senior management, the risk function and those responsible for the business lines and units. The risk profile contrasted with the risk appetite limits will be determined by aggregation of the measurements at portfolio, unit and business line level.

- **Coherence in the risk appetite of the various units and common risk language throughout the Organisation.** The risk appetite of each unit of the Group must be coherent with that defined in the remaining units and that defined for the Group as a whole.

- **Regular review, continuous backtesting and best practices and regulatory requirements adaptation.** Assessing the risk profile and backtesting it against the limits set for the risk appetite must be an iterative process. Adequate monitoring and control mechanisms must be established to ensure the risk profile is maintained within the levels established, as well as taking the necessary corrective and mitigating measures in the event of non-compliance.

Limits structure, monitoring and control

The risk appetite is formulated every year and includes a series of metrics and limits on these metric (statements) which express in quantitative and qualitative terms the maximum risk exposure that each unit of the Group or the Group as a whole is willing to assume.

Fulfilling the risk appetite limits is continuously monitored. The specialised control functions report at least every quarter to the board and its Risk committee on the risk profile adequacy with the authorised risk appetite.

The excesses and non-compliance with the risk appetite are reported by the risk control function to the relevant governance bodies. The presentation is accompanied by an analysis of the causes that provoked it, an estimation of the time they will remain this way, as well as the proposed actions to correct the excess when the corresponding governance body deems it opportune.

Linkage of the risk appetite limits with the limits used to manage the business units and portfolios is a key element for making the risk appetite an effective risk management tool.

The management policies and structure of the limits used to manage the different types and categories of risk, which are described in greater detail in this report, in sections C.1.5. Credit risk cycle, C.2.2.3. and C.2.3.3. Systems of controlling limits, have a direct and traceable relation with the principles and limits defined in the risk appetite.

The connection between the credit risk appetite of the Group and the credit portfolios management is implemented, formalized and materialized through the Strategic Commercial Plans (SCPs), which define the credit policies and the plans of means necessary to achieve the commercial strategies. The transposition and cascading down of credit risk metrics of the Group's risk appetite strengthens the control over credit portfolios. Each SCP includes the risk appetite metrics corresponding to the SCP segment, and also the risk appetite control is carried out through the portfolio and new production limits in order to anticipate the portfolio risk profile.

In this way, changes in the risk appetite can be translated into changes in the limits and controls used in Santander's risk management and each of the business and risk areas have the responsibility of verifying that the limits and controls used in their daily management are set in such a way that the risk appetite limits cannot be breached. The risk control and supervision function then validates this assessment, ensuring the adequacy of the management limits for the risk appetite.

Risk appetite pillars

The risk appetite is expressed via limits on quantitative metrics and qualitative indicators that measure the exposure or risk profile by type of risk, portfolio, segment and business line, in both current and stressed conditions. These metrics and risk appetite limits are articulated in five large areas that define the positioning that Santander's senior management is wiiling to adopt or maintain in the development of its business model:

- The **volatility** in the **income statement** that the Group is willing to accept.
- The **solvency** position that the Group wants to maintain.
- The minimum **liquidity** position that the Group wants to have.
- The maximum levels of **concentration** that the Group considers reasonable to accept.
- **Non-financial and transversal risks**.

RISK APPETITE PILLARS AND MAIN METRICS

Volatility of results	Solvency	Liquidity	Concentration	Non-financial and transversal risks
• Maximum loss the Group is prepared to accept under a scenario of acute tension	• Minimum capital position the Group is prepared to accept under a scenario of acute tension • Maximum leverage the Group is prepared to accept under a scenario of acute tension	• Minimum structural liquidity position • Minimum liquidity horizon position that the Group is prepared to accept under a scenario of acute tension • Minimum liquidity coverage position	• Concentration by individual customer • Concentration in non-investment grade counterparties • Concentration in large exposures	• Qualitative operational risk indicators: • Fraud • Technological • Security and cyber-risk • Litigation • Other... • Maximum operational risk losses • Maximum risk profile

Volatility of results

Its object is to limit the potential negative volatility of the results projected in the strategic and business plan in the event of stress conditions.

This axis contains metrics which measure the behaviour and evolution of real or potential losses in the business.

The stress tests included in this level, measure the results maximum fall under adverse conditions, in the main types of risk to which the Bank is exposed, with a feasible probability of occurrence and similar by risk type (thus allowing aggregation).

Solvency

The object of this axis is to ensure that the risk appetite adequately considers the maintenance and upkeep of the Entity's equity, keeping capital higher than the levels set by regulatory requirements and market demand.

Its purpose is to determine the minimum level of capital for which the Entity considers necessary to maintain, in order to cope with potential losses under both normal and stressed conditions and derived from its activity, its business and strategic plans.

This capital approach included in the risk appetite model is supplementary and consistent with the capital objective approved within the Group's capital planning process, which extends to a period of three years (more detail is available in the Pillar III disclosures).

Liquidity position

Santander Group 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 management framework 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 appeal to short-term financing, sufficient liquidity reserve) and revolves around three main pillars: governance model, balance sheet analysis and measurement of liquidity risk, and management adapted to business needs.

Santander's liquidity risk appetite establishes demanding objectives of liquidity positions and horizons under systemic and idiosyncratic stress scenarios (local and global). In addition, a limit is set for the structural funding ratio that relates customer deposits, equity and medium and long-term issuances to structural funding needs, together with a limit on the minimum liquidity coverage position.

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 business orientation to retail banking with a high degree of international diversification.

This axis includes, among others, the individual maximum exposure limits with customers, aggregated maximum exposure with major counterparties, and maximum exposure by activity sectors, in Commercial Real Estate and in portfolios with a high risk profile. Customers with an internal rating lower than investment grade or equivalent, or which have excessive exposure of a certain degree, are also monitored.

Non-financial and transversal risks

This involves qualitative and quantitative metrics that help pinpoint exposure to non-financial risks. These include specific indicators for fraud, technological risk, security and cyber-risk, money laundering prevention, regulatory compliance, product governance and customer protection, reputational risk and model risk.

A.4.2. Risk identification and assessment (RIA)

Santander Group carries out the identification and assessment of the different risks it is exposed to involving the different lines of defence to strengthen its advanced and proactive risk management practice, establishing management standards that not only meet regulatory requirements but also reflect best practices in the market, and being also a risk culture transmission mechanism.

The function includes all the risk identification and assessment processes, as well as its integration, within the Santander Group risk profile, its units and activities, thereby keeping the risk map up to date.

In addition to **identifying and assessing the Group's risk profile** by risk type and unit, RIA analyses the evolution of risks and identifies improvement areas in each of the blocks that compose it:

- **Risk performance,** enabling understanding of residual risk by risk type through a set of metrics and indicators calibrated using international standards.
- **Assessment of the control environment,** measuring the degree of implementation of the target operating model, pursuant to advanced standards.
- **Forward-looking analysis of the unit,** based on stress metrics and identification and/or assessment of the main threats to the strategic plan **(Top Risks)**, enabling specific action plans to be put in place to mitigate potential impacts and monitoring these plans.

Each block of these methodologies strengthens risk management and provide a comprehensive and holistic view of the risk profile. RIA uses, among others, the assessment of the risk level of the different risk metrics and indicators and their integration in risk management policies and limits, the control environment assessment consideration in internal audit annual planning, the use of Top risks as inputs to generate idiosyncratic scenarios in capital and liquidity planning and recovery and resolution plans, and the analysis of the risk profile of the Group and its units, used as a comparison with other external assessments of the Bank.

RIA strengthens Santander Group's risk management and control capacity to carry out more and better business in the markets in which it operates without jeopardising its P&L, or its defined strategic targets, and reducing earnings volatility.

In 2017, the function evolved along three main lines, ensuring the simplification and reinforcement of the interaction among the communities of control and the completeness of the risk profile:

- Updated control environment standards based on industry performance, internal management models and regulatory requirements:
  - i) Homogeneous conceptual architecture developed to enable consistent analysis and assessments, and to simplify data execution/exploitation, as well as the reporting to senior management.
  - ii) Environment control assessments simplification.
  - iii) Greater involvement of the different stakeholders of the control functions particularly local and corporate risk control functions and internal audit (communities of control).
  - iv) Prioritisation of areas for improvement identified according to their materiality.
- New technology platform to facilitate data exploitation and process implementation:
  - i) Manual processes automatization.
  - ii) Real time access to information in the different units and for all stakeholders.
  - iii) Internal technology solution with improved data safety and enhanced user experience.
  - iv) Information reporting module to design and produce ad hoc reports.
- Wider scope by risk type and geography.

As part of the ongoing review and improvement process, over the next few months the RIA will focus on the review of **risk indicators and metrics,** increasing the scope of application by risk type and geography, and further strengthening the risk culture in the Group's different lines of defence.

A.4.3. Scenario analysis

Santander conducts advanced management of risks by analysing the impact that different scenarios could trigger in the environment in which the Bank operates. These scenarios are expressed both in terms of macroeconomic variables, as well as other variables that alter management.

Scenario analysis is a very robust and useful tool for management at all levels. It enables the assessment of the Bank's resistance to stressed environments or scenarios, and puts into force a set of measures that reduce its risk profile to these scenarios. The objective is to maximise the stability of the income statement and capital and liquidity levels.

The robustness and consistency of the scenario analysis exercises are based on the following pillars:

- Development and integration of mathematical models that estimate the future evolution of metrics (e.g. credit losses), based on both historic information (internal to the Bank and external from the market), as well as simulation models.
- Inclusion of expert judgement and know-how of portfolios, questioning and backtesting the models results.
- The backtesting of the models results against the observed data, ensuring that the results are adequate.
- The governance of the whole process, covering the models, scenarios, assumptions and rationale of the results, and their impact on management.

The application of these pillars within the EBA (European Banking Authority) stress test, executed and reported bi-annually, has enabled Santander to satisfactorily meet the requirements set down - both quantitative and qualitative - and to contribute to the excellent results obtained by the Bank, particularly with regard to its peers.

From 1 January 2018, the processes, models and scenario analysis methodology will be included in the new regulatory provisions requirements (IFRS 9).

Uses of scenario analysis

The EBA guidelines establish that the scenario analysis should be integrated in the risk management framework and entities' management processes. This requires a forward-looking vision in risk management and strategic, capital and liquidity planning.

Scenario analysis is included in the Group's control and management framework, ensuring that any impact affecting the Group's solvency or liquidity can be rapidly identified and addressed.

With this objective, a systematic review of exposure to the different types of risk is included, not only in the baseline scenario but also in the simulation of various adverse scenarios, to ensure that the risk levels assumed comply with the established targets and thresholds.

The scenario analysis forms an integral part of several key processes of the Bank:

- **Regulatory uses.** Stress tests exercises are performed using the guidelines set by the European regulator or each local supervisor.
- **ICAAP or ILAAP.** In which, while the regulator can impose certain requirements, the Bank develops its own methodology to assess its capital and liquidity levels in the face of different stress scenarios. These tools enable capital and liquidity management to be planned.
- **Risk appetite.** Contains stressed metrics on which maximum levels of losses (or minimum of liquidity) are established that the Bank is not willing to exceed. These exercises are related to those for capital and liquidity, although they have different frequencies and present different granularity levels. Santander continues to work to improve the use of analysis of scenarios in the risk appetite and to ensure an adequate relation of these metrics with those used in the daily risk management. For more detail see sections A.4.1. Risk appetite and structure of limits and B.2.4. Liquidity risk in this report.
- **Recurrent risk management** in different processes/tests:
  - **Budgetary and strategic planning process,** in the generation of commercial policies for risk approval, in the global risk analysis made by senior management and in specific analyses of activities and portfolios.
  - Identification of **emerging and plausible risks** ("Top Risks"). After a systematic process to identify and assess all the risks to which the Group is exposed, the "Top Risks" are selected and the Entity's risk profile is established. Each "Top Risk" has an associated macroeconomic or idiosyncratic scenario. To assess the impact of these risks on the Group, internal scenario analysis and stress testing models and methodologies are employed.
  - **Recovery plan** performed annually to establish the available measures the Bank will have, in order to survive an extremely severe financial crisis. The plan sets out a series of financial and macroeconomic stress scenarios, with differing degrees of severity, that include idiosyncratic and/or systemic events that are relevant for the Entity.

Further details are provided in the sections on credit risk (C.1.5.1. Planning) and market risk (C.2.2.1.6., C.2.2.2.3. and C.2.4.2. Scenario analysis).

Additionally, the Bank is working together with other financial institutions on a joint project, led by UNEP FI[2] to implement the recommendations issued by the Task force on Climate-related Financial Disclosures (TCFD) of the Financial Stability Board (FSB). These recommendations incorporate, for the first time, stress exercises that include different climate scenarios.

Scenario analysis aims to assess the impact derived from climate change, both in the form of physical risks (i.e. natural disasters caused by climate change) or by the transition to an economy with lower emissions (due to the impact of regulatory, technological and market changes).

As an internal management tool, Banco Santander has a Map of Uses in place to strengthen the alignment of scenario analysis for each risk type, along with the continuous improvement of such uses. The goal is to reinforce the integration among the different regulatory and management exercises (ICAAP, ILAAP, risk appetite, recovery plan, budget, etc.).

Stress test and scenario analysis programme

The stress test and scenario analysis programme is a pluri-annual plan containing the requirements for the development of these activities as part of the Group´s risk management processes. The development of the programme and its objectives are reviewed and updated regularly. It is structured along five axis, as follows:

- **Processes and procedures:** performance of calculation processes and associate documentation, facilitating execution with suitable frequency, aligning the stress test with regulatory requirements and advanced risk management.

2. UN Environment Programme Finance Initiative.

- **Methodologies and models:** preparation of development plans for statistical stress models that are sufficiently precise and granular to meet the programme objectives, improving the capacity to assess the sensitivity to different scenarios and associated impacts.

- **Governance:** establishment and update (where applicable) of stress tests and scenario analysis governance, reviewing the defined structure efficiency, its interpretation and documentation.

- **Data and infrastructure:** implementation and development of a flexible calculation tool and a multi-user reporting environment with capacity to handle data with different levels of granularity, project parameters and losses with greater accuracy and automation, aggregate different types of risk during the process and report the results.

- **Integration into management:** expansion and improvement of the uses of scenario analysis in the different risk management areas.

A.4.4. Risk Reporting Framework (RRF)

In recent years, Santander Group has developed and implemented the necessary structural and operating improvements to reinforce and consolidate enterprise-wide risk, based on complete, precise and regular data. This has enabled the Group's senior management to assess risk and act accordingly. In this sense, the strategic risk transformation plan is aligned with regulatory requirements, as evidenced in the review performed by the European supervisor with regard to compliance with the standards defined by the Basel Committee (BCBS 239).

In 2017, the Group has worked to consolidate the comprehensive data and information management model, and the implementation and renewal of technology systems, thereby enabling a balanced reporting taxonomy to be maintained that covers all the key risk areas within the Organisation, in compliance with the Group’s size, risk profile and activity.

Therefore, three reports are submitted each month to senior management relating to risk management issues and the subsequent decision-making: the Group risks report, the risks report for each unit and a report for each risk factor.

B. Background and upcoming challenges

The global economy grew at a higher rate in 2017 compared to 2016 (3.6% vs 3.2%), the strongest performance seen in the past few years, fuelled by favourable financial conditions, buoyant trade, the recovery of commodity prices, improved confidence and a political environment in which uncertainties were reduced. Both the advanced and emerging economies participated in this revitalisation.

In the United States, the growth acceleration was combined with a moderation in underlying inflation. The Federal Reserve embarked on a gradual monetary policy normalisation. It increased interest rates in three ocassions during the year, and in October began reducing its balance sheet.

The Eurozone saw a notable economic reactivation, broadly based by component and countries. With inflation still low, the ECB has extended its debt repurchases until September 2018, although the programme has been scaled back, and its policy stance remains accommodative.

The UK economy has fared well in face of the uncertainties thrown up by the Brexit, although growth was slower. Inflation stood at around 3%, surpassing the 2% target, which prompted the Bank of England to raise its official interest rate to 0.5% at the end of the year, reversing the adjustment that followed the referendum.

Among the emerging markets, China unexpectedly sustained a slightly stronger growth than in 2016, and Latin America has recovered from the recession thanks to the economic revival in Brazil and Argentina.

Monetary policies remain uneven, according to the different inflation trends. Therefore, in Brazil and Chile, the central banks have cut the official rates in a context of reduced inflation, while in Argentina and Mexico, the monetary authorities increased the official interest rates to strengthen their anti-inflationary stance and setinflation expectations in a context of rising prices.

In general, the international banking sector continued to be characterised by the ongoing strengthening of balance sheets following improvements in capital adequacy, liquidity positions and impaired assets. As a result, in the developed nations, especially in Europe, entities continue to face significant challenges to boost profitability, in the midst of strong competition and low interest rates. Business volumes have been affected in the same way, although in both cases the trend is gradually becoming more favourable.

Top Risks

As part of its traditional forward-looking risk management strategy, the Group identifies, assesses and monitors potential threats affecting the development of its strategic plan, through regular assessment of the top risks.

The main strategic risks identified by the Group at present are subject to regular monitoring by the Bank's senior management, through a governance process that enables appropriate management and mitigation, using the following four categories as follows:

Macroeconomic and political risks

The **Eurozone economy** is in an expansion phase. Economic growth in 2017 was sound and well-founded. The unemployment rate has fallen to its lowest level since 2008. Nonetheless, inflation remains low. The growth rhythm is currently above its potential, suggesting a more moderate growth rates in the coming years.

The main risks affecting this favourable evolution derive from the political environment and the impact of the normalisation of US monetary policy on interest rates in the Eurozone. The ECB is also scaling back its asset purchase programme and while rates are expected to remain stable in 2018 given the lack of inflationary pressure, there could be hikes starting in 2019.

The performance of the **UK economy** will depend on the outcome of its negotiations to exit the EU, expected to take place in March 2019.

After phase I negotiations, an agreement has been reached with the European Commission on citizens' rights, in addition to a soft deal on the Irish border and the exit bill.

However, phase II will kick off with differences between the two parties with regard to the future relationship between the UK and the EU and the conditions of the transition period. The transition period and trade agreements eventually reached will be key for the UK economy in the short-medium term.

After years of recession, **confidence in the Brazilian economy** continues to grow and the outlook for the next few years is favourable. This trend is expected to run parallel with structural reforms, mainly relating to the tax deficit, which should continue irrespective of the result of the forthcoming election in order to maintain the growth expected.

In the **United States**, economic performance remains positive, with stable growth and a projected drop in the unemployment rate, which will have both a positive impact domestically and in emerging markets.

Given these macroeconomic and geopolitical risks, Banco Santander's business model, based on geographical diversification - balanced between mature and emerging markets - and on a retail banking business supported by customer loyalty, reduces the volatility of its results maintaining a medium-low risk profile.

Competitive environment and customer relations

Santander Group's business model is facing the challenge of adapting to changes in demand and consumer behaviour, the possibilities offered by new technologies, new value propositions and also changes in the strategic positioning of competitors.

The new technologies have had, have and will have a permanent impact on the banking industry, enabling a highly competitive environment, with the emergence of new and innovative financial participants that also offer ease of access to their services. This is also favoured by new regulation, such as PSD2 (Payment Services Directive 2) in force in 2018, which allows access to other operators to the data held by banks and thereby favours financial disintermediation. All this, and especially the growing tendency to open financial data without symmetrical initiatives for the data guarded by the large technological platforms, makes it imperative to adapt to this new environment with agility.

Therefore, constant innovation and review of the processes in place is required to allow the Bank to proactively adapt to the industry and its competitors in order to maintain its market share against new digital rivals - financial start-ups, big technology companies. The Santander Group sees this change in the industry as an opportunity to improve its market position, gain market share and optimise its business model, focusing on customers, shareholders, employees and society as a whole through innovation and digital transformation.

The automotive industry is undergoing a continuous process of innovation, driven in part by the more stringent regulatory environment, with environmental measures that imply an important transformation towards the use of technology with lower environmental impact, as well as due to possible strategic changes in the sector with the emergence of autonomous vehicles, shared mobility, higher taxes according to vehicle type, potential restrictions on access to cities, etc. This will trigger a shift in consumer behaviour and the perception held of this industry, making it essential to adapt to the new situation.

Regulatory environment

There has been intense activity in the regulatory field to improve the capitalisation of banks and their resilience to economic shocks, having a stronger impact in those institutions that are considered systemic.

This new regulation focuses mainly on capital, liquidity and resolution requirements, consistent information management and the adequacy of the internal governance of entities.

There is also increasing supervisory and regulatory pressure affecting mainly, aspects of conduct, transparency, consumer protection and the sale of products that are appropriate to customer needs, is due in part to relevant poor practices in the sector over recent years.

In addition, there is a growing interest in social and environmental aspects, for which different initiatives are emerging under the regulatory scope.

Entities have had to make significant efforts to respond to these increasing demands, which has led to a drop in profitability.

For the financial industry, it is crucial to have a stable and enduring regulatory framework, allowing banks to apply valid medium-term strategies, and to constantly assess the global impact of that framework so as to ensure a healthy balance between financial stability and economic growth. This framework must pursue the same level playing field for all competitors and must follow the activity principle, regulating what is done and not who does it. The reference should be: the same regulation and supervision should apply to the same activity and risks.

Systems threats (cyber risk)

In an increasingly digital environment, cyber attacks have become one of the main global risks, not only for the financial sector, but for all industries across the world. There has a been a noticible and high increase in such attacks in recent years.

Threats include espionage, cyber crime, data leaks, hacking and cyber warfare through the unauthorised access to networks or the release of viruses that threaten the confidentiality of the Bank's internal data and customer data, in addition to the strength of the systems themselves as security weaknesses are revealed.

The Group works intensively to enhance protection based on international standards and preventive measures, in order to be ready to respond to incidents of this type. These measures are set out in the Operational risk section C.3.4 Mitigation measures.

C. Risk profile

C.1. Credit risk

C.1.1. Introduction to credit risk treatment

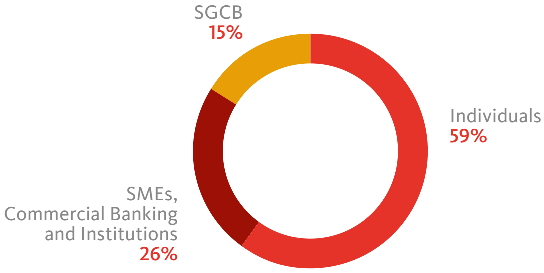
Credit risk is the risk of financial loss arising from the default or credit quality deterioration of a customer or other third party, to which the Santander Group has either directly provided credit or for which it has assumed a contractual obligation.

The Group's risks function is organised on the basis of three types of customers:

- The **Individuals segment** includes all individuals, except those with a business activity. This segment is, in turn, divided into sub-segments by income levels, which enables risk management adjusted to the type of customer.
- The **SMEs, Commercial Banking and Institutions segment** includes companies and individuals with business activity. It also includes public sector activities in general and private sector non-profit entities.
- The **Santander Global Corporate Banking** (SGCB) segment consists of corporate customers, financial institutions and sovereigns, comprising a closed list that is revised annually. This list is determined on the basis of a full analysis of the company (business type, level of geographic diversification, product types, volume of revenues it represents for the Bank, etc.).

The following chart shows the distribution of credit risk on the basis of the management model:

CREDIT RISK DISTRIBUTION



Notes: Excluding Popular. Risk segmentation.

The Group's profile is mainly retail, accounting for 85% of total risk generated by the retail and commercial banking businesses.

C.1.2. Key figures and change over time

C.1.2.1. Changes in scope

Banco Popular
On 7 June 2017, Santander Group acquired Banco Popular Español, S.A. (Popular) within the framework of the "resolution" adopted by the Single Resolution Board (SRB) and executed by the Fund for Orderly Bank Restructuring (FROB).

The transaction had a sound strategic and business fit that came at an attractive moment in the cycle, reinforcing the Group's position in Spain and Portugal.

After the adjustments associated with the acquisition, Banco Popular contributed[3] net loans of EUR 82,589 million and deposits of EUR 64,814 million, concentrated mainly in Spain. Additionally, it incorporated EUR 10,003 million in investment funds and EUR 8,118 million of other off-balance sheet assets.

At that date, Banco Popular had EUR 20,969 million of non-performing loans, with an NPL ratio of 20%. To cover this amount, an insolvency fund of EUR 12,689 million was set up, offering coverage of 61%.

Further, on 8 August, with the intention of reducing the Santander Group's unproductive assets, Banco Popular signed an agreement with Blackstone whereby the fund would acquire 51%, a controlling stake, of Banco Popular's real estate business comprising the foreclosed assets portfolio, non-performing loans from the real estate sector, and other assets relating to this activity owned by Banco Popular and its subsidiaries.

The transaction gave rise to the creation of a company to which Banco Popular would transfer the business unit containing these assets and 100% of the share capital of Aliseda. Since that date, Blackstone has been responsible for managing the assets included in the joint venture.

Citibank-Argentina
Having obtained the relevant regulatory authorisation, on 31 March 2017 an irrevocable offer was received and accepted to acquire the assets and liabilities of the retail banking business of the Citibank N.A. branch set up in Argentina with effect from 1 April. As a result of the transaction, the Bank obtained a network of 70 branches, with their employees and a portfolio of around 518 thousand new customers, increasing its volume of loans and deposits by EUR 604 million and EUR 1,261 million, respectively.

C.1.2.2. Changes in key figures in 2017
The tables below set out the main items related to credit risk derived from activity with customers:

KEY FIGURES OF CREDIT RISK ARISING FROM ACTIVITY WITH CUSTOMERS — Data at 31 December 2017

	Credit risk with customers[1] (million euros)			Non-performing loans (million euros)			NPL ratio (%)		
	2017	2016	2015	2017	2016	2015	2017	2016	2015
Continental Europe	**337,768**	**331,706**	**321,395**	**15,184**	**19,638**	**23,355**	**4.50**	**5.92**	**7.27**
Spain	172,176	172,974	173,032	8,120	9,361	11,293	4.72	5.41	6.53
Santander Consumer Finance	92,589	88,061	76,688	2,319	2,357	2,625	2.50	2.68	3.42
Portugal	32,816	30,540	31,922	1,875	2,691	2,380	5.71	8.81	7.46
Poland	24,391	21,902	20,951	1,114	1,187	1,319	4.57	5.42	6.30
UK	**247,625**	**255,049**	**282,182**	**3,295**	**3,585**	**4,292**	**1.33**	**1.41**	**1.52**
Latin America	**165,683**	**173,150**	**151,302**	**7,462**	**8,333**	**7,512**	**4.50**	**4.81**	**4.96**
Brazil	83,076	89,572	72,173	4,391	5,286	4,319	5.29	5.90	5.98
Mexico	28,939	29,682	32,463	779	819	1,096	2.69	2.76	3.38
Chile	40,406	40,864	35,213	2,004	2,064	1,980	4.96	5.05	5.62
Argentina	8,085	7,318	6,328	202	109	73	2.50	1.49	1.15
US	**77,190**	**91,709**	**90,727**	**2,156**	**2,088**	**1,935**	**2.79**	**2.28**	**2.13**
Puerto Rico	2,944	3,843	3,924	210	274	273	7.13	7.13	6.96
Santander Bank	44,237	54,040	54,089	536	717	627	1.21	1.33	1.16
SC USA	24,079	28,590	28,280	1,410	1,097	1,034	5.86	3.84	3.66
Total Group (excl. Popular)	**832,655**	**855,510**	**850,909**	**28,104**	**33,643**	**37,094**	**3.38**	**3.93**	**4.36**
Banco Popular	88,313			9,492			10.75		
Total Group	**920,968**	**855,510**	**850,909**	**37,596**	**33,643**	**37,094**	**4.08**	**3.93**	**4.36**

3. 30 June 2017 figures.

	Coverage ratio (%)			Net ASR provisions[2] (million euros)			Cost of credit (% /risk)[3]		
	2017	2016	2015	2017	2016	2015	2017	2016	2015
Continental Europe	**58.0**	**60.0**	**64.2**	**995**	**1,342**	**1,975**	**0.32**	**0.44**	**0.68**
Spain	45.9	48.3	48.1	513	585	992	0.33	0.37	0.62
Santander Consumer Finance	101.4	109.1	109.1	266	387	537	0.30	0.47	0.77
Portugal	59.1	63.7	99.0	(12)	54	72	(0.04)	0.18	0.29
Poland	68.2	61.0	64.0	137	145	167	0.62	0.70	0.87
UK	**32.0**	**32.9**	**38.2**	**205**	**58**	**107**	**0.08**	**0.02**	**0.03**
Latin America	**84.8**	**87.3**	**79.0**	**4,973**	**4,911**	**4,950**	**3.17**	**3.37**	**3.36**
Brazil	92.6	93.1	83.7	3,395	3,377	3,297	4.36	4.89	4.50
Mexico	97.5	103.8	90.6	905	832	877	3.08	2.86	2.91
Chile	58.2	59.1	53.9	462	514	567	1.21	1.43	1.65
Argentina	100.1	142.3	194.2	159	107	148	1.85	1.72	2.15
US	**170.2**	**214.4**	**225.0**	**2,780**	**3,208**	**3,103**	**3.42**	**3.68**	**3.66**
Puerto Rico	55.2	54.4	48.5	73	96	85	2.22	2.58	2.12
Santander Bank	102.2	99.6	114.5	116	120	64	0.25	0.23	0.13
SC USA	212.9	328.0	337.1	2,590	2,992	2,954	9.84	10.72	10.97
Total Group (excl. Popular)	**70.8**	**73.8**	**73.1**	**8,997**	**9,518**	**10,108**	**1.12**	**1.18**	**1.25**
Banco Popular[4]	48.7			114			0.23		
Total Group	**65.2**			**9,111**			**1.07**		

1. Includes gross lending to customers, guarantees and documentary credits.
2. Recovered write-off assets (EUR 1,621 million).
3. Cost of credit = loan-loss provisions twelve months / average lending.
4. Provisions carried out since the Bank's acquisition in June 2017.

Risk is diversified among the main regions where the Group operates: Continental Europe[4] (41%), UK (30%), Latin America (20%) and the US (9%), with a suitable balance between mature and emerging markets.

Credit risk with customers fell by 3% in 2017, considering an unchanged perimeter, mainly due to the US, UK and Brazil (as a result of exchange rate effects). Growth in local currency was generalised across all units with the exception of the United States and Spain.

These levels of lending, together with lower non-performing loans (NPLs) of EUR 28,104 million (-16% vs. 2016) reduced the Group's NPL ratio to 3.38% (-55 bp against 2016).

For coverage of these NPLs, the Group recorded provisions of EUR 8,997 million (-5.5% vs. December 2016), after deducting write-off recoveries. This fall is materialised in a decrease in the cost of credit to 1.12% (6 bp less than the previous year).

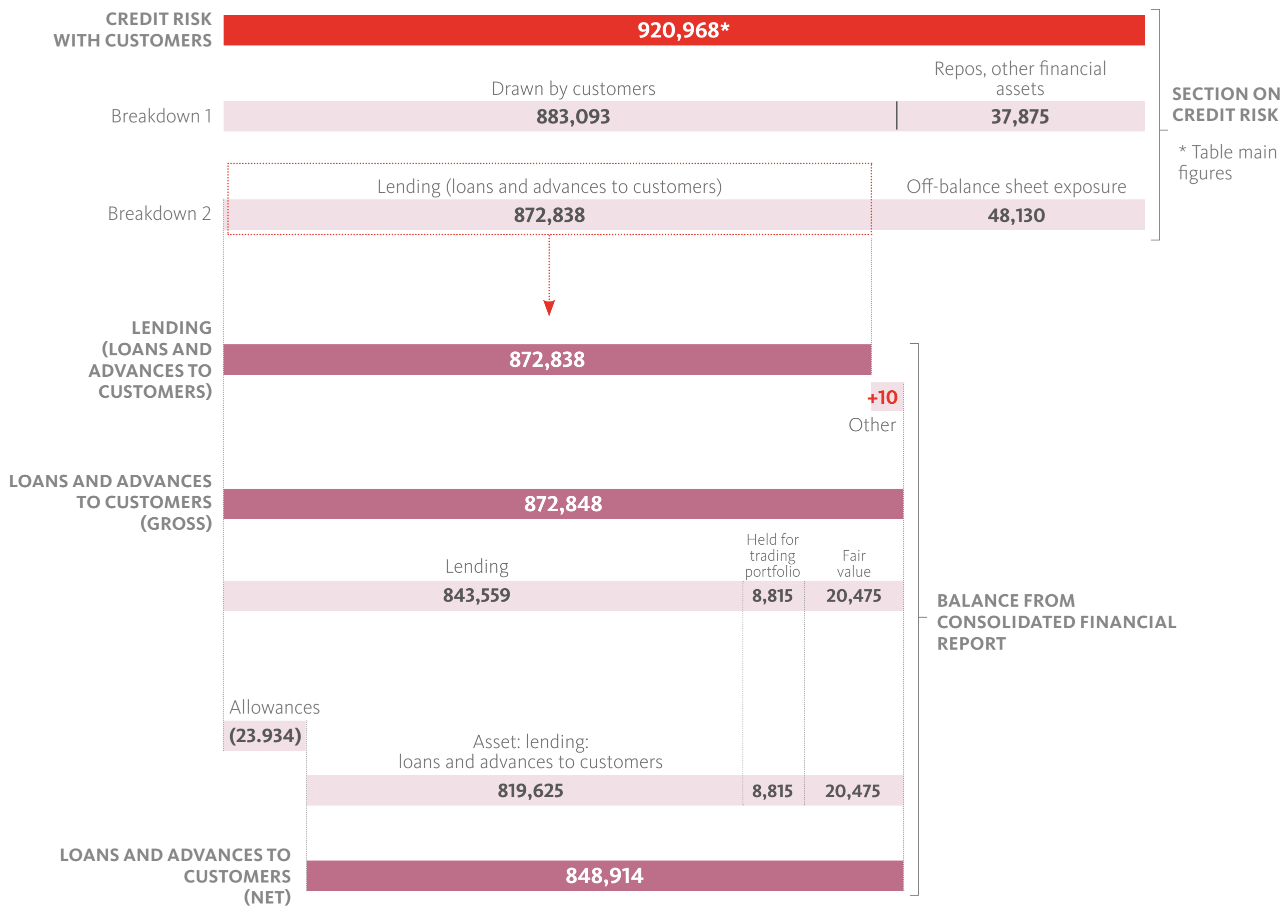
Total loan-loss allowances were EUR 19,906 million, bringing the Group's coverage ratio to 71%. It is important to bear in mind that this ratio is affected downwards by the weight of mortgage portfolios (particularly in the UK and Spain), since by having collateral, less provisions are required.

4. Excluding Popular.

Reconciliation of the key figures

The consolidated financial report details the portfolio of customer loans, both gross and net of funds. Credit risk also includes off-balance sheet risk. The following table shows the relation between the concepts that comprise these figures:

Million euros

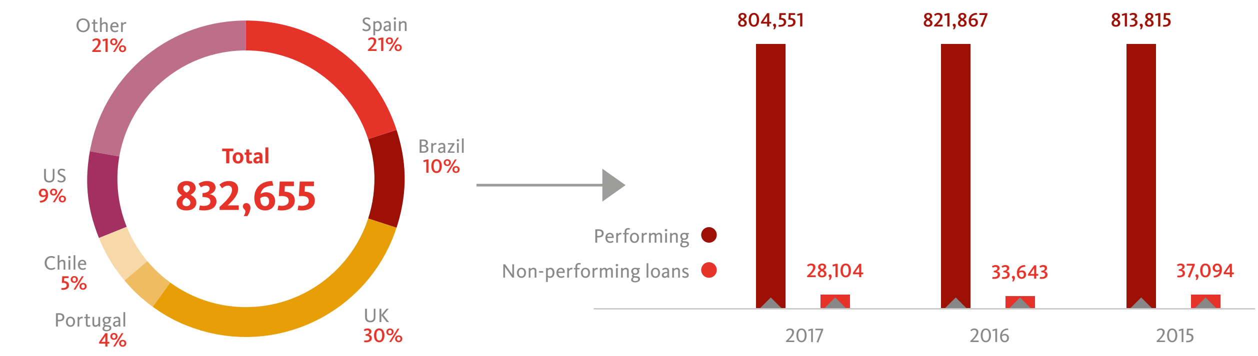


Geographical distribution and segmentation

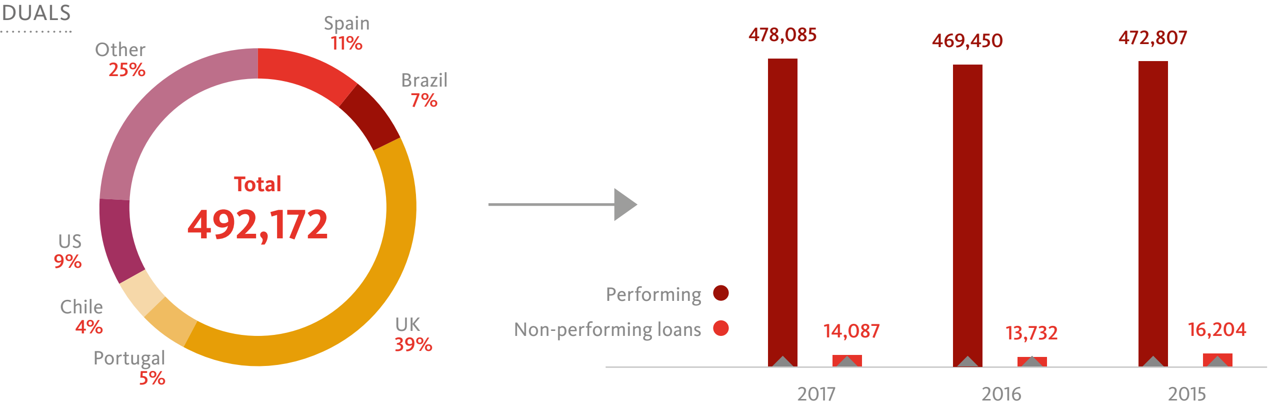
On the basis of the aforementioned segmentation, the geographical distribution and situation of the portfolio is shown in the following charts (excl. Popular):

Million euros

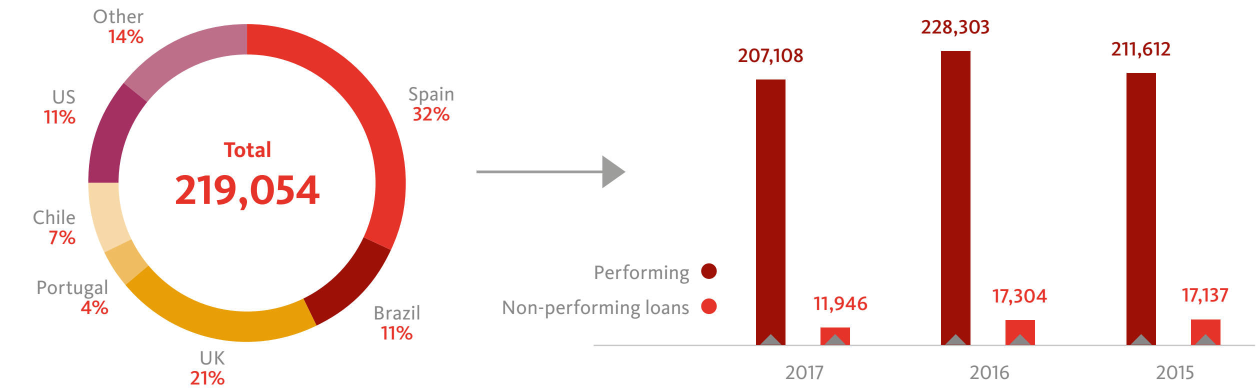
TOTAL



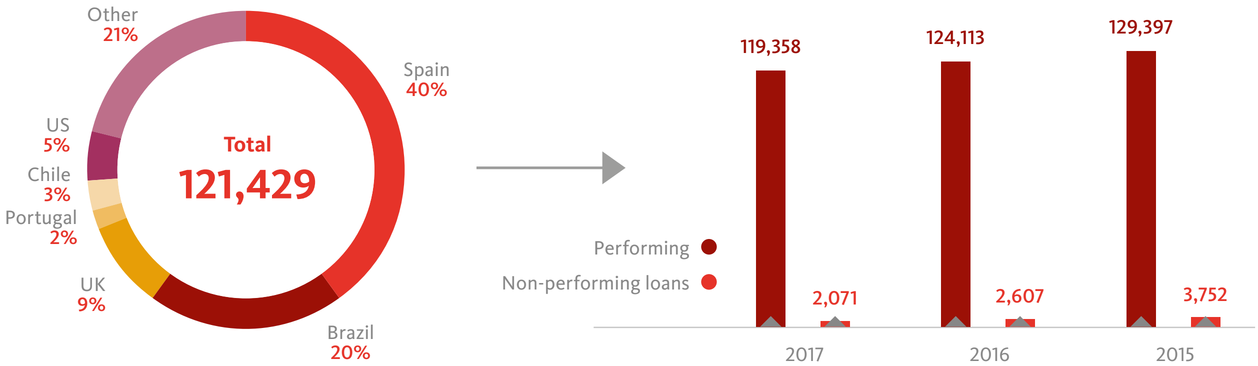
INDIVIDUALS



SMES, COMMERCIAL BANKING AND INSTITUTIONS



SGCB



Key figures by geographical area are shown below:

- **Continental Europe**
  - In **Spain**[5], the NPL ratio dropped to 4.72% (-69 bp compared to 2016), due mainly to the proactive management of non-performing loans and, to a lesser extent, portfolio sales and forbearance positions regularisation. The coverage ratio was 46%.
  - In **Portugal** the lower default entries and a proactive management of the portfolio have allowed to continue with the decreasing trend of non-performing loans putting the NPL ratio at 5.71% (-310 bp regarding 2016). The coverage ratio was 59%.
  - In **Poland** the NPL ratio decreased further to stand at 4.57% (-85 bp vs. 2016). The coverage ratio was 68%.
  - At **Santander Consumer** the NPL ratio was 2.50% (-18 bp in the year), with a strong overall performance by portfolios in most countries, with a coverage ratio higher than 100%.
  - At **Banco Popular**, the non-performing loans rise to EUR 9,492 million, representing an NPL ratio of 10.75%, a decrease of 9 pp in the quarter following the formalization, with Blackstone, of the acquisition agreement of 51% of the real estate business of Banco Popular. The coverage ratio was 49%.
- In the **UK**[6] the NPL ratio was reduced to 1.33% (-8 bp in the year), due to strong performance across all segments, particularly SMEs and individual customers. The coverage ratio maintains stable at 32%, thanks to an important presence of real guarantees.
- In **Brazil**[7], a sound risk culture based on preventive management, together with the improved macroeconomic scenario, pushed the NPL ratio down to 5.29% (-61 bp in the year) at the close of December 2017. The coverage ratio was 93%.
- **Chile** reduced its NPL ratio to 4.96% (-9 bp in the year), thanks to the good performance in non-performing loans mainly in the mortgage and SGCB segment. The coverage ratio was 58%.
- The NPL ratio in **Mexico** fell to 2.69% (-7 bp in the year), due to a fall in non-performing loans mainly in the SGCB segment. The coverage ratio was 98%.
- The NPL ratio in the **United States**[8] stood at 2.79% (+51 bp in the year), with the coverage ratio remaining high, at 170%.
  - At Santander Bank the NPL ratio was 1.21% (-12 bp), due to the strong performance of the individuals portfolio, proactive management of certain positions and customers credit profile improvement from the Oil&Gas sector. The coverage ratio was 102%.
  - SC USA reported an increase in its NPL ratio to 5.86%, due mainly to the forbearance portfolio. The coverage ratio stood at 213%.
  - Puerto Rico maintains its NPL ratio at 7.13% whilst the coverage ratio at 55%.

C.1.2.3. Amounts past due (performing loans)

Amounts past due by three months or less represented 0.26% of total credit risk with customers. The following table shows the structure at 31 December 2017, classified on the basis of the first maturity:

AMOUNTS PAST DUE. MATURITY DETAIL

Million euros

	Less than 1 month	1 to 2 months	2 to 3 months
Loans and advances to credit institutions	5	-	0
Loans and advances to customers	1,381	623	373
Public administrations	1	1	1
Other private sector	1,380	622	372
Debt instruments	-	-	-
Total	**1,386**	**623**	**373**

C.1.2.4. Non-performing loans portfolio and provisions: change over time and mix

Non-performing assets are classified as:

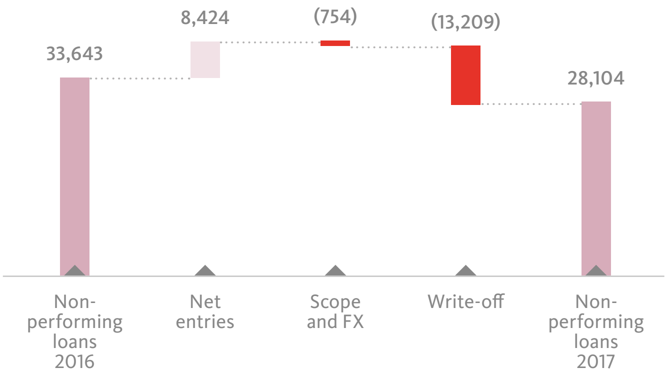
- **Assets classified as non-performing due to the delinquency of the counterparty:** debt instruments that are more than 90 days past due, irrespective of their holder or collateral. In the case of individually significant exposures, these assets are covered for the difference between the carrying value of the asset and the current value of expected future cash flows.
- **Assets classified as non-performing for reasons other than the delinquency of the counterparty:** debt instruments for which there are reasonable doubts about collection in the contractually agreed terms, even though there are no reasons to classify them as non-performing loans due to delinquency. In the case of individually significant exposures, these assets are covered for the difference between the carrying value of the asset and the current value of expected future cash flows.

5. Does not include real estate activity. Further details in section C.1.3.2. Spain.
6. Further details in section C.1.3.1. UK
7. Further details in section C.1.3.4. Brazil
8. Further details in section C.1.3.3. US

The table below shows the change over time in non-performing loans by constituent items:

CHANGE OVER TIME IN NON-PERFORMING LOANS BY CONSTITUENT ITEM (EXCL.POPULAR)

Million euros



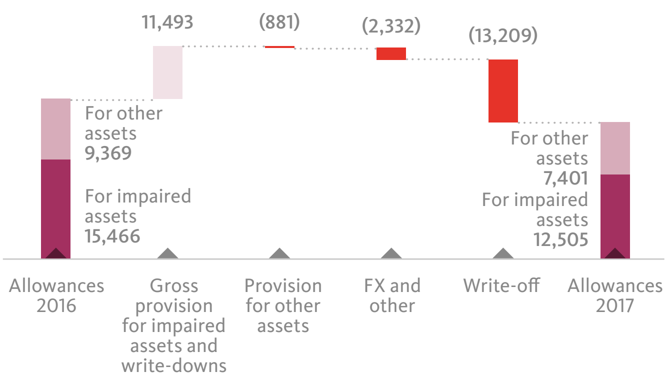
PERFORMANCE 2015-2017

Million euros

	2017	2016	2015
NPL (start of period)	**33,643**	**37,094**	**41,709**
Net entries	8,424	7,362	7,705
Scope	18	734	106
FX and other	(772)	1,211	(65)
Write-off	(13,209)	(12,758)	(12,361)
NPL (end of period excl. Popular)	**28,104**	**33,643**	**37,094**
Banco Popular	9,492		
NPL (end of period)	**37,596**	**33,643**	**37,094**

CHANGE OVER TIME IN ALLOWANCES, ACCORDING TO CONSTITUENT ITEM (EXCL. POPULAR)

Million euros



PERFORMANCE 2015-2017

Million euros

	2017	2016	2015
Allowances (start of period)	**24,835**	**27,121**	**28,046**
For impaired assets	15,466	17,706	19,786
For other assets	9,369	9,414	8,260
Gross provision for impaired assets and write-downs	**11,493**	**11,045**	**10,670**
Provision	11,493	11,045	10,670
Write-downs	-	-	-
Provision for other assets	**(881)**	**52**	**814**
FX and other	**(2.332)**	**(625)**	**(48)**
Write-off	**(13,209)**	**(12,758)**	**(12,361)**
Allowances (end of period excl. Popular)	**19,906**	**24,835**	**27,121**
Banco Popular	4,623		
Allowances (end of period)	**24,529**	**24,835**	**27,121**

C.1.2.5. Forbearance portfolio

The Group has a detailed corporate policy for forbearance which acts as a reference in the various local transpositions of all the subsidiaries that form part of the Group. These share the general principles established by the Bank of Spain and the European Banking Authority.

This policy defines forbearance as the modification of the payment conditions of a transaction that allow a customer who, is experiencing financial difficulties (current or foreseeable), to fulfil their payment obligations, on the basis that if this modification were not made it would be reasonably certain that they would not be able to meet their financial obligations. The modification could be made to the original transaction or through a new transaction replacing the previous one.

In addition, this policy also sets down rigorous criteria for the evaluation, classification and monitoring of such transactions, ensuring the strictest possible care and diligence in their granting and monitoring. Therefore, the forbearance transaction must be focused on recovery of the amounts due, the payment obligations must be adapted to the customer's actual situation and losses must be recognised as soon as possible if any amounts are deemed irrecoverable.

Forbearances may never be used to delay the immediate recognition of losses or to hinder the appropriate recognition of risk of default.

Further, the policies define the classification criteria for the forbearance transactions in order to ensure that the risks are suitably recognised, bearing in mind that they must remain classified as non-performing or watch-list for a prudential period of time to attain reasonable certainty that repayment capacity can be recovered.

FORBEARANCE PORTFOLIO

Million euros

	Performing	Non-performing loans	Total risk	
	Amount	Amount	Amount	% Coverage /total
Total forbearance	**27,661**	**20,044**	**47,705**	**24%**

The forbearance portfolio stood at EUR 47,705 million at the end of December. In terms of credit quality, 42% is classified as non-performing loans, with average coverage of 58% (24% of the total portfolio).

Regarding its evolution, and considering a constant perimeter, the Group's forbearance exposure has decreased by 19.8%, in line with the trend marked in prior years.

IFRS 9 Financial instruments - Classification and measurement, hedging and impairment (required for annual periods starting on 1 January 2018)

IFRS 9 establishes the recognition and measurement requirements for financial instruments and certain classes of contracts for trades involving non-financial assets. These requirements should be applied in a retrospective manner, by adjusting the opening balance at 1 January 2018, without restating the comparative financial statements. The main aspects of the new standard are:

a) Classification of financial instruments: the classification criteria depends on the business model, which refers to how an entity manages its financial assets in order to generate cash flows. Depending on these factors, the asset can be measured at amortised cost, at fair value with changes reported in other comprehensive income, or at fair value with changes reported through profit and loss for the period. IFRS 9 also establishes an option to designate an instrument at fair value with changes in profit or loss, under certain conditions. Santander Group uses the following criteria for the classification of financial debt instruments:

- Amortised cost: financial instruments under a business model whose objective is to collect principal and interest cash flows, over those where no significant unjustified sales exist and fair value is not a key factor in managing these financial assets. In this way, unjustified sales are those that are different from sales related with an increase in the asset's credit risk, unanticipated funding needs (stress case scenario), even if such sales are significant in value, changes in the investment policy no longer meet the credit criteria or sales imposed by third parties, except if the regulator requires to demonstrate that the assets are liquid. Additionally, the contractual flow characteristics substantially represent a "basic financing agreement".

- Fair value with changes recognised through other comprehensive income: financial instruments held in a business model whose objective is to collect principal and interest cash flows and the sale of these assets, where fair value is a key factor in their management. Additionally, the contractual cash flow characteristics substantially represent a "basic financing agreement".

- Fair value with changes recognised through profit or loss: financial instruments included in a business model whose objective is not obtained through the above-mentioned models, where fair value is a key factor in managing these assets, and financial instruments whose contractual cash flow characteristics do not substantially represent a "basic financing agreement".

Santander Group's main activity revolves around retail and commercial banking operations, and its exposure does not focus on complex financial products. The Group's main objective is to achieve consistent classification of financial instruments in the portfolios as established under IFRS 9. To this end, it has developed guidelines containing criteria to ensure consistent classification across all of its units. Additionally, the Group has analysed its portfolios under these criteria, in order to assign its financial instruments to the appropriate portfolio under IFRS 9, with no significant changes being identified. Based on this analysis, Santander Group concludes that:

- Most of its financial assets classified as loans and advances under IAS 39 will continue to be recognised at amortised cost under IFRS 9. As a consequence of the contractual cash flows characteristics analysis of the financial instruments, a 0.2% of the total balance under IAS 39 for the period will be reclassified to fair value with changes reported through profit and loss . As a result of the business model definition according to the assets management, a 0.2% of the total balance under IAS 39 will be reclassified to fair value with changes recognised in other comprehensive income.

- In general, debt instruments classified as available-for-sale financial assets will be measured at fair value with changes recognised through other comprehensive income. As a consequence of the contractual cash flows characteristics analysis of the financial instruments, a 0.2% of the total balance under IAS 39 for the period, will be reclassified to fair value with changes reported through profit and loss. As a result of the business model definition according to the assets management, a 5.1% of the total balance under IAS 39 will be reclassified to fair value with changes recognized in other comprehensive income.

However, the expected impact in shareholders' equity due to the reclassifications mentioned above is not considered significant.

Available-for-sale equity instruments will be classified at fair value under IFRS 9, with changes recognised through profit or loss, unless the Group decides, for non-trading assets, to classify them at fair value with changes recognised through other comprehensive income (irrevocably).

IAS 39 financial liabilities classification and measurement criteria remains substantially unchanged under IFRS 9. Nevertheless, in most cases, the changes in the fair value of financial liabilities designated at fair value with changes recognised through profit or loss for the year, due to the entity credit risk, are classified under other comprehensive income.

On 12 October 2017, the International Accounting Standards Board (IASB) published a clarification on the treatment of certain prepayment options in relation to the assessment of contractual cash flows of principal and interest on financial instruments, which is currently pending approval by the European Union. However, the Group does not expect a significant impact in the transition period prior to the adoption of this amendment.

b) **Credit risk impairment model:** the most important new development compared with the current model is that the new accounting standard introduces the concept of expected loss, whereas the current model (IAS 39) is based on incurred loss.

- Scope of application: The IFRS 9 impairment model applies to financial assets valued at amortised cost, debt instruments valued at fair value with changes reported in other comprehensive income, lease receivables, and commitments and guarantees given not valued at fair value.

- Use of practical expedients: IFRS 9 includes a number of practical expedients that may be implemented by entities to facilitate implementation. However, in order to achieve full and high quality implementation of the standard, considering industry best practices, these practical expedients will not be widely used:

  - Rebuttable presumption that the credit risk has increased significantly, when payments are more than 30 days past due: this threshold is used as an additional – but not primary - indicator of significant risk increase. Additionally, there may be cases in the Group where its use has been rebutted as a result of studies that show a low correlation of the significant risk increase with this past due threshold.

  - Assets with low credit risk at the reporting date: in general, the Group assesses the existence of significant risk increase in all its financial instruments.

- Impairment estimation methodology: the portfolio of financial instruments subject to impairment is divided into three categories, based on the stage of each instrument with regard to its level of credit risk:

  - Stage 1: financial instruments for which no significant increase in risk is identified since its initial recognition. In this case, the impairment provision reflects expected credit losses arising from defaults over the following 12 months from the reporting date.

  - Stage 2: if there has been a significant increase in risk since the date of initial recognition but the impairment event has not materialised, the financial instrument is classified as Stage 2. In this case, the impairment provision reflects the expected losses from defaults over the residual life of the financial instrument.

  - Stage 3: a financial instrument is catalogued in this stage when shows effective signs of impairment as a result of one or more events that have already occurred resulting in a loss. In this case, the amount of the impairment provision reflects the expected losses for credit risk over the expected residual life of the financial instrument.

  Additionally, the amount relative to the impairment provision reflects expected credit risk losses through the expected residual life in those financial instruments purchased or originated credit impaired (POCI).

  The methodology required for the quantification of expected loss due to credit events will be based on an unbiased and weighted consideration of the occurrence of up to five possible future scenarios that could impact the collection of contractual cash flows, taking into account the time-value of money, all available information relevant to past events, and current conditions and projections of macroeconomic factors deemed relevant to the estimation of this amount (e.g. GDP, house pricing, unemployment rate, etc.).

  In estimating the parameters used for impairment provisions calculation (EAD, PD, LGD and discount rate), the Group leverages on its experience of developing internal models for calculating parameters for regulatory and internal management purposes. The Group is aware of the differences between such models and regulatory requirements for provisions. As a result, it has focused on adapting to, such requirements the development of its IFRS 9 impairment provisions models.

- Determination of significant increase in risk: with the purpose to determine whether a financial instrument has increased its credit risk since initial recognition, proceeding with its classification into Stage 2, the Group considers the following criteria.

Quantitative criteria	Changes in the risk of a default occurring through the expected life of the financial instrument are analyzed and quantified with respect to its credit level in its initial recognition. With the purpose of determining if such changes are considered as significant, with the consequent classification into Stage 2, each Group unit has defined the quantitative thresholds to consider in each of its portfolios taking into account corporate guidelines ensuring a consistent interpretation in all geographies.
Qualitative criteria	In addition to the quantitative criteria mentioned above, the Group considers several indicators that are aligned with those used in ordinary credit risk management (e.g. over 30 days past due, forbearances, etc.). Each unit has defined these qualitative criteria for each of its portfolios, according to its particularities and with the policies currently in force. The use of these qualitative criteria is complemented with the use of expert judgement.

- Default definition: the definition considered for impairment provisioning purposes is consistent with that used in the development of advanced models for regulatory capital requirements calculations.

- Use of present, past and future information: estimation of expected losses requires a high component of expert judgement and it must be supported by past, present and future information. Therefore, these expected loss estimates take into consideration multiple macroeconomic scenarios for which the probability is measured considering past events, current situation and future trends and macroeconomic indicators, such as GDP or unemployment rate. The Group already uses forward looking information in internal management and regulatory processes, considering several scenarios. In this sense, the Group has leveraged its experience in the management of such information, maintaining consistency with the information used in the other processes.

  - Expected life of the financial instrument: with the purpose of its estimation all the contractual terms have been taken into account (e.g. prepayments, duration, purchase options, etc.), being the contractual period (including extension options) the maximum period considered to measure the expected credit losses. In the case of financial instruments with an uncertain maturity period and a component of undrawn commitment (e.g. credit cards), expected life is estimated considering the period for which the entity is exposed to credit risk and the effectiveness of management practices mitigates such exposure.

  - Impairment recognition: the main change with respect to the current standard related to assets measured at fair value with changes recognised through other comprehensive income. The portion of the changes in fair value due to expected credit losses will be recorded at the current profit and loss account while the rest will be recorded in other comprehensive income.

c) **Hedge accounting:** IFRS 9 includes new hedge accounting requirements which have a twofold objective: to simplify current requirements, and to bring hedge accounting in line with risk management, allowing to be a greater variety of derivative financial instruments which may be considered to be hedging instruments. Furthermore, additional breakdowns are required providing useful information regarding the effect which hedge accounting has on financial statements and also on the entity's risk management strategy. The treatment of macro-hedges is being developed as a separate project under IFRS 9. Entities have the option of continuing to apply IAS 39 with respect to accounting hedges until the project has been completed. According to the analysis performed until now, the Group will continue to apply IAS 39 in hedge accounting.

Transition

The European Union has already endorsed IFRS 9. The criteria established by this rule for the classification, measurement and impairment of financial assets, will be applied in a retrospective way, adjusting the first opening balances in the first application date (1 January 2018). This new international standard is aligned with the credit risk directives of the EBA and Bank of Spain Circular 4/2017.

Santander Group has estimated an impact in CET1 fully loaded of -20 bp. The Group will apply a progressive phased-in regime in the period of 5 years based on Regulation (EU) No 2017/2395 of the European Parliament and of the Council amending Regulation (EU) No 575/2013 as regards transitional arrangements for mitigating the impact of the introduction of IFRS 9 on own funds that would suppose an impact of the new impairment model of IFRS 9 of -1 bp on Common Equity Tier 1 capital during the period from 1 January 2018 to 31 December 2018 in 2018 or 5% of total impact. The increase in impairment provisions amounts to approximately EUR 2,200 million.

The main causes of this impact are the requirements to record impairment provisions for the whole life of the transaction for instruments where a significant risk increase has been identified after initial recognition, in addition to forward-looking information in the estimates of impairment provisions.

IFRS 9 implementation strategy and governance

The Group has established a global and multidisciplinary workstream with the aim of adapting its processes to the new classification standards for financial instruments, accounting of hedges and estimating credit risk impairment, ensuring that these processes have been applied in a uniform way for all Group units, and, at the same time, have been adapted to each unit's individual features.

Accordingly, since 2016, the Group has been working towards defining an objective internal model and analysing all the changes which are needed to adapt accounting classifications and credit risk impairment estimation models in force in each unit to the previous definitions. The process was completed in 2017.

Regarding the governance structure, the Group established a regular committee to manage the project, and a task force, which is responsible for its tasks, ensuring that the pertinent responsible teams take part in coordination with all geographical areas.

Hence, the main divisions involved in the project at the highest level, and which are thus represented in the project governance bodies, are: Risks, Financial Accounting & Management Control and Technology and Operations. Internal Audit division was involved in the project, having kept regular meetings regarding the status of the project.

The governance structure currently implemented at both corporate level and in each unit, complies with the requirements set out in the new standards both in IFRS 9, and in other related regulatory standards (e.g. EBA credit risk guidelines).

Main project stages and milestones

In relation to the entry into force of this new international standard, in its 2016 consolidated financial statements the Group reported the progress and main milestones achieved to that date regarding the implementation plan for its adoption. This report includes an update on this information included in the 2016 consolidated financial statements.

The work undertaken by Santander Group includes an assessment of the financial instruments included in the classification and measurement requirements of IFRS 9 and the development of impairment methodology for calculating expected loss impairment provisions.

The Group has drawn up the accounting policies and methodological framework for the implementation developments carried out by each local unit. These internal regulations have been approved by all relevant corporate bodies before the new standard comes into force.

With regard to classification and measurement, since 2016 the Group has been carrying out an analysis of its stock of products, focusing mainly on those that could trigger a change in accounting methodology, due to the business model involved and failure to meet SPPI test requirements (solely payments of principal and interest).

Additionally, using information from 2017, the Group has updated this analysis and reviewed any new products during the period, assessing both its asset management strategies (identifying the corresponding business model), and broadening the review of products in stock.

The local units have now finished developing impairment models for all their portfolios. The implementation of these impairment methodologies has enabled the Group to assess the cause of impact in each portfolio, the impact of each material Group unit, and to consider the total impact at group level.

The Group has started, in the second half of 2017, the parallel calculation of impairment provisions under IFRS 9 formally, without prejudice to the fact that a preliminary parallel calculation was already being made at consolidated level for monitoring, performance tracking and impact purposes. Based on the preliminary results obtained from the impairment provisions calculations, the Group has addressed the disclosure requirements of the EBA's second Quantitative Impact Study (QIS).

The governance process has been completed for the development, validation and approval of the model that started with a validation of the first models by the Corporate Internal Validation team and the Internal Validation units of the countries where these exist.

Further, given the importance of the control environment in the processes, the corporate development of the governance model of the impairment provisions calculation process as well as aspects related to the classification of financial instruments has been completed. The proposed model includes a reference design of the controls to be implemented in the new developments made in the implementation of the new standard. Also, as part of the proposed government model, has defined a process of periodic review of the main elements including, among others, the following areas:

- Business models defined in each Group unit.
- Quantitative and qualitative criteria defined for significant increase in risk.
- Macroeconomic scenario defined for impairment provisions calculation.
- Model adequacy for impairment provisions calculation.

C.1.3. Details of main geographies

The portfolios of the geographies where the Santander Group has the highest risk concentrations are set out below, based on the data in section C.1.2.2. Changes in key figures in 2017.

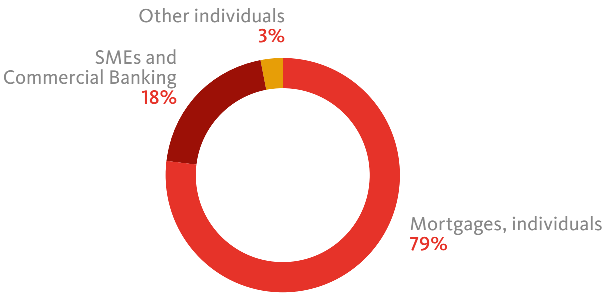
C.1.3.1. UK

C.1.3.1.1. Portfolio overview

Credit risk with customers in the UK amounted to EUR 247,625 million at the end of December 2017, accounting for 30% of the Group total.

Santander UK portfolio is divided into the following segments:

PORTFOLIO SEGMENTATION



C.1.3.1.2. Mortgage portfolio

It is worth highlighting the individuals mortgage portfolio because of its importance for Santander UK and all of the Group's lending. This stood at EUR 174,930 million at the end of 2017.

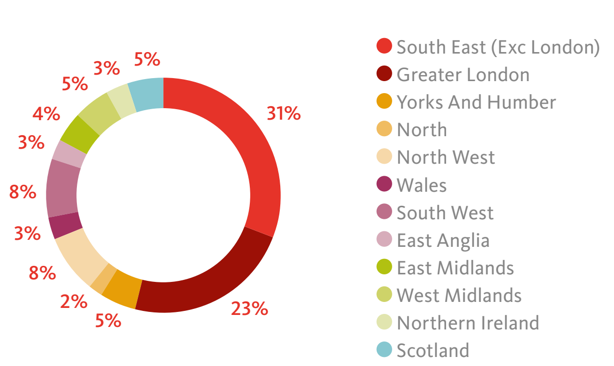
This portfolio consists of mortgages for the housing acquisition, granted to new, as well as existing customers and always constituting the first mortgage. There are no operations that entail second or successive liens on mortgaged properties.

The real estate market has shown price growth of 2,7% in the year – higher than expected – and a stable number of transactions.

The NPL ratio fell from 1.35% in 2016 to 1.13% in December 2017. This was due to the implementation of prudent policies and a resilient housing markets. The volume of non-performing loans therefore dropped by 10%, continuing the trend seen in 2016.

Geographically, the credit exposures are predominantly concentrated in the south east area of the UK and, particularly, in the metropolitan area of London.

GEOGRAPHICAL CONCENTRATION



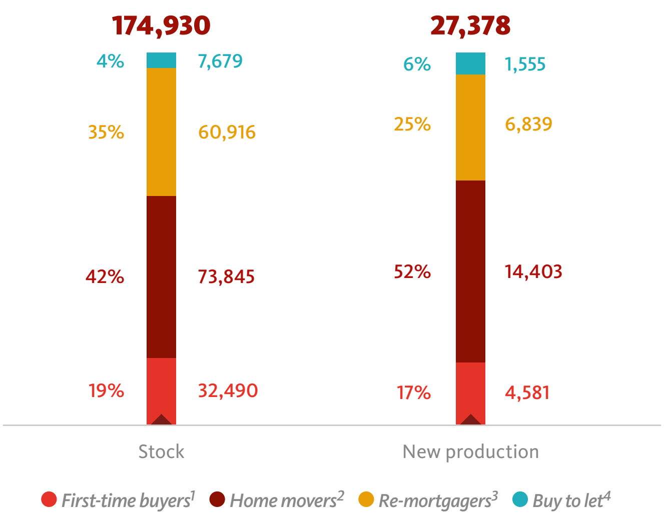
All properties are valued independently before each new transaction is approved, in accordance with the Group's risk management principles.

The value of the property used as collateral for mortgages that have already been granted is updated quarterly by an independent agency, using an automatic valuation system in accordance with market practices and in compliance with the prevailing legislation.

The distribution of the portfolio by type of borrower is shown in the chart below:

MORTGAGE PORTFOLIO LOAN TYPE

Million euros



1. First-time buyers: customers who purchase a home for the first time..
2. Home movers: customers who change houses, with or without changing the bank granting the loan.
3. Re-mortgages: customers who switch the mortgage from another financial entity.
4. Buy to let: houses bought for renting out.

Santander UK offers a wide range of mortgage products, in alignment with its policies and risk limits. Most of the portfolio contains standard products (repayment including principal and interest) but also other specific type of products:

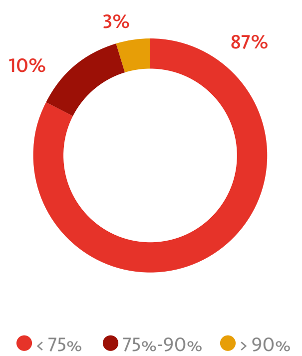
- **Interest only loans** (25.1%)[9] : the customer pays the interest every month and repays the capital at maturity. An appropriate repayment vehicle such as a pension plan, mutual funds, etc. is required. This is a common product in the UK market for which Santander UK applies restrictive policies in order to mitigate the inherent risks. For example: a maximum loan to value (LTV) of 50%, more stringent approval criteria and assessment of payment capacity, simulating the repayment of capital and interest instead of just interest.
- **Flexible loans** (9.8%): the contract for this type of loan enables the customer to modify their monthly payments or make additional drawdowns of funds up to a previously pre-established limit, under various conditions.
- **Buy to let** (4.4%): buy to let mortgages (purchase of a property to rent out) account for a small percentage of the total portfolio. These loans were halted between 2009 and 2013, although they were reactivated following the improvement in market conditions, with approval subject to strict risk policies. In December 2017, they represented approximately 6% of total underwriting and 4% of the remaining portfolio.

It is also necessary to point out the more conservative approach adopted in Santander UK's definition of an NPL, in line with the criteria set by the Bank of Spain and Santander Group, with regard to the standard applied in the UK market.

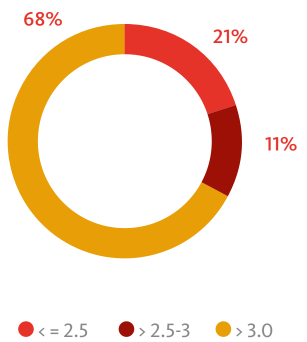
The application of these prudent policies has brought the average LTV of the portfolio to 42% and the weighted average LTV to 38.5%. The proportion of the portfolio with an LTV of more than 100% was down to 1.0% in December 2017, from 1.2% in 2016 and 1.7% in 2015.

The following charts show the LTV structure for the stock of residential mortgages and their breakdown according to the income multiple for new loans as of December 2017:

LOAN TO VALUE (AVERAGE 42%)[1]



INCOME MULTIPLE (AVERAGE 3.0)[2]



1. Loan to value: relation between the amount of the loan and the appraised value of the property. Based on indices.
2. Income multiple: relation between the total original amount of the mortgage and annual gross income declared in the customer loan application.

9. Percentage calculated for loans with total or some interest only component.

The credit risk policies currently used explicitly forbid loans regarded as high risk (subprime mortgages) and establish demanding requirements for credit quality, both for operations and for customers. For example, as of 2009 mortgages with a loan-to-value of more than 100% have not been allowed.

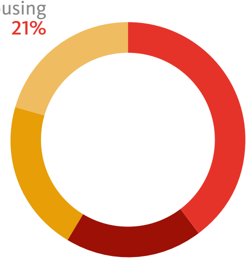
An additional indicator of the portfolio's good performance is the reduced volume of foreclosed properties, which in December 2017 amounted to EUR 30.1 million, less than 0.02% of total mortgage exposure.

C.1.3.1.3 SMEs and Commercial Banking

As shown in the portfolio segmentation chart at the beginning of this section, lending to SMEs and Commercial Banking (EUR 40,142 million) represented 18% of total lending at Santander UK as of December 2017.

The following sub-segments are included in these portfolios:

SMES AND COMMERCIAL BANKING PORTFOLIO SEGMENTS (1%)



SMEs: this segment includes firms that are served through small business banking and regional busines centres. Total lending was EUR 15,748 million, with an NPL ratio of 2.9%.

Commercial Banking: this includes companies to which a risk analyst is assigned. Total lending was EUR 7,600 million, with an NPL ratio of 1.8 %. It also includes portfolios considered to be non strategic (legacy and non-core).

SGCB: includes companies under the Santander Global Corporate Banking risk management model. Lending amounted to EUR 8,269 million with an NPL ratio of 5.5%.

Social housing: this includes lending to companies that build, sell and rent social housing. This segment is supported by local and central government and has no NPLs. Investment stood at EUR 8,525 million.

C.1.3.2. Spain (excl. Popular)

C.1.3.2.1. Portfolio overview

Total credit risk (including guarantees and documentary credits) at Santander Spain (excluding the real estate unit, which is discussed subsequently in more detail) amounted to EUR 172,176 million (20.7% of the Group total), with an adequate level of diversification by both product and customer segment.

Growth in new production in the main portfolios for individuals and corporates continued in 2017, underpinned by the improved economic situation and the different strategies implemented by the Bank.
Total credit risk was down 0.5% in year-on-year terms, mainly due to decreased funding extended to public administrations and the pace of repayments that exceeded growth in new production in the housing mortgages segment. All other individuals loans (consumer loans and credit cards) returned to growth tendency, and the commercial banking segment consolidated its tendency started in 2016.

CREDIT RISK BY SEGMENT

Million euros

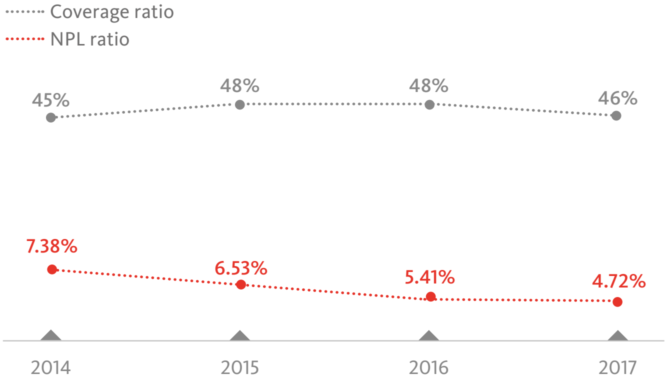
	2017	2016	2015	Var 17/16	Var 16/15
Total credit risk*	172,176	172,974	173,032	(0.5%)	0%
Household mortgages	45,483	46,213	47,924	(2%)	(4%)
Other credit for individuals	17,053	16,614	16,729	3%	(1%)
Business portfolio	96,726	96,082	92,789	1%	4%
Public administrations	12,914	14,065	15,590	(8%)	(10%)

* Including guarantees and documentary credits

The NPL ratio for the total portfolio was 4.72% 69 bp less than in 2016. The fall in lending (which increased the NPL ratio by 3 bp) was offset by the better NPL figure (which reduced the ratio by 72 bp). This improvement was mainly due to gross NPL entries, which were 19% lower than in 2016, and to the normalisation of several restructured positions and portfolio sales.

The coverage rate stood at 46%, a year-on-year decline of 2 pp, as a result of portfolio sales.

■ NPL AND COVERAGE RATIO



The more relevant portfolios are described in the following subsections.

C.1.3.2.2. Household mortgages

Home acquisition mortgages in Spain amounted to EUR 45,775 million at the end of 2017 (26% of total credit risk), 99% of which have a mortgage guarantee.

■ HOME MORTGAGES*

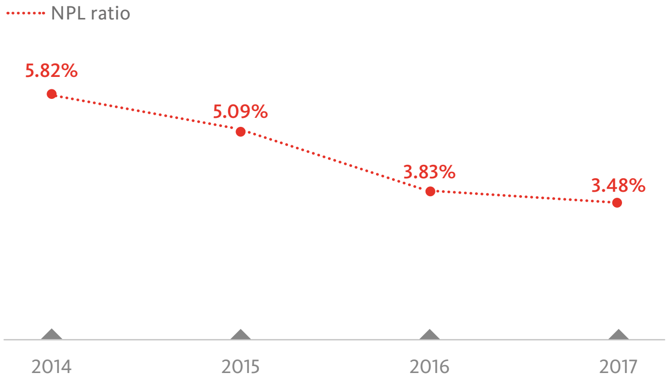
Million euros

	2017	2016	2015
Gross amount	**45,775**	**46,858**	**48,404**
Without mortgage guarantee	292	645	480
With mortgage guarantee	45,483	46,213	47,924
of which non-performing loans	**1,624**	**1,796**	**2,477**
Without mortgage guarantee	39	27	40
With mortgage guarantee	1,585	1,769	2,437

* Does not include the Santander Consumer Spain mortgage portfolio (EUR 2,007 million, with EUR 83 million of non-performing loans)

The NPL ratio of mortgages extended to households to acquire a home was 3.48%, 35 bp less than in 2016, supported by a continuing decline in gross NPL entries.

■ NPL RATIO, HOME MORTGAGES, SPAIN

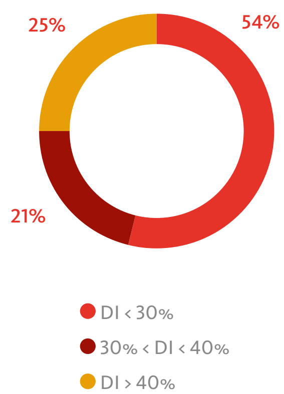


The portfolio of mortgages extended to acquire homes in Spain kept its medium-low risk profile with an limited:

- The principal is repaid on all mortgages from the start.
- Early repayment is usual and so the average life of the transaction is well below that of the contract.
- High quality of collateral concentrated almost exclusively in financing the first home.
- Average affordability rate stood at 28%.

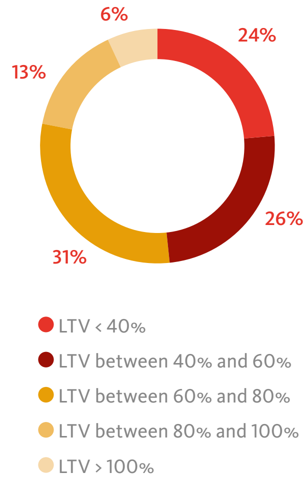
■ DEBT TO INCOME

Average 28.2%



■ LOAN TO VALUE

%



Loan to value: percentage indicating the total risk/latest available house appraisal.

Debt to income: relation between the annual instalments and the customer's net income.

C.1.3.2.3. Business portfolio

Credit risk assumed directly with SMEs, Corporates and SGCB (EUR 96,726 million) is the main lending segment in Spain (56% of the total).

Most of the portfolio (95%) corresponds to customers who have been assigned an analyst to monitor them continuously throughout the risk cycle.

The portfolio is highly diversified, with more than 200,817 active customers and with no significant concentrations by activity sector.

BUSINESS PORTFOLIO DISTRIBUTION

The NPL ratio for this portfolio stood at 4.88% in 2017, 91 bp lower than in 2016, with gross NPL entries falling vs. the previous year, normalisation of several restructured positions and portfolio sales.

C.1.3.2.4. Real estate activity (incl. Popular)

The Group manages, as a separate unit, the real estate business portfolio as result of the previous year's sector crisis and the new business identified as viable. In both cases the Group has specialised teams not only involve in the risk areas, but also complement and support all these transactions life cycle: commercial management, legal treatment and an eventual recovery function.

In recent years the Group's strategy has been geared towards reducing these assets. The changes in property development loans to customers were as follows:

REAL ESTATE PORTFOLIO EVOLUTION

Million euros

	2017	2016	2015
Balance at beginning of year	**5.515**	**7.388**	**9.349**
Foreclosed assets	(27)	(28)	(62)
Banco Popular (Perimeter)	2.934	-	-
Reductions*	(1.620)	(1.415)	(1.481)
Written-off assets	(330)	(430)	(418)
Balance at end of year	**6.472**	**5.515**	**7.388**

* Includes portfolio sales, cash recoveries and third-party subrogations.

The NPL ratio of this portfolio ended the year at 29.96% (compared with 61.87% at December 2016) due to the increase in the proportion of non-performing assets in the troubled loan portfolio and, in particular, to the sharp reduction in lending in this segment. The coverage ratio of the real estate non-performing exposure in Spain stands at 38.7%.

C.1.3.3. US

Credit risk at Santander Holding USA (SHUSA) increased to EUR 77,190[10] million at the end of December (representing 9% of the total Group), is made up of the following business units:

- **Santander Bank N.A.:** with total loans, including off-balance sheet exposure, of EUR 44,237 million (57% of Santander US total). It focuses on retail and commercial banking, of which 38% is with individuals and approximately 62% with companies. One of the main strategic goals for this unit is to continue to roll out its transformation plan. This focuses on compliance with all regulatory programmes, together with the development of the retail and commercial banking model towards a comprehensive solution for its customers.

- **Santander Consumer USA (SC USA):** vehicles finance company, with lending of EUR 24,079 million (31% of the total for the USA), with a vehicle leasing portfolio amounting to EUR 9,439 million. This activity is mainly based on its business relationship with the Fiat Chrysler Automobiles (FCA) group, which dates back to 2013. Through this agreement, SC USA became the preferred finance provider for Chrysler vehicles in the USA.

- **Other USA businesses:** Banco Santander Puerto Rico (BSPR) is a retail and commercial bank operating in Puerto Rico. Its lending stood at EUR 2,944 million at December 2017, 4% of the total. Santander Investment Securities (SIS), the New York, is dedicated to wholesale banking, with total lending at the end of December 2017 of EUR 2,451 million (3% of total in the USA). Finally, Banco Santander International (BSI), the Miami, focuses mainly on private banking. Its lending portfolio stood at EUR 3,471 million at the close of December 2017 with 4% of the total in the USA.

10. Includes EUR 11 million of lending under the holding company.

In consolidated terms, US reported a 16% drop in lending compared to year-end 2016 due to the pricing policy implemented from the second quarter by SC USA, the disposal of non-strategic assets from SBNA and the sale of the finance provider in Puerto Rico. NPLs and the cost of credit remain at moderate levels thanks to the stricter underwriting policy for new loans adopted by SC USA, and following the good performance of loans to individuals and Commercial Banking at Santander Bank. The NPL ratio stood at 2.79% (+52 bp) at the close of December, with a cost of credit of 3.42% (-26 bp). US main units performance details are set out below.

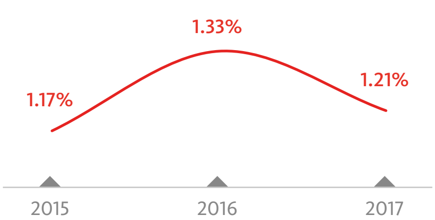
Additionally, great progress has been made in projects related to existing regulatory commitments, particularly with regard to stress testing and CCAR (Comprehensive Capital Analysis and Review) exercises, passing both the qualitative and quantitative tests set by the Federal Reserve and allowing SHUSA once again to distribute dividends in the third quarter of the year.

C.1.3.3.1. Santander Bank N.A. performance

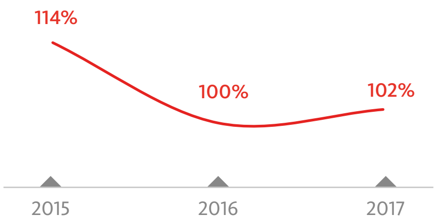
Most of the lending of Santander Bank is secured - around 59% of the total - mainly through mortgages and lending to Commercial Banking. This explains its low NPL ratio and cost of credit. Lending has decreased by 16% over 2017, due to the sale of non-core assets in a bid to optimise its balance sheet and improve profitability, and due to the exchange rate effect.

The NPL ratio remains very low, and continues to decline, as shown in the charts below, standing at 1.21% in December (-12 bp). This reduction is explained by a proactive management of certain positions and the improvement of customer's credit profile in the Oil&Gas sector due to more favourable oil prices, in addition to the good performance of loans to individuals, mainly mortgage loans. Higher coverage in some segments means that despite the good performance of NPLs, the cost of credit remains stable at 0.25% (+2 bp). The coverage ratio remains at comfortable levels, ending the year at 102%.

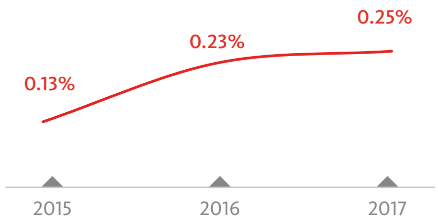
NON-PERFORMING LOANS RATIO



COVERAGE RATIO



COST OF CREDIT



The unit's strategic priority is its transformation plan, which seeks to ensure regulatory compliance and the alignment of management and governance standards with the corporate model. Significant progress was made throughout the year.

C.1.3.3.2. Santander Consumer USA business performance

The risk indicators for SC USA are higher than those of the other US units, due to the nature of its business, which focuses on vehicle financing through loans and leasings. The credit profile of the unit's customers covers a wide spectrum as SC USA seeks to optimise the risk assumed and the associated returns. As a result, the cost of credit is higher than in other Group units, but this is offset by the returns generated.

This is facilitated by one of the most advanced technological platforms in the industry, including a servicing structure for third parties that is scalable and extremely efficient. Other competitive advantages include its excellent knowledge of the market and the use of internally-developed pricing, underwriting, monitoring and recovery models, based on effective management of comprehensive databases. This is complemented by the availability of numerous other business tools, such as discounts from the brands (OEM - Original Equipment Manufacturers), pricing policies with highly responsive recalibration capacity, strict monitoring of new production and optimised recovery management.

On a residual basis, SC USA lending also includes the personal lending portfolio, which is considered non-strategic.

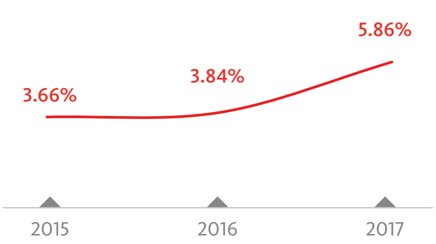
The NPL ratio stands at 5.86%, compared to 3.84% at year-end 2016, due mainly to the forbearance portfolio, although it remains at moderate levels thanks to the early management of NPLs resulting from the nature of the business. The cost of credit improved to 9.84% at 31 December, from 10.72% at year-end 2016. This was due to new pricing policy implemented from the second quarter and more stringent requirements on new production, in terms of both risk and price, resulting in a higher quality new lending mix, and lower new lending volumes for vehicle financing.

The leasing portfolio - business carried out exclusively under the FCA agreement and focused on customers with high quality credit profiles - grew by 4% in the year, to EUR 9,439 million, providing stable and recurrent earnings. The performance of customers has been positive, and the focus is now on managing and mitigating the residual value risk of leasing: i.e. the difference between the estimated residual vehicle value at the contract signature and the real vehicle value at the end of the contract.

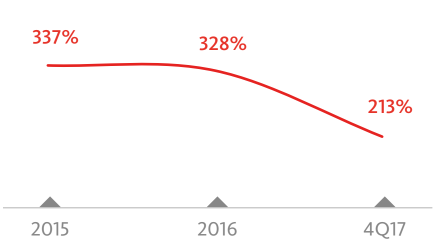
These mitigating actions are carried out in accordance with the prudent risk appetite, through the definition of limits, and through business management, with rapid and efficient sales of the vehicles when the agreements end, in addition to accelerated depreciation policies to mitigate future potential losses on the value of the vehicles. The mark to market of the vehicles held by SC USA on its balance sheet remain positive, standing at EUR 241 million at the end of December.

Coverage dropped to 213% (-115 pp) due to the reduction in funds and an improved portfolio mix, in addition to the rise in NPLs associated with the forbearance portfolio. Despite the reduction, coverage remains high, surpassing the average figure for its competitors.

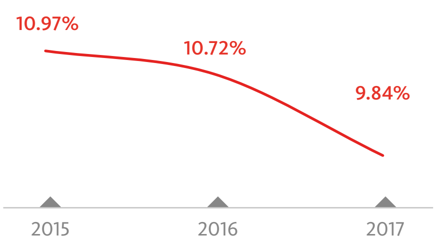
NON-PERFORMING LOANS RATIO



COVERAGE RATIO



COST OF CREDIT



The main strategic focus is to improve the return obtained on the different portfolios, by improving risk-related predictability and pricing policies, in addition to the optimisation of control and monitoring processes deriving from events related to regulatory compliance and customer practices.

C.1.3.4. Brazil

Credit risk in Brazil amounts to EUR 83,076 million, down approximately 7% against 2016 and largely due to the depreciation of the Brazilian currency. Santander Brazil therefore accounts for 10% of the Group lending.

Santander Brazil is adequately diversified and has an increasingly marked retail profile, with more than 60% of loans extended to individuals, consumer financing and SMEs.

In December 2017, growth in local currency was approximately 7.5%. This increase was more pronounced in retail segments with a more conservative risk profile, at the same time boosting customer relations and loyalty and business attracted through digital channels.

In the individuals loan segment, it is noteworthy the increase in payroll discount loans through the *Olé Consignado* brand, in addition to credit cards. It is also significant the growing interest in increasing the mortgage loan portfolio, under stricter admission requirements. At the same time, *Santander Financiamentos* has reported strong growth thanks to the new *+Negócios* (auto financing) and *+Vezes* (financing for goods and services) platforms and has enabled the Bank to increase its leadership position in the market, attaining a market share of over 20%.

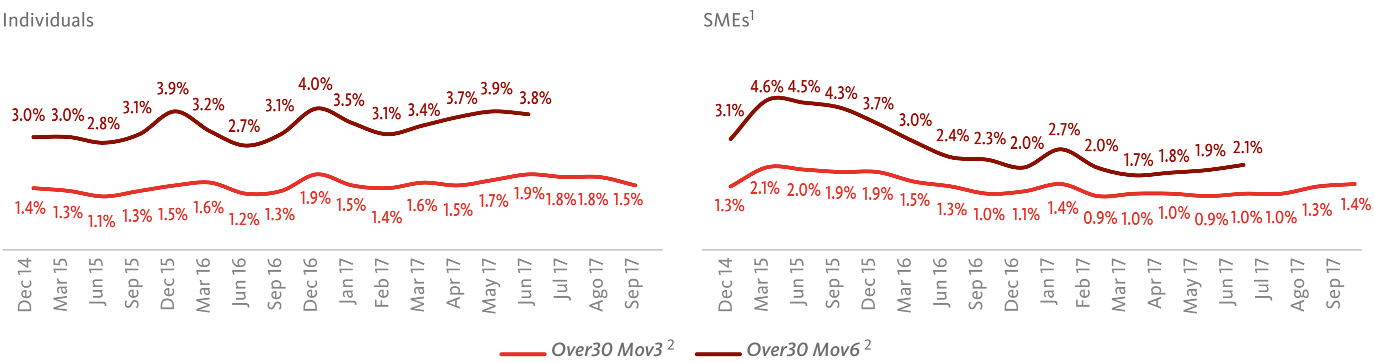
In the SME segment, the main highlight is the increase in rural loans, with low risk profile and the continued growth of *Adquirência*.

Finally, the Corporate and SGCB portfolios (with significant dollar positions in both cases) were once again hit by the depreciation in the last quarter of the brazilian real against the US dollar. On the other hand the strategy of reducing exposure to certain sectors, while boosting exposure to the agricultural and foreign trade segments. Other products, such as financing working capital continue to hold a substantial weighting in the portfolio.

The leading indicators for the credit profile of new loans (vintages) are continuously tracked. These are shown below, confirming the Entity's resilience. The vintages show transactions over 30 days in arrears at three and six months respectively from their origination date, in order to anticipate any possible portfolio impairment. This enables the entity to define corrective measures if any deviations from expected scenarios are detected.

As observable in the following chart, vintages have been kept at historically low levels thanks to proactive risk management. The rebound observed in individuals loans was rapidly identified (concentration in a specific product) and the appropriate measures taken to improve performance.

VINTAGES. PERFORMANCE OF THE *OVER 30** RATIO AT THREE AND SIX MONTHS FROM EACH VINTAGE ADMISSION



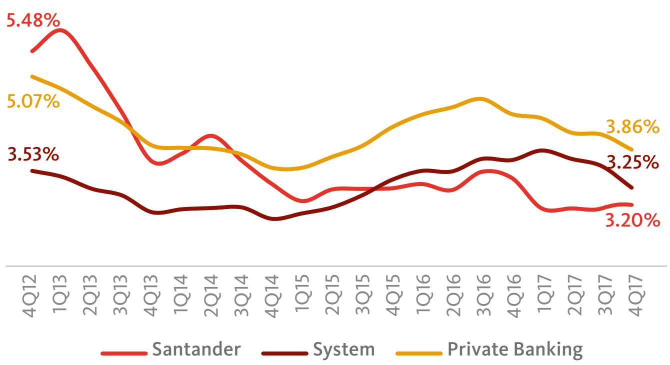
* Ratio calculated as the total value of business more than 30 days in arrears over the total value of the vintage.
1. Based on the new SME segmentation.
2. Months on Book.

The NPL ratio stood at 5.29% at year-end 2017 (-61 bp compared to the year-end of 2016). This fall was due to the preventive management of risks on the portfolio, in addition to the improved macroeconomic outlook and the implementation of certain structural reforms that were well received by the market.

The outlook is optimistic since the economy returned to growth, with GDP rising on the back of private consumption and exports. This is significant as it marks a trend change after several years of recession. Investment has also picked up, supported by the improved business confidence climate. Additionally, inflation is below the government's target, which has allowed the Monetary Policy Committee to significantly reduce the country's official interest rate (SELIC). The unemployment rate, while still high, has also shown improvement signs.

The Santander Brazil impairment rate on the lending portfolio, known locally as "over 90 rate", stood at 3.20% year-end 2017, below the average for private Brazilian banks for the second consecutive year, despite of the occasional rise in the last quarter due to a specific client.

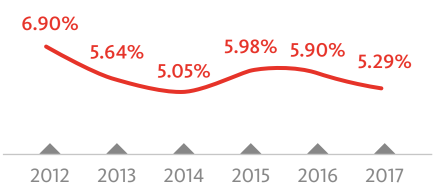
OVER 90 TOTAL



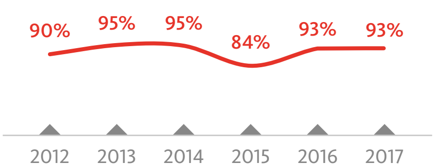
In general terms, and taking into consideration the last years evolution, a decreasing trend is observable in the cost of credit (4.36% at the end of 2017), falling by 53 pp compared to the previous year. This is due, mainly, to the increase in coverage achieved in 2016 in certain economic groups for the Corporates and SGCB portfolios (overall impact on the local financial system). As a result, in 2017 provisioning requirements for these portfolios were reduced, which, in addition to the ongoing positive performance of the retail portfolios, has consolidated its cost of credit downward tendency, for which there is confidence that it will remain stable in the year in spite of the new regulatory requirements.

The coverage ratio at year-end stood at 92.6%, at a comfortable level and presenting stability regarding the previous year.

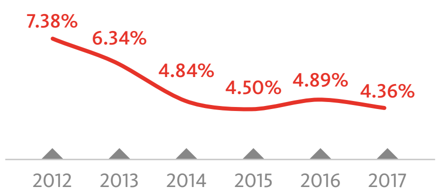
NON-PERFORMING LOANS RATIO



COVERAGE RATIO



COST OF CREDIT



C.1.4. Other credit risk aspects

C.1.4.1. Credit risk by activity in the financial markets[11]

This section covers credit risk generated in treasury activities with customers, mainly with credit institutions. The operations are developed through money market financial products with different financial institutions and through counter-party risk products which serve the Group's customers.

According to chapter six of the CRR (EU regulation 575/2013), the counterparty credit risk is the risk that the client in an operation could default before the definitive settlement of the cash flows of the operation. It includes the following types of operations: derivative instruments, operations with repurchase commitment, stock and commodities lending, operations with deferred settlement and financing of guarantees.

There are two methodologies for measuring this exposure: (i) mark to market (MtM) methodology (replacement value of derivatives) plus potential future exposure (add on) and (ii) the calculation of exposure using Monte Carlo simulation for some countries and products. The capital at risk or unexpected loss is also calculated, i.e. the loss which, once the expected loss has been 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 the exposures can be controlled directly against the limits approved by senior management. Risk control is performed 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.

Exposures in counterparty risk: over the counter (OTC) operations and organised markets (OM)

As of December 2017, total exposure on the basis of management criteria in terms of positive market value after applying netting agreements and collateral for counterparty risk activities was EUR 14,869 million (net exposure of EUR 32,876 million).

COUNTERPARTY RISK: EXPOSURE IN TERMS OF MARKET VALUE AND CREDIT RISK EQUIVALENT, INCLUDING MITIGATION EFFECT[1]

Million euros

	2017	2016	2015
Market value, netting effect[2]	31,162	34,998	34,210
Collateral received	16,293	18,164	15,450
Market value with netting effect and collateral [3]	14,869	16,834	18,761
Net CRE[4]	32,876	44,554	52,148

1. Figures with management criteria. Listed derivatives have a market value of zero. No collateral is received for these types of transactions.
2. Market value used to include the effects of mitigation agreements so as to calculate exposure for counterparty risk.
3. Considering the mitigation of netting agreements and having deducted the collateral received.
4. CRE (credit risk equivalent): net value of replacement plus the maximum potential value, minus collateral received. Includes regulatory EAD for organised markets (EUR 90 million in December, EUR 3 million in December 2016 and EUR 41 million in 2015).

11. Includes Banco Popular derivative positions with wholesale customers, excluding repos notional of EUR 9,222 million.

In the following table the distribution is shown, both in nominal and market value terms, of the Group's different products that generate counterparty credit risk. The latter, is mainly concentrated in interest and exchange rate hedging insturments:

COUNTERPARTY RISK: DISTRIBUTION BY NOMINAL RISK AND GROSS MARKET VALUE *

Million euros

	2017			2016			2015		
		Market value			Market value			Market value	
	Nominal	Positive	Negative	Nominal	Positive	Negative	Nominal	Positive	Negative
CDS protection bought**	18,134	36	(95)	23,323	83	(384)	32,350	80	(529)
CDS protection sold	12,097	266	(0)	19,032	339	(33)	26,195	428	(52)
Total credit derivatives	**30,231**	**302**	**(95)**	**42,355**	**422**	**(416)**	**58,545**	**508**	**(581)**
Equity forwards	733	4	(0)	134	48	(0)	980	5	(6)
Equity options	10,572	770	(2,841)	15,154	448	(426)	23,564	959	(1,383)
Spot equities	-	-	-	234	0	(0)	20,643	794	-
Equity swaps	25,264	859	(554)	15,388	631	(461)	28	-	(1,210)
Equities - ETF	26,088	-	-	36,512	-	-	6,480	-	-
Total equity derivatives	**62,657**	**1,633**	**(3,395)**	**67,421**	**1,127**	**(888)**	**51,695**	**1,758**	**(2,598)**
Fixed income forwards	8,660	89	(13)	6,357	37	(83)	11,340	39	(66)
Fixed income options	-	-	-	483	5	(2)	789	8	-
Spot fixed income	-	-	-	5,159	5	(2)	3,351	-	-
Fixed income - ETF	-	-	-	349	-	-	831	-	-
Total fixed income derivatives	**8,660**	**89**	**(13)**	**12,348**	**48**	**(88)**	**16,311**	**47**	**(66)**
Spot and term exchange rates	128,914	2,604	(3,870)	150,095	3,250	(6,588)	148,537	5,520	(3,315)
Exchange rate options	37,140	256	(343)	31,362	479	(624)	32,421	403	(644)
Other exchange rate derivatives	963	23	(17)	606	7	(27)	189	1	(4)
Exchange rate swaps	488,671	18,264	(15,892)	510,405	25,753	(24,175)	522,287	20,096	(21,753)
Exchange rate - organised markets	1,404	-	-	824	-	-	-	-	-
Total exchange rate derivatives	**657,092**	**21,147**	**(20,122)**	**693,292**	**29,489**	**(31,413)**	**703,434**	**26,019**	**(25,716)**
Asset swaps	22,736	1,194	(817)	22,948	1,178	(758)	22,532	950	(1,500)
Call money swaps	376,596	2,544	(2,301)	223,005	2,006	(1,581)	190,328	2,460	(1,792)
Interest rate structures	4,180	977	(594)	7,406	2,321	(593)	8,969	2,314	(3,031)
Forward rate agreements - FRAs	190,476	23	(39)	370,433	41	(106)	178,428	19	(78)
IRS	3,219,369	71,346	(75,391)	3,182,305	92,268	(92,873)	3,013,490	85,047	(85,196)
Other interest rate derivatives	185,925	2,816	(2,113)	210,061	3,762	(2,985)	194,111	3,838	(3,208)
Interest rate - ETF	127,288	-	-	117,080	-	-	26,660	-	-
Total interest rate derivatives	**4,126,570**	**78,900**	**(81,255)**	**4,133,238**	**101,576**	**(98,896)**	**3,634,518**	**94,628**	**(94,806)**
Commodities	221	0	-	539	108	(5)	468	130	(40)
Commodities - ETF	124	-	-	47	-	-	59	-	
Total commodity derivatives	**345**	**0**	**-**	**586**	**108**	**(5)**	**526**	**130**	**(40)**
Total OTC derivatives	**4,730,651**	**102,071**	**(104,880)**	**4,794,429**	**132,770**	**(131,706)**	**4,431,000**	**123,089**	**(123,805)**
Total derivatives organised markets* **	**154,904**			**154,812**			**34,028**		
Repos	**165,082**	**2,322**	**(2,363)**	**122,035**	**2,374**	**(2,435)**	**128,765**	**3,608**	**(3,309)**
Securities lending	**54,923**	**15,469**	**(16,580)**	**33,547**	**9,449**	**(4,124)**	**30,115**	**10,361**	**(1,045)**
Total counterparty risk	**5,105,560**	**119,862**	**(123,823)**	**5,104,823**	**144,593**	**(138,265)**	**4,623,908**	**137,058**	**(128,159)**

* Figures with management criteria.

** Credit derivatives acquired including hedging of loans.

*** Refers to transactions involving listed derivatives (proprietary portfolio). Listed derivatives have a market value of zero. No collateral is received for these types of transactions.

The following chart shows a breakdown of nominals in counterparty operations by maturity. The Bank's derivatives transactions focus on terms of less than five years, repos and securities loans maturing in less than one year.

COUNTERPARTY RISK: DISTRIBUTION OF NOMINALS BY MATURITY*

Million euros

	Up to 1 year	Up to 5 years	Up to 10 years	More than 10 years	TOTAL
Credit derivatives**	40%	50%	0%	10%	30,231
Equity derivatives	71%	25%	4%	0%	62,657
Fixed income derivatives	100%	0%	0%	0%	8,660
Exchange rate derivatives	51%	29%	15%	5%	657,092
Interest rate derivatives	26%	43%	21%	10%	4,126,570
Commodity derivatives	100%	0%	0%	0%	345
Total OTC derivatives	**29%**	**41%**	**20%**	**10%**	**4,730,651**
Total derivatives organised markets* **	**68%**	**30%**	**2%**	**0%**	**154,904**
Repos	**96%**	**4%**	**0%**	**0%**	**165,082**
Securities lending	**100%**	**0%**	**0%**	**0%**	**54,923**
Total counterparty risk	**33%**	**39%**	**19%**	**9%**	**5,105,560**

* Figures with management criteria.

*** Credit derivatives acquired including hedging of loans.

*** Refers to transactions involving listed derivatives (proprietary portfolio). Listed derivatives have a market value of zero. No collateral is received for these types of transactions.

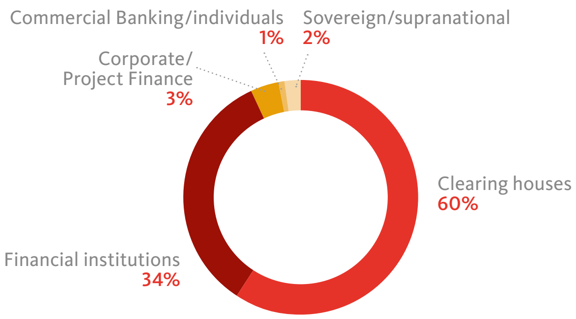
From the client´s perspective, counterparty credit risk exposure is concentrated in those clients with high credit quality (90.5% counterparty risk with a rating equal or higher than A), and mainly with clearing houses (60%) and financial institutions (34%).

DISTRIBUTION OF COUNTERPARTY RISK BY CUSTOMER RATING (IN NOMINAL TERMS)*

AAA	0.87%
AA	9.92%
A	79.70%
BBB	7.15%
BB	2.30%
B	0.06%
Other	0.00%

* Ratings based on equivalences between internal ratings and credit agency ratings .

COUNTERPARTY RISK BY CUSTOMER TYPE

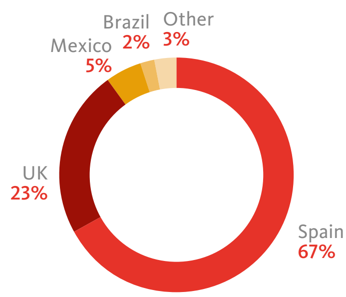


In general, transactions with financial institutions are performed under netting and collateral agreements, and constant efforts are made to ensure that all other operations are covered under this type of agreement. Generally, the collateral agreements that the Group signs are bilateral with counted exceptions, mainly with multilateral institutions and securitisation funds, in which are unilateral in favour of the client.

The collateral received under the different types of collateral (CSA, OSLA, ISMA, GMRA, etc.) signed by the Group amounted to EUR 16,293 million (of which EUR 11,398 million corresponded to collateral received by derivatives), mostly cash (81.2%), and the rest of the collateral types are subject to strict policies of quality regarding the issuer type and its rating, debt seniority and haircuts applied.

In geographical terms, the collateral received is distributed as shown in the following chart:

COLLATERAL RECEIVED. GEOGRAPHICAL DISTRIBUTION



As a consequence of the risk associated with the credit exposure that is taken on with each counterparty, Santander Group includes a valuation adjustment for OTC (over the counter) derivatives due to the risk associated with credit exposure assumed with each counterparty, i.e. a Credit Valuation Adjustment (CVA)[12], and a valuation adjustment due to the risk relating to the Group itself assumed by counterparties on OTC derivatives, i.e. Debt Valuation Adjustment (DVA).

At year-end, there were CVAs of EUR 322.5 million (-49.9% compared to December 2017) and DVA of EUR 219.6 million (-43.7%). The decrease is due to the fact that credit spreads have been reduced by percentages greater than 40% in the most liquid terms and reductions in the main counterparty's exposure.

Counterparty risk, 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, repos and securities lending, whether settled by clearing house or traded bilaterally. In recent years, there has been a gradual standardisation of OTC operations in order to conduct clearing and settlement of all new trading operations through clearing houses, as required by the recent regulation and to foster internal use of electronic execution systems.

Furthermore, the Group actively manages operations not settled through clearing houses and seeks to optimise their volume, given the spread and capital requirements imposed by new regulations.

With regard to organised markets, regulatory credit exposure has been calculated for such operations since 2014 and the entry into force of the new CRD IV (Capital Requirements Directive) and CRR (Capital Requirements Regulation), transposing the Basel III principles for calculating capital, even though counterparty risk management does not consider credit risk on such operations[13].

The following tables show the weighting of trades settled through clearing houses as a portion of total counterparty risk at December 2017:

DISTRIBUTION OF COUNTERPARTY RISK BY SETTLEMENT CHANNEL AND PRODUCT TYPE*

Nominal in million euros

	Bilateral		CCP**		Organised markets ***		
	Nominal	%	Nominal	%	Nominal	%	Total
Credit derivatives	27,707	91.6%	2,524	8.4%	-	0.0%	**30,231**
Equity derivatives	36,568	58.4%	0	0.0%	26,088	41.6%	**62,657**
Fixed income derivatives	8,660	100%	-	0.0%		0.0%	**8,660**
Exchange rate derivatives	655,501	99.8%	188	0.0%	1,404	0.2%	**657,092**
Interest rate derivatives	1,175,774	28.5%	2,823,508	68.4%	127,288	3.1%	**4,126,570**
Commodity derivatives	221	64.2%	-	0.0%	124	35.8%	**345**
Repos	100,996	61.2%	64,086	38.8%	-	0.0%	**165,082**
Securities lending	54,923	100%	-	0.0%	-	0.0%	**54,923**
General total	**2,060,350**		**2,890,306**		**154,904**		**5,105,560**

* Figures with management criteria.
** Central counterparties (CCP).
*** Refers to transactions involving listed derivatives (proprietary portfolio). Listed derivatives have a market value of zero. No collateral is received for these types of transactions.

12. The definition and methodology for calculating the CVA and DVA are set out in C.2.2.2.6. Credit Valuation Adjustment (CVA) and Debt Valuation Adjustment (DVA) in this report.
13. Credit risk is eliminated when organised markets act as the counterparty in the transaction, as they have in place mechanisms that enable them to protect their financial position through deposit and guarantee replacement systems and processes that ensure the liquidity and transparency of transactions.

DISTRIBUTION OF RISK SETTLED BY CCP AND ORGANISED MARKETS, BY PRODUCT AND CHANGE OVER TIME (*)

Nominal in million euros

	2017	2016	2015
Credit derivatives	2,524	3,916	1,778
Equity derivatives	26,088	36,568	6,522
Fixed income derivatives	-	349	896
Exchange rate derivatives	1,592	1,419	11,755
Interest rate derivatives	2,950,796	2,732,103	2,069,802
Commodity derivatives	124	47	59
Repos	64,086	29,763	44,679
Securities lending	-	4	-
General total	**3,045,210**	**2,804,170**	**2,135,489**

* Figures with management criteria.

Off-balance sheet credit risk[14]

The off-balance sheet risk corresponding to funding and guarantee commitments with wholesale customers was EUR 90,453 million, with the following distribution by products:

OFF BALANCE SHEET EXPOSURE

Million euros

	Maturity				
Product	< 1 year	1-3 years	3-5 years	> 5 years	Total
Funding*	13,834	19,231	27,229	3,004	63,298
Technical guarantees	5,657	7,242	819	328	14,046
Financial and commercial guarantees	6,936	3,944	965	637	12,482
Foreign trade**	459	143	22	3	627
General total	**26,886**	**30,560**	**29,035**	**3,972**	**90,453**

* Mainly including committed bilateral and syndicated credit lines.

** Mainly including stand-by letters of credit.

Activity in credit derivatives[15]

Santander Group uses credit derivatives to cover loans, customer business in financial markets and trading operations. The volume of this activity is small compared to that the main 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 Value at Risk (VaR)[16], nominal by rating, spread sensitivity by rating and name, and recovery rate and correlation sensitivity. Jump-to-default limits are also set by individual name, geographical area, sector and liquidity.

In notional terms, the CDS position incorporates EUR 13,019 million of protection acquired[17] and EUR 12,117 million of protection sold.

At 31 December 2017, the lending sensitivity to increases in spreads of one basis point was EUR -3.7 million, whilst the average VaR at year-end 2017 was EUR 2.3 million, lower than the 2016 figure (EUR 1.7 million).

C. 1.4.2. Concentration risk[18]

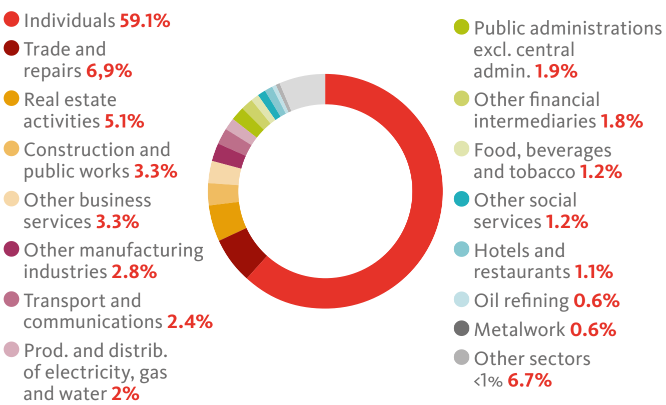
The concentration risk control is a vital part of management. The Group continuously tracks the degree of concentration of its credit risk portfolios using various criteria: geographical areas and countries, economic sectors, products and groups of customers.

The board, via the risk appetite, determines the maximum levels of concentration, as detailed in section A.4.1. Risk appetite and structure of limits. In line with the risk appetite, the Executive Risk Committee establishes the risk policies and reviews the appropriate exposure levels for the adequate management of the degree of concentration of credit risk portfolios.

As indicated at the beginning of this chapter, in geographical terms, credit risk with customers is diversified in the main markets where the Group operates (UK 30%, Spain 21%, USA 9%, Brazil 10%, etc.).

In terms of diversification by sector, approximately 59% of the Group's credit risk corresponds to individual customers, who, due to their inherent nature, are highly diverse. In addition, the lending portfolio is well distributed, with no significant concentrations in specific sectors. The following chart shows the distribution at the end of the year:

SECTOR DIVERSIFICATION



14. Excluding Popular.
15. Excluding Popular.
16. The definition and calculation methodology for VaR is set out in section C.2.2.2.1. Value at Risk (VaR).
17. This figure excludes CDSs with an approximate value of EUR 2,293 million used to hedge loans that for accounting purposes are recorded as financial guarantees rather than credit derivatives, as their change in value has no impact on results or reserves, in order to avoid accounting asymmetry.
18. Excluding Popular.

The Group is subject to the regulation on large risks contained in the fourth part of the CRR (EU regulations 575/2013), according to which the exposure contracted by an entity with a customer or group of customers linked among themselves will be considered a large exposure when its value is equal or greater than 10% of eligible capital. In addition, in order to limit large exposures, no entity can assume exposure exceeding 25% of its eligible capital with a single customer or group of linked customers, after taking into account the impact of the reduction of credit risk contained in the regulation.

Having applied the risk mitigation techniques, no groups triggered these thresholds at the end of December.

Regulatory credit exposure with the 20 largest groups within the scope of large risks represented 4.7%[19] of outstanding credit risk with customers (lending plus balance sheet risks) at December 2017.

The Group's Risk 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 securitisations to optimise the risk-return relationship for the whole portfolio.

C.1.4.3. Country risk

Country risk is a component of credit risk in all cross-border credit operations for circumstances other than normal commercial risk. The main elements involved are sovereign risk, transfer risks and other risks that affect international financial activity (wars, natural disasters, balance of payments crises, etc.).

At 31 December 2017, the provisionable exposure to country-risk was EUR 184 million (EUR 181 million in 2016). At the end of December 2017, total provisions stood at EUR 37 million, compared to EUR 29 million at the end of the previous year.

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 relationship with customers.

C.1.4.4. Sovereign risk vis-á-vis the rest of public administrations

As a general criteria, sovereign risk is that contracted in transactions with a central bank (including the regulatory cash reserve requirement), the Treasury risk issuer or similar entity (public debt portfolio) 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 criteria, historically used by the Group, differs in some respects from that requested by the EBA for its regular stress exercises. The main differences are that the EBA's criterion does not include deposits with central banks, exposures with insurance companies, indirect exposures via guarantees and other instruments. On the other hand, it includes public administrations in general (including regional and local bodies), not only the state sector.

Exposure to sovereign risk (according to the criteria applied in the Group) mainly emanates from the obligations to which the Bank´s subsidiaries are subject regarding the establishment of certain deposits in central banks, the establishment of deposits with liquidity excess and fixed-income portfolios held as part of the structural interest rate risk-management strategy for the balance sheet and treasury trading books. The vast majority of such exposure is in local currency and is funded on the basis of customer deposits captured locally, also in the local currency.

Local sovereign exposure in currencies other than the official currency of the country of issuance is not very significant (EUR 13,175 million, 5% of total sovereign risk), and exposure to non-local sovereign issuers involving cross-border[20] risk is even less significant (EUR 2,886 million, 1.2% of total sovereign risk).

In general, over the past few years, total exposure to sovereign risk has remained at adequate levels to support the regulatory and strategic motives of this portfolio.

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 percentage exposure by rating levels[21]:

EXPOSURE BY RATING

	2017	2016	2015
AAA	13%	16%	34%
AA	19%	17%	4%
A	29%	29%	22%
BBB	14%	8%	33%
Lower than BBB	25%	30%	7%

The sovereign risk distribution by rating level has been affected by several rating reviews for the sovereign issuers of the countries where the Group operates over the last few years (Brazil, UK, etc.).

19. Including Popular.
20. Countries that are not considered as "low risk" by the Bank of Spain.
21. Internal ratings used.

On the basis of the EBA criteria already mentioned, the exposure to public administrations at the end of each of the last three years is shown in the table below (figures in million euros)[22].

EXPOSURE TO SOVEREIGN RISK (EBA CRITERION)

Million euros

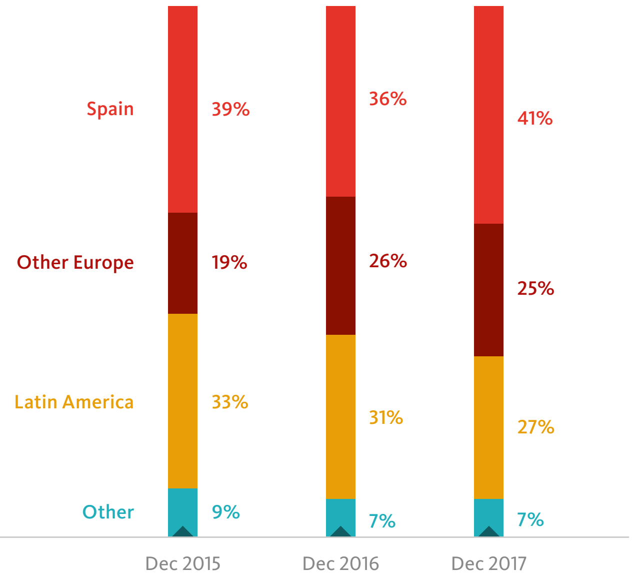
	31 Dec 2017					31 Dec 2016	31 Dec 2015
	Portfolio						
	Trading and other at fair value	Available for sale	Lending	Held-to-maturity portfolio	Total net direct exposure	Total net direct exposure	Total net direct exposure
Spain	4,928	37,748	18,055	1,906	62,637	45,893	48,694
Portugal	53	5,220	3,541	3	8,817	7,072	10,007
Italy	1,479	4,613	16	-	6,108	1,952	2,717
Greece	-	-	-	-	-	-	-
Ireland	-	-	-	-	-	-	-
Rest Eurozone	(1,192)	497	81	-	(614)	(341)	1
UK	2	1,751	7,236	7,414	16,403	17,639	5,163
Poland	1,034	5,566	40	-	6,640	6,290	5,401
Rest of Europe	172	358	40	-	570	791	670
US	2,548	2,616	765	-	5,929	5,713	5,093
Brazil	3,202	20,201	1,171	2,720	27,294	24,286	23,929
Mexico	1,780	5,152	2,586	-	9,518	10,461	10,519
Chile	428	2,985	312	-	3,725	3,525	5,362
Rest of America	147	424	940	-	1,511	1,172	1,802
Rest of the world	3,422	512	920	-	4,854	3,475	5,890
Total	**18,003**	**87,643**	**35,703**	**12,043**	**153,392**	**127,930**	**125,248**

Exposure is moderate and remained on an upward tendency in 2017, The sovereign risk exposure of Spain (where the Group has its headquarters) is not high in terms of total assets (4.3% at the end of December 2017), compared to its peers.

Sovereign exposure in Latin America is mostly in local currency, being recognised in the local accounts and concentrated in short-term maturities with lower interest rate risk and greater liquidity.

SOVEREIGN RISK AND VIS-Á-VIS OTHER PUBLIC ADMINISTRATIONS: NET DIRECT EXPOSURE (EBA CRITERION)

Million euros



22. In addition at 31 December 2017, the Group maintained direct net exposures in derivatives with a fair value of EUR 1,681 million, and indirect net exposures in derivatives with a fair value of EUR 15 million.

C.1.4.5. Social and environmental responsibility

Social and environmental policy
Banco Santander contributes with society for sustainable economic growth, promoting the protection, conservation and recovery of the environment, and human rights protection. To this end, Santander has included the social, environmental and reputational risk assessment of its operations and customers in the decision-making processes across the whole Organisation, in line with its sustainability policy.

The sustainability policies are annually revised. After the 2015 review, they apply to more activities, more customers and follow the best international practices and standards. These policies define the banking activity behaviour framework regarding sectors of defence, energy and soft commodities. A summary of these policies is provided in Santander´s website. It is noteworthy the approval in 2017, by the board, of a new mining and metal sector.

The policies were implemented throughout the Group by creating social-environmental risk task forces in the main geographies in which all functions involved in the decision making of the banking activities are represented. These groups were created as a replica of the corporate working group headed by the Group Chief Compliance Officer to assess and issue a collegiate opinion on the transactions and customers affected by these policies, as a prior step to the imposition of sanctions by the corresponding decision-making bodies.

In addition to the above, the Group has applied the Equator Principles (EP) since 2009, to project finance and corporate funding for a known purpose, including bridge loans before finance is granted for building or remodelling a specific project. An in-depth report is available on the Equator Principles website and in the Santander Group Sustainability Report.

Climate change
As indicated in section A.4.3 Scenario analysis, the Task Force on Climate-related Financial Disclosures (TCFD) of the Financial Stability Board recently published a series of recommendations for corporate governance, strategy, risk management, measurements and targets in relation to climate change. These recommendations will imply a significant advance in the reporting of risk and opportunities associated with climate change by financial institutions.

The banking sector is key in the transition, both in terms of investment opportunities that it will present and the importance in terms of risk management derived from adjusting the system and world economic activities to the new climate change challenges.

Santander Group integrates the risks related to climate change in its control module through, among other aspects, social and environmental policies incorporated in the decision-making process and the periodic risk identification exercise (for further detail consult section B. Background and upcoming challenges). In addition, to implement some of the TCFD recommendations, the Group is participating together with other entities in an UNEP FI financial initiative aforementioned in section A.4.3. Scenario analysis.

As a result of the Paris climate agreement, governments in the different countries are currently working to develop and implement the financial mechanisms necessary to meet the established targets and facilitate the transition to a lower emission economy. In Europe, the High Level Expert Group on Sustainable Finance of the European Commission is the main developer of this type of measure, seeking to adjust the financial system for a more sustainable future.

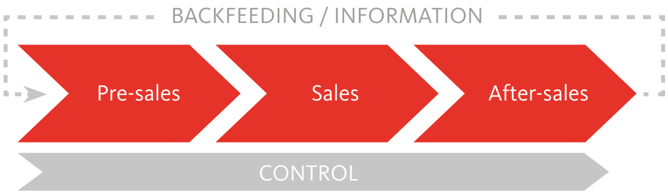
C.1.5.Credit risk cycle

Credit risk management is organised around a sound organisational and governance model, with the participation of the board of directors and the Executive Risk Committee, which establishes the risk policies and procedures, the limits and delegation of powers, and approves and oversees the framework of the credit risk function.

Exclusively within the field of credit risk, the Credit Risk Control Committee is the collegiate body responsible for its oversight and control within the Santander Group. The aim of the committee is to effectively control credit risk, ensuring and advising the Chief Risk Officer and the Risk Control Committee that credit risk is managed in accordance with the level of risk appetite approved by the board of directors.

The cycle that includes credit risk management, with the involvement of the business areas of risk and senior management, is predicated on the key risk management, and control processes mentioned in section A.4. Management processes and tools, Specifically for credit risk, these processes are split into three interrelated phases, including the results of the post sales phase in the risk study and planning pre sales phase.

Each of these phases is associated with specific decision models established for decision-making in line with the business objectives and credit policies defined by the Group.



1. Planning
2. Assessment: study of the risk and credit rating process
3. Establishment of limits/ pre-classifications/ pre-approvals

4. Decision-making on transactions

5. Monitoring
6. Measurement and control
7. Recovery management

C.1.5.1. Planning

When defining joint business objectives among business and risks areas, including the types and levels of risk to be assumed, the following factors stand out:

Identification

The identification of credit risk is a key component for the active management and an effective control of portfolios. The identification and classification of external and internal risk in each business allows corrective and mitigating measures to be adopted.

Planning (strategic commercial plan-SCP)

Strategic commercial plans (SCPs) are a basic management and control tool for the Group's credit portfolios. The plans are prepared jointly by the commercial and risks areas, and define the commercial strategies, risk policies and measures/infrastructures required to meet the annual budget targets. These three factors are considered as a whole, ensuring a holistic view of the portfolio to be planned and allowing a map of all the Group's credit portfolios to be drawn up.

Planning allows business targets to be set and specific action plans to be defined, within the risk appetite established by the Entity, and these targets to be met by assigning the necessary means (models, resources, systems).

The comprehensive management of the SCP means that an up-to-date view of the credit quality of the portfolios is available at all times, credit risk can be measured, internal controls carried out, in addition to regular monitoring of the planned strategies, to anticipate deviations and identify significant changes in risk and their potential impact, along with the application of corrective measures.

SCPs are approved by each entity's most senior executive Risks Committee, and validated at corporate level in the Executive Risks Committee or equivalent body. The regular monitoring, established by the governance in place, is performed by the same bodies that approve and validate the plans.

Scenario analysis

As described in section A.4.3. Scenarios analysis of this report, credit risk scenario analysis enables senior management to better understand the portfolio's evolution in the face of market conditions and changes in the environment. It is a key tool for assessing the sufficiency of the provisions made and the capital to stress scenarios.

Scenario analysis is applied to all of the Group's significant portfolios, usually over a three year horizon. The process involves the following main stages:

- Definition of **benchmark scenarios**, both central or most likely scenarios (baseline), as well as economic scenarios that although less likely to occur can be more adverse (stress scenarios). A global stress scenario is defined describing a world crisis situation and the way it would affect each of the countries in which the Group operates. In addition, a local stress scenario is defined which affects in an isolated way some of the main units with a greater degree of stress than the global stress scenario.

  These scenarios are defined by the Santander Group's research department in coordination with each unit, using figures published by leading international institutions as a benchmark. All scenarios are backed by a rationale and are verified and reviewed by all areas involved in the simulation process.

- Determination of the value of risk parameters and metrics (probability of default, loss given default, etc.) for the scenarios defined. These parameters are established using internally developed **statistical-econometric models**, based on portfolio and historical losses for which they are developed, in relation to historical data for macroeconomic variables. The simulation models employed by the Group use data from a complete economic cycle in order to calibrate the risk factors performance regarding changes in macroeconomic variables.

  These forecasting models follow the same development, validation and governance cycles as with other internal models of the Group. They are subject to regular backtesting and recalibration to ensure they correctly capture the relationship between macroeconomic variables and the risk parameters.

- Adaptation of the new projection methodology to the new regulatory requirements (IFRS 9), with an impact on the estimation of the **expected loss** associated with each of the scenarios put forward, as well as with other **important credit risk metrics** deriving from the parameters obtained (NPLs, provisions, allowances, etc.).

- Analysis and rationale for the credit risk profile evolution at portfolio, segment, unit and Group levels, in the face of different scenarios and compared to previous years.

- **Integration of management indicators** to supplement the analysis of the impact caused by macroeconomic factors on risk metrics.

- A series of controls and comparisons are run to ensure that the **controls and backtesting** are adequate, thus completing the process.

The entire process takes place within a corporate governance framework, and is thus adapted to the growing importance of this framework and to best market practices, assisting the Group's senior management in gathering knowledge for their decision making.

C.1.5.2. Assessment: study of the risk and credit rating process

Generally speaking, risk study consists of analysing a customer's capacity to meet their contractual commitments with the Bank and other creditors. This entails analysing the customer's credit quality on a short and medium term horizon, risk operations, solvency and expected return on the basis of the risk assumed.

With this objective, the Group uses customer credit decision models in all segments in which it operates: SGCB (Santander Global Corporate Banking: sovereign, financial institutions and corporate companies), Commercial Banking, institutions, SMEs and individuals.

The decision models applied are based on credit rating drivers. These models and drivers are monitored and controlled to calibrate and precisely adjust the decisions and ratings they assign. Depending on the segment, drivers may be:

- Rating: resulting from the application of mathematical algorithms incorporating a quantitative model based on balance sheet ratios or macroeconomic variables, and a qualitative module supplemented by the analyst's expert judgement. Used for the SGCB, Commercial Banking, institutions and SMEs (treated on an individual basis) segments.

- Scoring: an automatic assessment system for credit applications. It automatically assigns an individual assessment of the customer for subsequent decision making. There are two types: approval or performance and it is used in the individuals and SMEs (treated on a standard basis) segments.

The resulting ratings are regularly reviewed, incorporating the latest available financial information and experience in the development of banking relations. The reviews are increased in the case of customers who reach certain levels previously determined in the automatic warning systems and are classified as special watch.

C.1.5.3. Establishment of limits, pre-classifications and pre-approvals

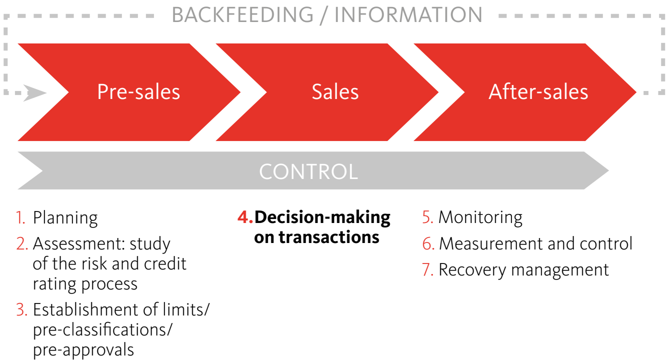
This process establishes the risk that each customer is able to assume. These limits are set jointly by the business and risks areas and have to be approved by the executive Risks Committee (or committees delegated by it) and reflect the expected risk-return by the business.

Different models are used according to the segment:

- 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 customer or group can assume, in terms of amount or maturity.

- For **commercial banking and institutions** that meet certain requirements (high knowledge, rating, etc.) a more simplified pre-classification model is used.

- For **SMEs and individuals**, in specific situations where a series of requirements are met, pre-approved operations are established for customers, or pre-approved operations for potential customers (campaigns and policies to encourage the use of limits).



C.1.5.4. Decision-making on transactions

The sales phase consists of the decision-making process, which analyses and resolves operations. Approval by the risk area is a prior requirement before contracting any risk operation. All decisions regarding risks must consider the risk appetite, limits and management policies defined in the planning stage, in addition to other factors relevant to the risk and profitability equilibrium.

According to the segment, decision-making follows different procedures:

- For SGCB, and according to the prior limit-setting phase, two types of decision will be available: (1) automatic, within the limits set under the pre-classification framework, (2) approval from a risk analyst or committee (although the operation meets the amount, maturity and other conditions set in the pre-approved limit).

- For commercial banking and institutions, approval is required from a risk analyst or committee (although the operation meets the amount, maturity and other conditions set in the pre-approved limit).

- In terms of individual customers and SMEs with low turnover, large volumes of credit operations can be managed more easily with the use of automatic decision models for classifying the customer/ transaction binomial.

Mitigation measures

Santander Group applies various credit risk mitigation techniques on the basis, among other factors, of the type of customer and product. Some are inherent to specific operations (e.g. real estate guarantees) while others apply to a series of operations (e.g. netting and collateral). The different mitigation techniques can be grouped into the following categories:

Personal guarantees and credit derivatives

This type of guarantees correspond 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 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. Hedging with credit derivatives, mainly through credit default swaps (CDS), is contracted with front-line banks.

Real guarantees

These are assets that are subject to compliance with the guaranteed obligation. They can be provided by the customer or by a third party. The real goods or rights used for the guarantee may be financial (cash, securities deposits, gold, etc.) or non-financial (property, other moveable property, etc.). Therefore guarantees can be in the form of:

- **Pledges / financial assets:** debt/equity instruments or other financial assets received as the guarantee.

  A very important example of a real financial guarantee is **the collateral**, which is used for the purpose (as with the netting technique) of reducing counterparty risk. This 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 operations subject to the collateral agreement are regularly valued (normally daily) applying the parameters defined in the contract so that a collateral amount is obtained (usually cash or securities), which is to be paid to or received from the counterparty.

- **Real estate mortgages:** real estate assets used in transactions with an ordinary or maximum mortgage guarantee. There are regular appraisal processes, based on real market values, for the different types of property, which meet the requirements established by local and the Group regulators.

- **Other real guarantees:** any other type of real guarantee.

As a general rule, the repayment capacity is the most important aspect in decisions on the acceptance of risks, although this is no impediment to seek the highest level of real or personal guarantees. In order to calculate the regulatory capital, only those guarantees that meet the minimum qualitative requirements set out in the Basel agreements are taken into consideration.

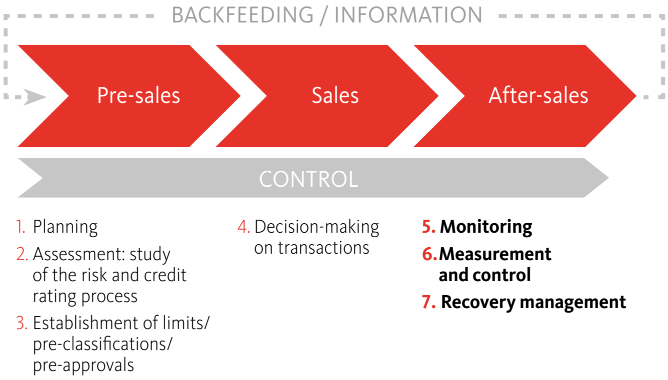
Implementation of the mitigation techniques follows the minimum requirements established in the guarantee management policy: legal certainty (possibility of legally requiring the settlement of guarantees at all times), the lack of substantial positive correlation between the counterparty and the value of the collateral, the correct documentation of all guarantees, the availability of documentation for the methodologies used for each mitigation technique and appropriate monitoring, traceability and regular control of the goods/assets used for the guarantee.

Determination of a net balance by counterparty

The concept of netting is the possibility of determining a net balance between operations of the same type, under the umbrella of a framework agreement such as the ISDA or similar.

It consists of aggregating the positive and negative market values of derivative transactions that Santander has with a certain counterparty, so that in the event of default it owes (or Santander owes, if the netting off is negative) a single net figure and not a series of positive or negative values corresponding to each operation with the counterparty.

An important aspect of framework contracts 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 the contract with the same counterparty.



C.1.5.5. Monitoring

Monitoring business performance on a regular basis, and comparing performance against agreed plans is a fundamental task. Monitoring is performed in several areas:

Monitoring / Anticipation of customers

All customers must be monitored in an ongoing and holistic manner that enables the earliest detection possible of any incidents that may arise in relation to risk impacting the customer's credit rating, so that specific measures (predefined or ad-hoc) can be implemented to correct any deviations that could have a negative impact for the entity. This responsibility is shared by the commercial and risk functions.

Monitoring is carried out by local and global risk teams, supplemented by internal audit. It is based on customer segmentation:

- In the commercial banking, institutions and SMEs with individual treatment, the function consists of identifying and tracking customers whose situations require closer monitoring, reviewing ratings and continuously analysing indicators.

- In the individual customers, businesses and SMEs with a low turnover segment monitoring is carried out through automatic alerts for the main indicators, in order to detect shifts in the performance of the loan portfolio with respect to the forecasts in strategic plans.

Portfolio measurement and control

In addition to the monitoring customer credit quality, Santander establishes the control procedures needed to analyse portfolios and their performance, as well as possible deviations regarding planning or approved alert levels.

The function is developed through an integrated and holistic vision of credit risk, establishing as the main elements the control by countries, business areas, management models, products, etc., facilitating early detection of specific attention points, as well as preparing action plans to correct any deteriorations.

Portfolio analysis permanently and systematically controls the evolution of credit risk with regard to budgets, limits and benchmark standards, assessing the impacts of future situations, both exogenous and resulting from strategic decisions, to establish measures to bring the risk portfolio profile and volumes within the parameters set by the Group and in line with its risk appetite.

The credit risk control phase uses, among others and, in addition to traditional metrics such as:

- **Cost of credit:** is the result of dividing credit risk allowances net of recovery of write-offs at 12 months, by the average gross loans and advances to customers on the balance sheet for those 12 months. The monitoring and control of this metric reflect a direct relationship between the risk appetite of the Group and the business units, giving rise to a medium-low risk profile.

- **Concentration:** in the individuals and SMEs segments, the monitoring of HRP (high risk profile) portfolios prevent concentration in portfolios with a risk profile that does not fit with the Group's medium-low risk profile target. In the SGCB, commercial banking and institutions segment concentration limits are monitored in sectors, single names, large exposure, underwriting, specialised lending and counterparties with ratings of < 5.0.

- **Expected loss:** is the estimate of the economic loss that would occur during the next year of the current portfolio at a given moment. It is an additional activity cost that must impact on the operations price.

C.1.5.6. Recovery management

Recovery activity is a significant element in the Bank's risk management. This function is carried out by the recovery area, which defines a global strategy and an enterprise-wide focus for recovery management.

The Group has a corporate recovery management model that sets the guidelines and general lines of action to be applied in the various countries, always taking into account the local particularities that the recovery activity requires (economic environment, business model or a mixture of both).

Recovery activity has been aligned with the socio-economic reality of the Group's countries and different risk management mechanisms are used with adequate prudential criteria on the basis of age, guarantees and unpaid debt conditions.

The recovery areas are business areas that directly manage customers for which the corporate model has a business focus, where sustained value creation is based on effective and efficient collection management The new digital channels are becoming increasingly important in recovery management, and new forms of customer relations are developing.

The diverse features of Santander´s customers make segmentation necessary in order to manage recoveries adequately. Mass management of large groups of customers with similar profiles and products is conducted through processes with a high technological and digital component, while personalised management focuses on customers who, because of their profile, require a specific manager and more individualised management.

Recovery management is divided into four phases: irregularity or early non-payment; recovery of non-performing loans; recovery of write-offs; and management of foreclosed assets.

The management scope for the recovery function includes management of non-productive assets (NPAs), corresponding to the forbearance portfolios, NPLs, write-off loans and foreclosed assets, where the Bank may use mechanisms to rapidly reduce these assets, such as disposals of loan portfolios or foreclosed assets.

The Bank employs specific policies for recovery management that include the principles of the different recovery strategies, while ensuring the required rating and provisions are maintained. Therefore, the Group is constantly seeking alternative solutions to legal channels for collecting debt.

In countries with a high exposure to real estate risk, very efficient sales management instruments have been put in place that enable capital to be recovered by the Bank, reducing the stock on the balance sheet.

C.2. Trading market risk, structural risk and liquidity risk

C.2.1. Activities subject to market risk and types of market risk

The **perimeter** of activities subject to market risk involve those operations where patrimonial risk is assumed as a consequence of variations in market factors. Thus, they include trading risks and also structural risks, which are also affected by market shifts.

This risk comes from changes in **risk factors** - interest rates, inflation rates, exchange rates, share prices, the spread on loans, commodity prices and the volatility of each of these elements - as well as from the liquidity risk of the various products and markets in which the Group operates, and balance sheet liquidity risk.

- **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 loans, deposits, debt securities, most assets and liabilities in the trading books and derivatives, among others.

- **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 instruments such as loans, debt securities and derivatives, where the return is linked to inflation or to a change in the actual rate.

- **Exchange rate risk** is the sensitivity of the value of a position in a currency other than the base currency to a movement in exchange rates. Hence, a long or open position in a foreign currency will produce a loss if that currency depreciates against the base currency. Among the positions affected by this risk are the Group's investments in subsidiaries in non-euro currencies, as well as any foreign currency transactions.

- **Equity risk** is the sensitivity of the value of positions in equities to adverse movements in market prices or 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, equity swaps, etc.).

- **Credit spread risk** is the risk or sensitivity of the value of positions 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 the difference between financial instruments listed with a margin over other benchmark instruments, mainly the IRR of Government bonds and interbank interest rates.

- **Commodities price risk** is the risk derived from the effect of potential changes in prices. The Group's exposure to this risk is not significant and is concentrated in derivative operations on commodities with customers.

- **Volatility risk** is the risk or sensitivity of the value of a portfolio to changes in the volatility of risk factors: interest rates, exchange rates, shares, credit spreads and commodities. This risk is incurred by all financial instruments where volatility is a variable in the valuation model. The most significant case is financial options portfolios.

All these market risks can be partly or fully mitigated by using options, futures, forwards and swaps.

Other types of market risk require more complex hedging. For example:

- **Correlation risk.** Correlation risk is the sensitivity of the portfolio to changes in the relationship between risk factors (correlation), either of the same type (for example, two exchange rates) or different types (for example, an interest rate and the price of a commodity).

- **Market liquidity risk.** Risk when a Group entity or the Group as a whole cannot reverse or close a position in time without having an impact on the market price or the cost of the transaction. Market liquidity risk can be caused by a reduction in the number of market makers or institutional investors, the execution of a large volume of transactions, or market instability. It increases as a result of the concentration of certain products and currencies.

- **Prepayment or cancellation risk.** When the contractual relationship in certain transactions explicitly or implicitly allows the possibility of early cancellation without negotiation before maturity, there is a risk that the cash flows may have to be reinvested at a potentially lower interest rate. This mainly affects mortgage loans and mortgage securities.

- **Underwriting risk.** This occurs as a result of an entity's involvement 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.

In addition to market risks, balance sheet liquidity risk must also be considered: unlike market liquidity risk, **liquidity risk** is defined as the possibility of not meeting payment obligations on time, or doing so at excessive cost. Among the losses caused by this risk are losses due to forced sales of assets or margin impacts due to the mismatch between expected cash inflows and outflows.

Pension and actuarial risks, which are described below, also depend on shifts in market factors.

Depending on the nature of the risk, activities are segmented as follows:

a) Trading: financial services for customers and purchase-sale and taking positions in fixed-income, equity and currency products, mainly. The SGCB (Santander Global Corporate Banking) division is responsible for managing this risk.

b) Structural risks: market risks inherent in the balance sheet, excluding the trading portfolio. Management decisions on these risks are taken by the Assets and Liabilities Committee (ALCO) of each country in coordination with the Group's ALCO and are executed by the Financial division. This management seeks to inject stability and recurrence into the financial margin on the Group's commercial activity and economic value, maintaining adequate levels of liquidity and solvency. The risks are:

- **Structural interest rate risk:** this arises from maturity mismatches and re-pricing of all assets and liabilities.

- **Structural exchange rate risk/hedging:** exchange rate risk occurs when the currency in which the investment is made is different from the euro, irrespective of whether the company consolidates or not (structural exchange rate). Exchange-rate hedging positions for future profits in currencies other than the euro (hedging of profits) are also included under this heading.

- **Structural equity risk:** this involves investments via stakes in financial or non-financial companies that are not consolidated, as well as available-for-sale portfolios consisting of equity positions.

c) Liquidity risk: when measuring liquidity risk, the following types of risk are considered:

- **Financing risk** (or short-term liquidity risk): this identifies the possibility that the entity is unable to meet its obligations as a result of the inability to sell assets or obtain financing.

- **Mismatch risk** (or long term liquidity risk): this identifies the possibility that differences between the maturity structures of assets and liabilities generate an additional cost to the entity as a consequence of unappropriated management or a market situation that might affect the availability or the cost of funding sources.

- **Contingency risk**: this identifies the possibility that adequate management levers will be unavailable to raise liquidity as a result of an outlier event that entails greater financing needs or more strict collateral requirements to raise funds.

- **Concentration risk:** this identifies the possibility that the entity is overly concentrated as to sources of funding in terms of counterparties, maturities, products or geographies that might give rise to issues if such concentration were to lead to non-renewal of financing.

- **Market risk for liquidity risk purposes:** the risk of loss of value of the entity's liquid assets buffer and that changes in the value of the entity's transactions (derivatives and guarantees, among others) may imply additional collateral needs and therefore impair liquidity.

- **Asset encumbrance risk** or risk of excess assets committed in financing transactions and other types of market dealing: the risk of not having sufficient unencumbered assets available to meet collateral or margin requirements or to execute actions under the liquidity contingency plan.

d) Pension and actuarial risk:

- **Pension risk:** the risk assumed by the Bank in relation to pension commitments with its employees. The risk lies in the possibility that the fund will not cover these commitments in the accrual period for the provision and the profitability obtained by the portfolio will not be sufficient, requiring the Group to increase its contributions.

- **Actuarial risk:** unexpected losses resulting from an increase in commitments to holders of insurance policies, as well as losses from unforeseen cost increases.

C.2.2. Trading market risk

C.2.2.1. Key figures and change over time[23]

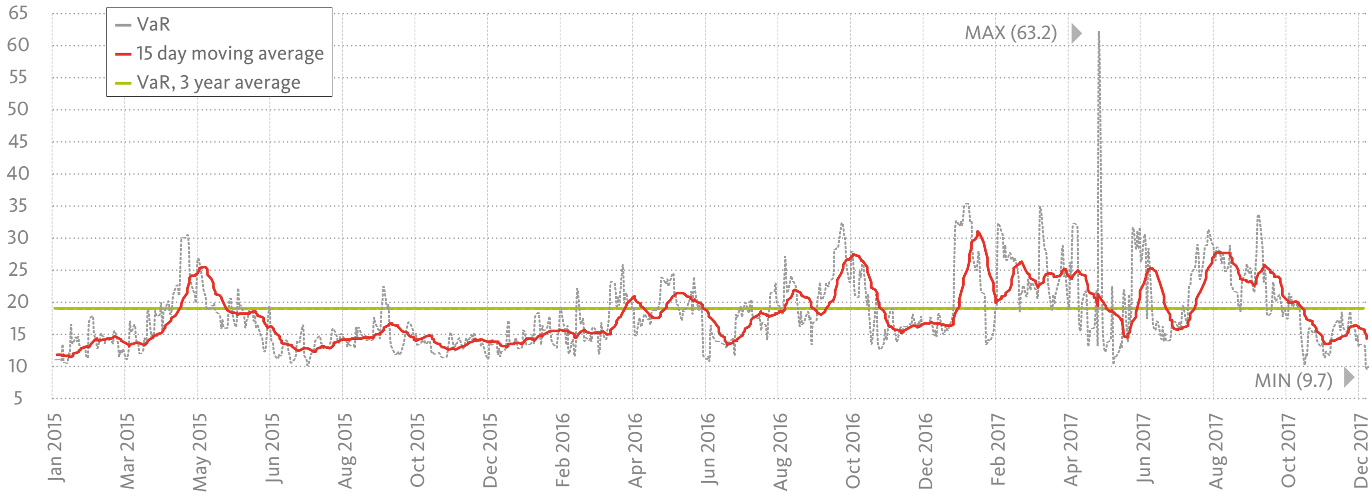
Santander Group's trading risk profile remained relatively low in 2017, in line with previous years, due to the fact that the Group's activity has traditionally focused on providing services to its customers, with only limited exposure to complex structured assets, as well as geographic diversification and by risk factors.

C.2.2.1.1. VaR analysis[24]

In 2017, Santander Group maintained its strategy of concentrating its trading activity on customer business, minimising where possible exposures to directional risk in net terms. This is reflected in the Value at Risk (VaR) of the SGCB trading book, which, despite the volatility in Brazil in May in terms of interest rates and exchange rates owing to the political turmoil, rose slightly above its average path over the last three years, ending 2017 at EUR 10.2 million, close to the minimum level of the year[25].

VAR 2015-2017 (EXCL. POPULAR)

Million euros. VaR at 99% over a one day horizon.



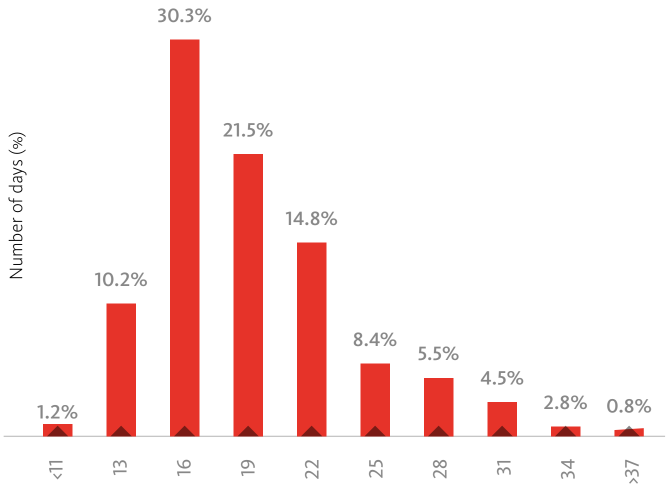
VaR during 2017 fluctuated between EUR 9.7 million and EUR 63.2 million. The most significant changes were related to variations in exchange and interest rate exposures and also market volatility.

The average VaR in 2017 was EUR 21.5 million, slightly higher than in the two previous years (EUR 18.3 million in 2016 and EUR 15.6 million in 2015).

The following histogram shows the distribution of risk in VaR terms from 2015 to 2017. The accumulation of days with levels of between EUR 13 million and EUR 31 million (95.2%) is shown. Values higher than EUR 31 million (3.6%) largely occur in periods affected by temporary spikes in volatility, mainly in the Brazilian real against the dollar and also in the Brazilian interest rates.

HISTOGRAM VaR 2015-2017

VaR at 99% over a one day horizon
Number of days (%) in each range



VaR in million euros

23. Excluding Popular. Trading portfolios of Popular represents less than 1% of the equivalent market risk of Santander Group with very low activity and complexity.
24. Value at Risk. The definition and calculation methodology for VaR is set out in section C.2.2.2.1. Value at Risk (VaR).
25. Regarding trading activity in SGCB (Santander Global Corporate Banking) financial markets. In addtion to the trading activity of SGCB, there are other positions catalogued for accounting purposes. The total VaR of trading of this accounting perimeter was EUR 9.9 million.

Risk per factor

The following table displays the average and latest VaR values at 99% by risk factor over the last three years, the lowest and highest values in 2017 and the Expected Shortfall (ES) at 97.5%[26] at the close of 2017:

VAR STATISTICS AND EXPECTED SHORTFALL BY RISK FACTOR[27, 28]

Million euros. VaR at 99% and ES at 97.5% with one day time horizon.

		2017					2016		2015	
		VaR (99%)				ES (97.5%)	VaR		VaR	
		Minimum	Average	Maximum	Latest	Latest	Average	Latest	Average	Latest
Total trading	**Total**	**9.7**	**21.5**	**63.2**	**10.2**	**11.5**	**18.3**	**17.9**	**15.6**	**13.6**
	Diversification effect	(2.1)	(8.0)	(39.9)	(7.6)	(7.9)	(10.3)	(9.6)	(11.1)	(5.8)
	Interest rate	7.7	16.2	70.4	7.9	10.0	15.5	17.9	14.9	12.7
	Equities	1.0	3.0	5.9	1.9	2.1	1.9	1.4	1.9	1.1
	Exchange rate	2.1	6.6	15.7	3.3	2.8	6.9	4.8	4.5	2.6
	Credit spread	2.3	3.6	5.1	4.6	4,6	4.2	3.3	5.2	2.9
	Commodities	0.0	0.0	0.1	0,0	0.0	0.1	0.1	0.2	0.1
Europe	**Total**	**4.8**	**7.0**	**12.0**	**6.4**	**6.9**	**9.0**	**9.4**	**11.6**	**11.1**
	Diversification effect	(3.2)	(6.1)	(11.1)	(6.0)	(5.6)	(9.1)	(7.6)	(8.3)	(5.6)
	Interest rate	4.3	6.1	11.5	5.7	5.7	8.2	9.1	10.6	10.9
	Equities	0.3	1.1	2.9	0.5	0.6	1.6	1.5	1.4	1.0
	Exchange rate	0.3	2.1	5.7	1.4	1.5	4.1	3.0	3.3	1.9
	Credit spread	2.4	3.7	5.7	4.7	4.7	4.1	3.4	4.4	2.8
	Commodities	0.0	0.0	0.1	0.0	0.0	0.1	0.1	0.2	0.1
Latin America	**Total**	**7.7**	**20.1**	**72.8**	**8.4**	**9.2**	**13.7**	**13.5**	**10.6**	**9.7**
	Diversification effect	1.6	(3.7)	(34.9)	(4.1)	(4.3)	(3.6)	(2.7)	(4.8)	(4.4)
	Interest rate	7.2	15.1	82.3	7.5	8.7	11.4	13.0	10.7	9.3
	Equities	0.5	3.3	6.5	1.9	2.2	1.4	0.8	1.5	0.5
	Exchange rate	1.5	5.5	14.7	3.1	2.6	4.5	2.4	3.2	4.3
USA and Asia	**Total**	**1.2**	**2.1**	**3.7**	**1.2**	**1.5**	**1.3**	**2.7**	**0.9**	**0.9**
	Diversification effect	0.5	(0.6)	(1.7)	(0.4)	(0.2)	(0.5)	(0.6)	(0.5)	(0.4)
	Interest rate	1.2	2.0	2.9	1.2	1.4	1.3	2.7	0.8	0.8
	Equities	0.0	0.2	1.4	0.0	0.0	0.1	0.0	0.1	0.0
	Exchange rate	0.1	0.5	1.3	0.4	0.2	0.4	0.5	0.4	0.4
Global activities	**Total**	**0.1**	**0.4**	**0.7**	**0.2**	**0.2**	**0.6**	**0.5**	**1.6**	**0.4**
	Diversification effect	(0.0)	(0.1)	(0,2)	(0,1)	(0.0)	(0.1)	(0.1)	(0.6)	(0.2)
	Interest rate	0.0	0.1	0.3	0.0	0.0	0.1	0.1	0.5	0.1
	Credit spread	0.1	0.4	0.6	0.2	0.2	0.5	0.5	1.6	0.4
	Exchange rate	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

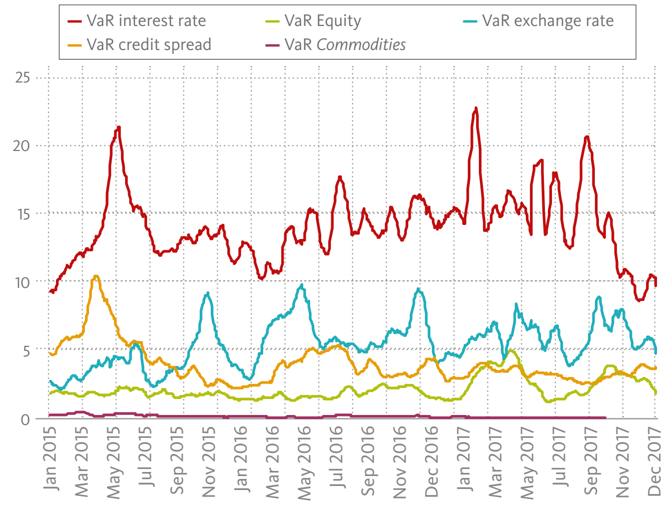
26. This metric is defined in detail in section C.2.2.2.2. Following the recommendation of the Basel Committee in its Fundamental review of the trading book: a revised market risk framework (October 2013), the confidence level of 97.5% approximates a risk level similar to that captured by VaR with a 99% confidence level.
27. The VaR of global activities includes operations that are not assigned to any particular country.
28. In Latin America, the United States and Asia, VaR levels are not shown separately for credit spreads and commodities, because of their scarce or zero materiality.

At the end of 2017, VaR decreased by EUR 7.7 million regarding year-end 2016, increasing average VaR by EUR 3.2 million. By risk factor, average VaR increased in interest rate and equity risk, but fell in exchange rate, credit spread and commodities. By geographies, there was a slight increase in Latin America and the United States/Asia, although it fell in the other geographies.

The evolution of VaR by risk factor has, in general, been stable over the last few years. The temporary rises in VaR for various factors are explained more by temporary increases in the volatility of market prices than by significant changes in positions.

HISTORICAL VAR BY RISK FACTOR

Million euros. VaR at 99% with one day time horizon (15 day moving average)



Lastly, the table below compares the VaR with stressed VaR[29] figures for the trading activity of the two units with the highest average VaR in 2017.

VAR VS. STRESSED VAR IN 2017: MAIN PORTFOLIOS

Million euros. VaR and stressed VaR at 99% with one-day time horizon

		2017				2016	
		Mín	Average	Max	Latest	Average	Latest
Spain	VaR (99%)	2.3	3.9	5.6	5.3	5.7	4.7
	Stressed VaR (99%)	12.8	17.6	25.0	17.9	14.9	14.3
Brazil	VaR (99%)	6.2	18.6	72.7	6.3	12.0	10.6
	Stressed VaR (99%)	9.0	31.4	66.7	11.7	22.2	23.0

C.2.2.1.2. Gauging and backtesting measures

The real losses can differ from the VaR forecasts for various reasons related to the limitations of this metric. This is set out in more detail in the section C.2.2.2. Methodologies. The Group regularly analyses and contrasts the accuracy of the VaR calculation model in order to confirm its reliability.

The most important test consists of backtesting exercises, analysed at local and global levels and in all cases with the same methodology. Backtesting consists of comparing the VaR forecast measurements, with a certain level of confidence and time frame, with the real results of losses obtained in a same time frame. This enables anomalies in the VaR model of the portfolio in question to be detected (for example, shortcomings in the parameterisation of the valuation models of certain instruments, not very adequate proxies, etc.).

Santander calculates and evaluates three types of backtesting:

- “Clean” backtesting: daily VaR is compared to the results obtained without taking into account intraday results or changes in portfolio positions. This method compares the effectiveness of the individual models used to assess and measure the risks of positions.
- Backtesting on complete results: the daily VaR is compared with the day’s net results, including the results of intraday operations and those generated by fees.
- Backtesting on complete results without mark-ups or fees: the daily VaR is compared to the day’s net results from intraday operations but excluding those generated by mark-ups and fees. This method aims to give an idea of the intraday risk assumed by Group treasuries.

In 2017, for the total portfolio, there were two exceptions for Value at Earnings (VaE)[30] at 99% (day on which daily profit was higher than VaE). The first, on 23 May, explained by the major shifts in the exchange rates of the euro and US dollar against the Brazilian real and the interest rate curves for Brazil, as a result of political events in the country, and the second on 28 December due to a general markets movement favourable to the portfolio positions.

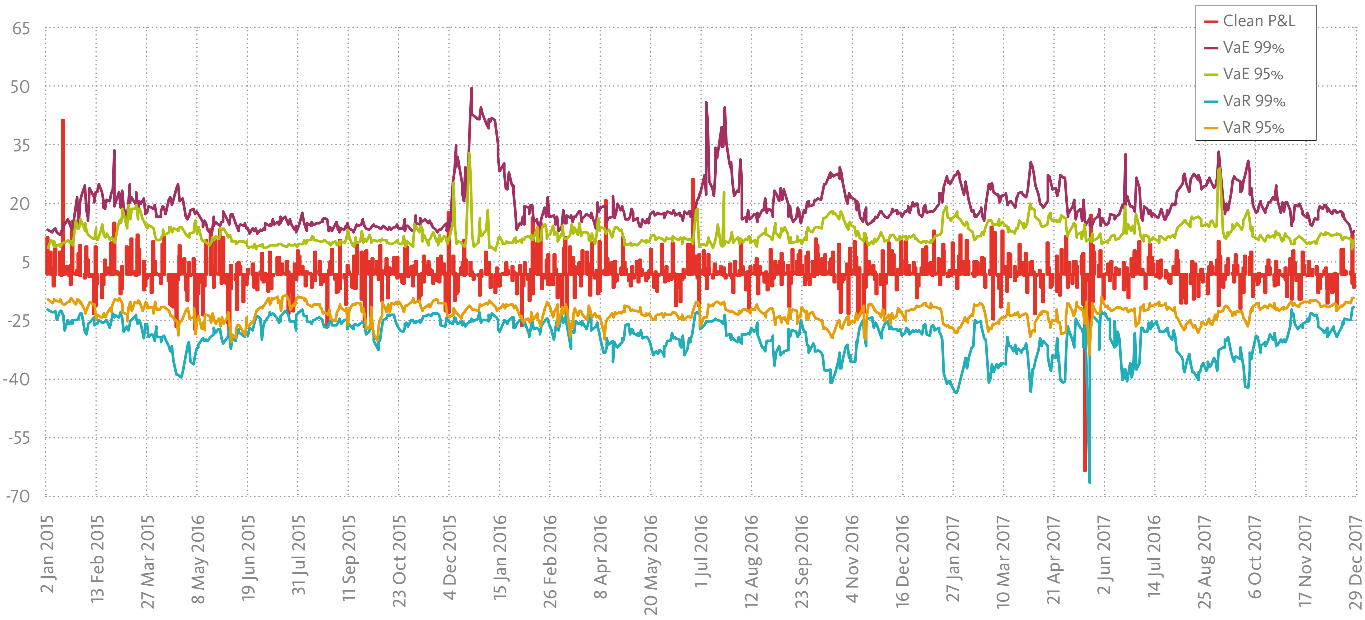
There was also an exception to VaR at 99% (day on which the daily loss was higher than the VaR) on 18 May, for the same reason as the exception to VaE of the same month.

The number of exceptions which occurred is consistent with the assumptions specified in the VaR calculation model.

29. Description in section C.2.2.2.2.
30. The definition and calculation methodology for VaE is set out in section C.2.2.2.1.

BACKTESTING OF TRADING PORTFOLIOS: DAILY RESULTS VS. VAR FOR PREVIOUS DAY

Million euros



C.2.2.1.3. Distribution of risks and management results[31]

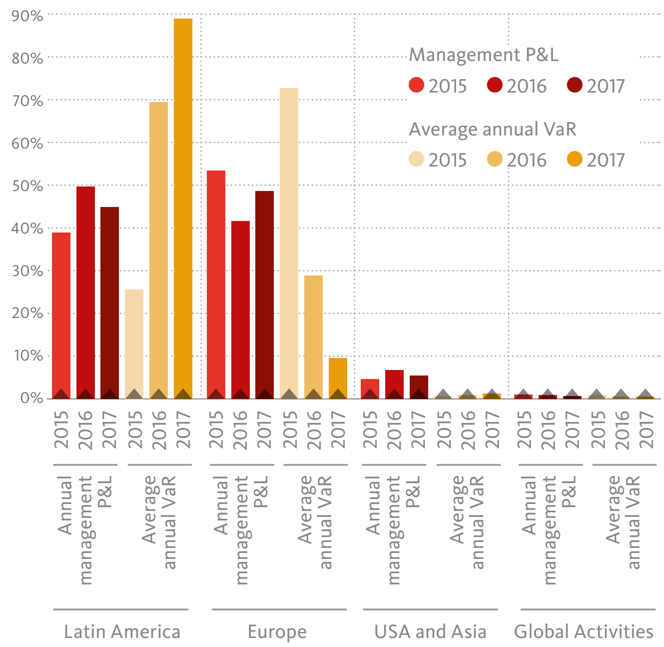
Geographical distribution

In the trading activity, the average contribution of Latin America to the Group's total VaR in 2017 was 88.4% compared with a contribution of 43.8% in economic results. Europe, with 10.6% of global risk, contributed 50.5% 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) to the Group total, both in risks, measured in VaR terms, as well as in results, measured in economic terms.

VAR / MANAGEMENT P&L: GEOGRAPHICAL DISTRIBUTION

Average VaR (at 99% with a 1 day time horizon) and Annual cumulative management P&L (EUR million), % of annual totals

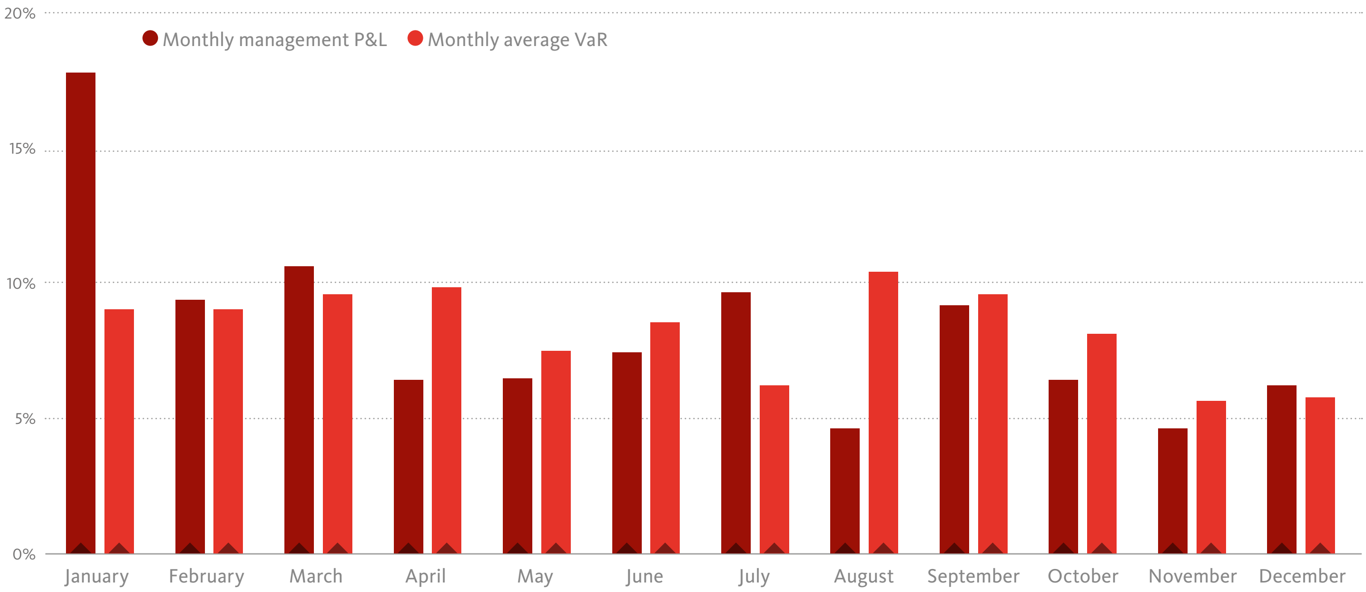


31. Results similar in terms to Gross Margin (excluding operating costs, the financial margin would be the only cost).

Distribution of risk by time
The next chart shows the risk assumption profile, in terms of VaR, compared to results in 2017. The average VaR remained relatively stable in the first half, as did results, although they displayed higher volatility in the second half owing to market instability.

■ TIME DISTRIBUTION OF RISKS AND P&L IN 2017: PERCENTAGES OF ANNUAL TOTALS

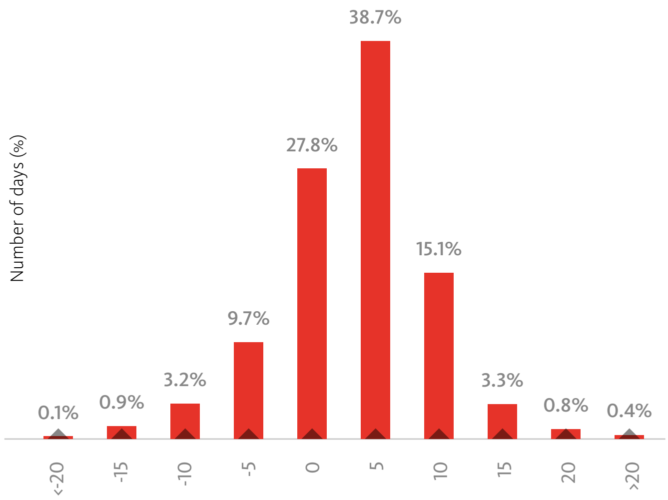
VaR (at 99% with a 1 day time horizon) and annual cumulative management P&L (million euros), % of annual totals.



The following frequency histogram shows the distribution of daily economic results on the basis of their size between 2015 and 2017. It shows that in more than 94.5% of the days with open markets, the daily returns[32] were between a range of EUR -10 and +10 million.

■ DAILY MANAGEMENT P&L (MTM) 2015-2017 FREQUENCY HISTOGRAM

Daily management P&L "clean" of fees and intraday operations (EUR mn). Number of days (%) in each range.



C.2.2.1.4. Risk management of derivatives
Derivatives activity is mainly focused on marketing investment products and hedging risks for customers. 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: Spain, Brazil, UK and Mexico.

The following chart shows the VaR Vega[33] performance of structured derivatives business over the last three years. It fluctuated at around an average of EUR 4 million. In general, the periods with higher VaR levels related to episodes of significant rises in volatility in the markets.

Although in 2015, VaR Vega was similar to the previous year in the first quarter of the year, in the two next quarters it was affected by high market volatility due to events such as Greece's bail-out, high stock market volatility in China currency depreciation, and rating downgrade in Brazil, as well the strong depreciation of its currency against the euro and the dollar.

During 2016, a number of different events pushed up market volatility (Brexit, general elections in Spain and the US, political-economic situation in Brazil, constitutional referendum in Italy).

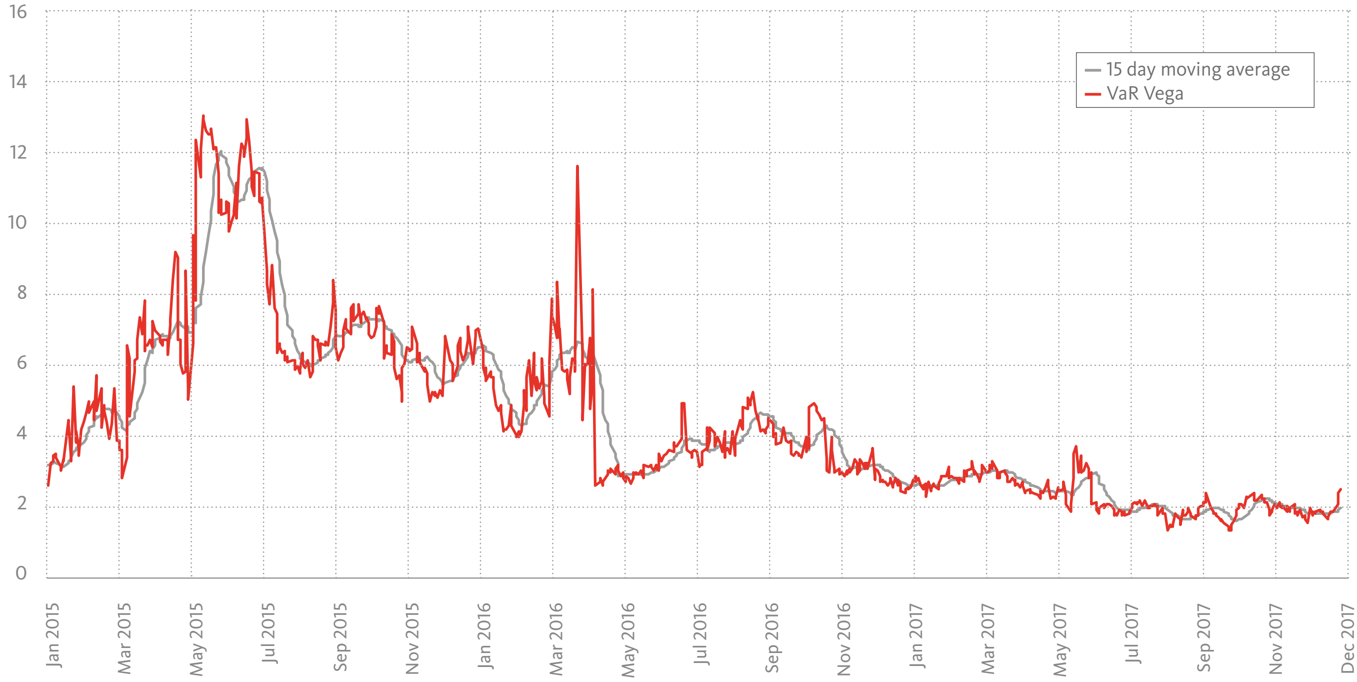
32. Yields "clean" of fees and results of intraday derivative operations.

33. Vega, a Greek term, means here the sensitivity of the value of a portfolio to changes in the price of market volatility.

2017, excluding certain occasions, was less volatile than the two previous years, which means less risk and, hence a lower VaR Vega.

CHANGE IN RISK OVER TIME (VAR) OF THE DERIVATIVES BUSINESS

Million euros. VaR vega at a 99% over a one day horizon.



Regarding the VaR by risk factor, on average, the exposure was concentrated, in this order: equities, interest rates, exchange rates and commodities. This is shown in the table below:

FINANCIAL DERIVATIVES. RISK (VAR) BY RISK FACTOR

Million euros. VaR at a 99% over a one day horizon.

	2017				2016		2015	
	Minimum	Average	Maximum	Latest	Average	Latest	Average	Latest
Total VaR Vega	**1.4**	**2.3**	**3.7**	**2.5**	**4.0**	**2.5**	**6.8**	**7.0**
Diversification effect	(0.6)	(1.5)	(3.1)	(0.6)	(2.4)	(2.3)	(2.3)	(1.7)
VaR interest rate	0.6	1.3	2.5	0.7	3.6	2.6	6.5	7.3
VaR equities	0.9	1.5	2.2	1.4	1.7	1.3	1.5	0.8
VaR exchange rate	0.4	0.9	2.4	1.0	1.1	0.9	1.1	0.6
VaR commodities	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.0

Exposure by business unit was mainly concentrated in Spain, Brazil, UK and Mexico (in that order).

FINANCIAL DERIVATIVES. RISK (VAR) BY UNIT

Million euros. VaR at a 99% over a one day horizon.

	2017				2016		2014	
	Minimum	Average	Maximum	Latest	Average	Latest	Average	Latest
Total VaR Vega	**1.4**	**2.3**	**3.7**	**2.5**	**4.0**	**2.5**	**6.8**	**7.0**
Spain	1.0	1.9	3.0	1.7	3.6	2.3	6.6	6.9
Santander UK	0.5	0.6	0.8	0.6	1.3	0.9	0.9	0.9
Brazil	0.4	0.8	3.1	0.9	0.8	0.7	0.7	0.4
Mexico	0.2	0.5	1.2	0.7	0.4	0.2	0.8	0.3

The average risk in 2017 (EUR 2.3 million) is lower compared to 2016 and 2015, for the reasons explained above.

Santander Group 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. In both cases exposure has once again been reduced compared to the prior year, and the Group therefore holds:

- Hedge funds: the total exposure is not significant (EUR 32.6 million at close of December 2017) and is all indirect, acting as counterparty in derivatives transactions. 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.

- Monolines: exposure to bond insurance companies (monolines) as of December 2017 was EUR 27.3 million, all of it indirect, by virtue of the guarantee provided by this type of entity for various financing or traditional securitisation transactions. The exposure in this case is to double default, as the primary underlying assets are of high credit quality.

This was mainly due to the integration of positions of institutions acquired by the Group, as Sovereign in 2009. 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 Risk 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 apply this valuation model.

  And provided these two points are always met:

  - The availability of appropriate systems, duly adapted to calculate and monitor the results, positions and risks of new operations every day.

  - The degree of liquidity of the product or underlying asset, in order to make possible their coverage when deemed appropriate.

C.2.2.1.5. Issuer risk in trading portfolios

Trading activity in credit risk is mainly conducted in the Treasury Units 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 indices (Itraxx, CDX).

The accompanying table shows the major positions at year-end in Spain, distinguishing between long (purchases of bonds and sales of CDS protection) and short (sales of bonds and purchases of CDS protection) positions.

LONG AND SHORT MAJOR POSITIONS

Million euros

	Top 'long' positions (sales of protection)		Top 'short' positions (purchase of protection)	
	Exposure at *default* (EAD)	**% of total EAD**	**Exposure at *default* (EAD)**	% of total EAD
1st reference	129	2.9%	(166)	2.8%
2nd reference	89	2.0%	(25)	0.4%
3rd reference	68	1.5%	(16)	0.3%
4th reference	64	1.4%	(14)	0.2%
5th reference	60	1.3%	(9)	0.2%
Sub-total top 5	**410**	**9.1%**	**(230)**	**3.9%**
Total	**4,462**	**100%**	**(5,863)**	**100%**

Note: zero recoveries are supposed (LCR=0) in the EAD calculation

C.2.2.1.6. Scenario analysis

Various stress scenarios were calculated and analysed regularly in 2017 (minimum monthly) at the local and global levels for all the trading portfolios and using the same risk factor assumptions.

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). A historic volatility equivalent to six standard 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.

At year-end, that scenario implied, for the global portfolio, interest rate rises in Latin American markets and falls in core markets, stock market falls, depreciation of all currencies against the euro, and increased credit spreads and volatility.

The results for this scenario at the close of 2017 are shown in the following table:

STRESS SCENARIO: MAXIMUM VOLATILITY *(WORST CASE)*

Million euros

	Interest rate	Equities	Exchange rate	Credit spread	Commodities	Total
Total trading	**(32.5)**	**(8.7)**	**(5.3)**	**(18.7)**	**(0.0)**	**(65.2)**
Europe	(10.3)	(3.3)	(1.9)	(18.2)	(0.0)	(33.7)
Latin America	(21.0)	(5.4)	(3.0)	(0.0)	(0.0)	(29.4)
US	(0.1)	(0.0)	(0.3)	(0.0)	(0.0)	(0.4)
Global activities	(0.1)	(0.0)	(0.0)	(0.5)	(0.0)	(0.6)
Asia	(1.0)	(0.0)	(0.1)	(0.0)	(0.0)	(1.1)

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 EUR 65.2 million, if the stress movements defined in the scenario materialised in the market. This loss would be concentrated in Europe (in the following order: credit spread, interest rate, equities and exchange rate) and in Latin America (in the following order: interest rates, equities and exchange rate).

Other global stress scenarios

"Abrupt crisis": an ad hoc scenario with sharp market movements. Rise in interest rate curves, sharp falls in stock markets, strong appreciation of the dollar against other currencies, rise in volatility and in credit spreads.

"Subprime crisis": historic scenario of the US mortgage crisis. The objective of the analysis was to capture the impact on results of the reduction in liquidity in the markets. Two time horizons were used (one day and 10 days), and in both cases there were falls in stock markets and in interest rates in core markets and rises in emerging markets, and dollar appreciation against other currencies.

"Plausible Forward Looking Scenario": a hypothetical plausible scenario defined at local level in market risk units, based on the portfolio positions and their expert judgement regarding short-term changes in market variables which can have a negative impact on such positions.

"EBA adverse scenario": the scenario proposed by the EBA in April 2014 as part of the EBA 2014 EU-Wide Stress Test and updated in January 2016. It was initially conceived as an adverse scenario proposed by European banks thinking in terms of a 2014-2016 time horizon and updated last year to the 2016-2018 time horizon. It reflects the systemic threats which are considered to be the most serious threats to the stability of the banking sector in the European Union.

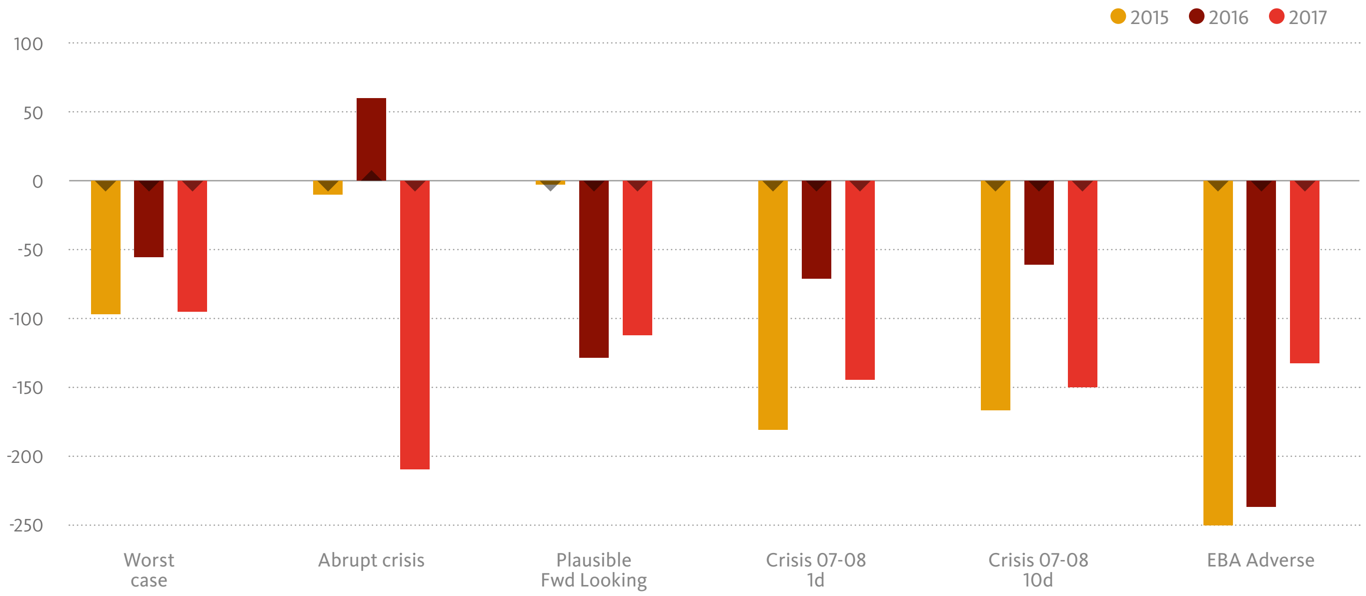
Reverse stress tests analysis, which are based on establishing a predefined result (unfeasibility of a business model or possible insolvency) and subsequently the risk factor scenarios and movements which could cause that situation are identified.

Every month a consolidated stress test report is performed with explanations of the main changes in results for the various scenarios and units. An early warning mechanism has also been established so that when the loss for a scenario is high in historic terms and/or in terms of the capital consumed by the portfolio in question, the relevant business executive is informed.

The results of these global scenarios for the last three years are shown in the following table:

STRESS TEST RESULTS. COMPARISON OF 2015-2017 SCENARIOS (ANNUAL AVERAGES)

Million euros



C.2.2.1.7. Linkage with balance sheet items. Other alternative risk measures

Below are the year-end 2017 balance sheet items in the Group's consolidated position that are subject to market risk, distinguishing the positions whose main risk metric is the VaR from those where monitoring is carried out with other metrics. The items subject to market trading risk are highlighted.

RELATION OF RISK METRICS WITH BALANCES IN GROUP'S CONSOLIDATED POSITION

Million euros

		Main market risk metric		
	Balance sheet amount	VaR	Other	Main risk factor for 'Other' balance
Assets subject to market risk	**1,444,305**	**167,943**	**1,276,362**	
Cash and deposits at central banks	110,995		110,995	Interest rate
Trading portfolio	125,458	124,924	534	Interest rate, credit spread
Other financial assets at fair value	34,782	34,500	282	Interest rate, credit spread
Available-for-sale financial assets	133,271	-	133,271	Interest rate; equities
Investments	6,184	-	6,184	Equities
Hedging derivatives	8,537	8,519	18	Interest and exchange rates
Loans	916,504		916,504	Interest rate
Other assets financials[1]	47,390		47,390	Interest rate
Other non-financial assets[2]	61,184		61,184	
Liabilities subject to market risk	**1,444,305**	**175,088**	**1,269,217**	
Trading portfolio	107,624	107,442	182	Interest rate, credit spread
Other financial liabilities at fair value	59,616	59,609	7	Interest rate, credit spread
Hedging derivatives	8,044	8,037	7	Interest and exchange rates
Financial liabilities at amortised cost[3]	1,126,399		1,126,399	Interest rate
Provisions	14,489		14,489	Interest rate
Other financial liabilities	8,709		8,709	Interest rate
Equity	106,833		106,833	
Other non-financial liabilities	12,591		12,591	

1. Includes adjustments to macro hedging, non-current assets held for sale, reinsurance assets, and insurance contracts linked to pensions and fiscal assets.
2. Includes intangible assets, material assets and other assets.
3. Macro-hedging adjustment.

For activity managed with metrics other than VaR, alternative measures are used, mainly: sensitivity to different risk factors (interest rate, credit spread, etc.).

In the case of the trading portfolio, the securitisations and "level III" exposures (those in which non-observable market data constitutes a significant input in the corresponding internal valuation models) are excluded from the VaR measurement.

Securitisations are mainly treated as if they were part of the credit risk portfolio (in terms of default, recovery rate, etc.). For "level III" exposures, which are not very significant in the Santander Group (basically derivatives linked to the home price index - HPI - in market activity in the UK, and interest rate and correlation derivatives for share prices in the parent bank's market activity), as well as for inputs, in general, that cannot be observed in the market (correlation, dividends, etc.), a very conservative policy is followed: this is reflected in valuation adjustments as well as sensitivity.

C.2.2.2. Methodologies

C.2.2.2.1. Value at Risk (VaR)

The standard methodology Santander Group applies to trading activities is 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 affecting the levels of risk assumed to be incorporated efficiently and on a timely manner. 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 decay factor that accords less weight to the observations furthest away in time and another with the same weight for all observations. The higher of the two is reported as the VaR.

Value at Earnings (VaE) is also calculated. This measures the maximum potential gain with a certain level of confidence and time frame, applying the same methodology as for VaR.

VaR by historic simulation has many advantages as a risk metric (it sums up in a single number the market risk of a portfolio; it is based on market movements that really occurred without the need to make assumptions of functions forms or correlations between market factors, etc.), but it also has its limitations.

Some limitations are intrinsic to the VaR metrics, regardless of the methodology used in their calculation, including:

- The VaR calculation is calibrated at a certain level of confidence, which does not indicate the levels of possible losses beyond it.
- There are some products in the portfolio with a liquidity horizon greater than that specified in the VaR model.
- VaR is a static analysis of the portfolio risk, and the situation could change significantly during the following day, although the likelihood of this occurring is very low.

Using the historic simulation methodology also has its limitations:

- High sensitivity to the historic window used.
- Inability to capture plausible events that would have significant impact, if these do not occur in the historic window used.
- The existence of valuation parameters with no market input (such as correlations, dividend and recovery rate).
- Slow adjustment to new volatilities and correlations, if the most recent data receives the same weight as the oldest data.

Some of these limitations are overcome by using Stressed VaR and Expected Shortfall, calculating VaR with exponential decay and applying conservative valuation adjustments. Furthermore, as previously stated, the Group regularly conducts analysis and backtesting of the VaR calculation model accuracy.

C.2.2.2.2. Stressed VaR (sVaR) and Expected Shortfall (ES)

In addition to standard VaR, Stressed VaR is calculated daily for the main portfolios. The calculation methodology is the same as for VaR, with the two following exceptions:

- The historical observation period for the factors: when calculating Stressed VaR a window of 260 observations is used, rather than 520 for VaR. However, this is not the most recent data: rather, the data used is from a continuous period of stress for the portfolio in question. This is determined for each major portfolio by analysing the history of a subset of market risk factors selected based on expert judgement and the most significant positions in the books.
- Unlike VaR, Stressed VaR is obtained using the percentile with uniform weighting, not the higher of the percentiles with exponential and uniform weightings.

Moreover, the Expected Shortfall (ES) is also calculated, estimating the expected value of the potential loss when this is higher than the level set by VaR. Unlike VaR, ES has the advantages of capturing the risk of large losses with low probability (tail risk) and being a subadditive metric[34]. The Basel Committee considers that ES with a 97.5% confidence interval delivers a similar level of risk to VaR at a 99% confidence interval. ES is calculated by applying uniform weights to all observations.

C.2.2.2.3. Scenario analysis

The Group uses other metrics in addition to VaR, giving it greater control over the risks it faces in the markets where it is active. These measures include scenario analysis, which consists in defining alternative behaviours for various financial variables and obtaining the impact on results of applying these to activities. These scenarios may replicate events that occurred in the past (such as a crisis) or determine plausible alternatives that are unrelated to past events.

The potential impact on earnings of applying different stress scenarios is regularly calculated and analysed, particularly for trading portfolios, considering the same risk factor assumptions. Three scenarios are defined, as a minimum: plausible, severe and extreme. Taken together with VaR, these reveal a much more complete spectrum of the risk profile.

A number of trigger thresholds have also been established for global scenarios, based on their historical results and the capital associated with the portfolio in question. When these triggers are activated, the portfolio managers are notified so they can take appropriate action. The results of the global stress exercises, and any breaches of the trigger thresholds, are reviewed regularly, and reported to senior management, when this is considered appropriate.

C.2.2.2.4. Analysis of positions, sensitivities and results

Positions are used to quantify the net volume of the market securities for the transactions in the portfolio, grouped by main risk factor, considering the delta value of any futures or options. All risk positions can be expressed in the base currency of the unit and the currency used for standardising information. Changes in positions are monitored on a daily basis to detect any incidents, so they can be corrected immediately.

Measurements of market risk sensitivity estimate the variation (sensitivity) of the market value of an instrument or portfolio to any change in a risk factor. The sensitivity of the value of an instrument

34. According to the financial literature, subaddivity is a desirable property for a coherent risk metric. This property establishes that f(a+b) is less than or equal to f(a)+f(b). Intuitively, it assumes that the more instruments and risk factors there are in a portfolio, the lower the risks, because of the benefits of diversification. Whilst VaR only offers this property for some distributions, ES always does so.

to changes in market factors can be obtained using analytical approximations by partial derivatives or by complete revaluation of the portfolio.

Furthermore, the daily definition of the income statement by the Risks area is an excellent indicator of risks, as it allows the impact of changes in financial variables on portfolios to be identified.

C.2.2.2.5. Derivatives activities and credit management
Also noteworthy is the control of derivative activities and credit management which, because of its atypical nature, is conducted daily with specific measures. First, the sensitivities to price movements of the underlying asset (delta and gamma), volatility (vega) and time (theta) are controlled. Second, measures such as the sensitivity to the spread, jump-to-default, concentrations of positions by level of rating, etc., are reviewed systematically.

With regard to the credit risk inherent to trading portfolios, and in line with the recommendations of the Basel Committee on Banking Supervision and prevailing regulations, a further metric is also calculated: the Incremental Risk Charge (IRC). This seeks to cover the risks of non-compliance and ratings migration that are not adequately captured in VaR, through changes in the corresponding credit spreads. This metric is essentially applied to fixed-income bonds, both public and private, derivatives on bonds (forwards, options, etc.) and credit derivatives (credit default swaps, asset backed securities, etc.). IRC is calculated using direct measurements of loss distribution tails at an appropriate percentile (99.9%), over a one year horizon. The Montecarlo methodology is used, applying one million simulations.

C.2.2.2.6. Credit Valuation Adjustment (CVA) and Debt Valuation Adjustment (DVA)
Santander Group incorporates CVA and DVA when calculating 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 exposures with each counterparty in each future maturity.

The CVA for a particular counterparty is the sum of the CVA for all maturities. For its calculation, the following inputs are considered:

- Expected exposure: including, for each operation the current market value (MtM) as well as the potential future risk (add-on) to each maturity. CVA also considers mitigating factors such as collateral and netting agreements, together with a decay factor for derivatives with interim payments.
- Loss given default: the percentage of final loss assumed in case of credit/ non-payment of the counterparty.
- Probability of default: for cases in which there is no market information (spread curve traded through CDS, etc.), general proxies generated on the basis of companies with listed CDSs for the same sector and external rating as the counterparty are used.
- Discount factor curve.

The **Debt Valuation Adjustment (DVA)** is a valuation adjustment similar to the CVA, but in this case as a result of the Group's risk that counterparties assume in OTC derivatives.

C.2.2.3. System for controlling limits
Setting market risk and liquidity limits is designed to be a dynamic process, responding to the Group's risk appetite level (as described in section A.4.1. Risk appetite and limits structure). This process is part of an annual limits plan defined by the Group's senior management, involving every Group entity.

The market risk limits used in the Group are established based on different metrics and try to cover all activities subject to market risk from many perspectives, applying a conservative approach. The main ones are:

- VaR and Stressed VaR limits.
- Limits of equivalent and/or nominal positions.
- Interest rate sensitivity limits.
- Vega limits.
- Delivery risk limits for short positions in securities (fixed income and securities).
- Limits to constrain the volume of effective losses, and protect results generated during the period:
  - Loss trigger.
  - Stop loss.
- Credit limits:
  - Total exposure limit.
  - Jump to default by issuer limit.
  - Others.
- Limits for origination transaction.

These general limits are complemented by other sub-limits to establish a sufficiently granular limits framework for the effective control of the market risk factors to which the Group is exposed in its trading activities. Positions are monitored on a daily basis globally and for each unit at desk level, as well as with an exhaustive control of changes to portfolios, so as to identify any incidents that might need immediate correction, and thus comply with the Volcker Rule.

Three categories of limits were established based on the scope of approval and control: global approval and control limits, global approval limits with local control, and local approval and control limits. The limits are requested by the business executive of each country/entity, considering the particular nature of the business in order to achieve the budget established, seeking consistency between the limits and the risk/return ratio. The limits are approved by the corresponding risk bodies.

Business units must comply with the approved limits at all times. In the event of a limit being exceeded, the local business executives have to explain, in writing and on the day, the reasons for the excess and the action plan to correct the situation, which in general might consist of reducing the position until it reaches the prevailing limits or setting out the strategy that justifies an increase in the limits.

If the business unit fails to respond to the excess within three days, the global business executives will be asked to set out the measures to be taken in order to make the adjustment to the existing limits. If this situation lasts for 10 days as of the first excess, senior risk management will be informed so that a decision can be taken: the risk takers could be made to reduce the levels of risk assumed.

C.2.3. Structural balance sheet risks[35]

C.2.3.1. Key figures and change over time

The market risk profile inherent in Santander Group's balance sheet, in relation to its asset volumes and shareholders' funds, as well as the budgeted financial margin, remained moderate in 2017, in line with previous years.

C.2.3.1.1. Structural interest rate risk

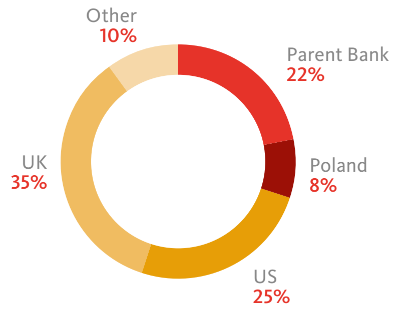
Europe and the United States

The main balance sheets, the Parent, United Kingdom and United States, in mature markets and in a low interest rate setting, usually show positive sensitivities to interest rates in economic value of equity and net interest income.

Exposure levels in all countries are moderate in relation to the annual budget and capital levels.

At the end of 2017, net interest income risk at one year, measured as sensitivity to parallel changes in the worst-case scenario of ±100 basis points, was concentrated in the British pound yield curve, at EUR 246 million, the Euro, at EUR 219 million, the US dollar, at EUR 190 million and the Polish zloty, at EUR 55 million, all relating to risks of rate cuts.

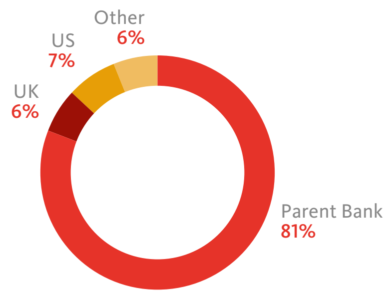
NET INTEREST INCOME (NII) SENSITIVITY[36]



Other: Portugal and SCF.

At the same date, the most relevant risk in economic value of equity, measured as its sensitivity to parallel changes in the worst-case scenario of ±100 basis points, was in the euro interest rate curve, at EUR 4,902 million, followed by the US dollar at EUR 626 million, the British pound at EUR 431 million and the Polish zloty at EUR 72 million, all with a risk of falling interest rates, scenarios which are now very unlikely.

ECONOMIC VALUE OF EQUITY (EVE) SENSITIVITY[37]



Other: Poland, Portugal and SCF.

35. Includes the total balance sheet with the exception of trading portfolios. Excluding Popular with the exception in the VaR metric.
36. Sensitivity to the worst-case scenario between +100 and -100 basis points.
37. Sensitivity to the worst-case scenario between +100 and -100 basis points.

The tables below set out the balance-sheets interest-rate risk of the Parent Bank and UK by maturity, at the end of 2017:

PARENT: INTEREST RATE REPRICING GAP[38]

Million euros

	Total	3 months	1 year	3 years	5 years	> 5 years	Not sensitive
Assets	377,668	107,820	71,307	25,701	16,939	33,876	122,026
Liabilities	430,024	108,696	49,425	60,258	47,721	72,469	91,455
Off balance sheet	52,355	51,431	734	4,605	321	(4,735)	0
***Net* gap**	**0**	**50,555**	**22,615**	**(29,952)**	**(30,461)**	**(43,329)**	**30,571**

SANTANDER UK: INTEREST RATE REPRICING GAP[39]

Million euros

	Total	3 months	1 year	3 years	5 years	> 5 years	Not sensitive
Assets	324,613	151,018	39,066	66,785	21,128	18,318	28,297
Liabilities	327,639	200,826	20,291	28,727	20,002	29,841	27,953
Off balance sheet	3,027	(11,703)	(3,409)	4,919	6,353	6,867	0
***Net* gap**	**0**	**(61,511)**	**15,366**	**42,977**	**7,479**	**(4,655)**	**344**

In general, the gaps by maturities are at reasonable levels in relation to the size of the balance sheet.

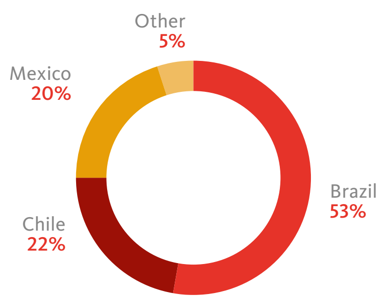
Latin America

Latin American balance sheets are usually positioned for interest rate cuts for both economic value and net interest income, except for net interest income in Mexico, where liquidity excess is invested in the short term in the local currency.

In 2017, exposure levels in all countries were moderate in relation to the annual budget and capital levels.

At the end of the year, net interest income risk over one year, measured as sensitivity to parallel changes in the worst-case scenario of ±100 basis points, was concentrated in three countries: Brazil (EUR 95 million), Chile (EUR 39 million) and Mexico (EUR 36 million), as shown in the chart below:

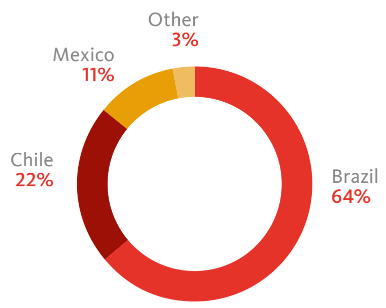
NET INTEREST INCOME (NII) SENSITIVITY[40]



Other: Argentina, Peru and Uruguay.

Risk to the economic value of equity over one year, measured as sensitivity to parallel ± 100 basis point movements in the worst-case scenario, was also concentrated in Brazil (EUR 521 million), Chile (EUR 179 million) and Mexico (EUR 91 million).

ECONOMIC VALUE OF EQUITY (EVE) SENSITIVITY[41]



Other: Argentina, Peru and Uruguay.

38. Aggregate gap for all currencies on the balance sheet of the parent bank unit, in euros.
39. Aggregate gap for all currencies on the balance sheet of the Santander UK unit, in euros.
40. Sensitivity to the worst-case scenario between +100 and -100 basis points.
41. Sensitivity to the worst-case scenario between +100 and -100 basis points.

The table below shows the interest-rate risk maturity structure of the Brazil balance sheet in December 2017:

BRAZIL: INTEREST RATE REPRICING GAP[42]

Million euros

	Total	3 months	1 year	3 years	5 years	> 5 years	Not sensitive
Assets	172,337	52,940	20,807	17,673	8,180	14,355	58,382
Liabilities	172,337	77,555	6,722	7,973	3,757	8,457	67,873
Off balance sheet	0	5,689	(268)	(4,231)	598	(1,367)	(421)
***Net* gap**	**0**	**(18,926)**	**13,818**	**5,469**	**5,021**	**4,531**	**(9,912)**

Balance sheet structural interest rate VaR

In addition to sensitivities to interest rate movements (in which, assessments of ±100 bp movements are complemented by assessments of +/-25 bp, +/-50 bp and +/-75 bp movements to give a fuller understanding of risk in countries with very low rates), Santander also uses other methods to monitor structural balance sheet risk from interest rates: these include scenario analysis and VaR calculations, applying a similar methodology to that for trading portfolios.

The table below shows the average, minimum, maximum and year-end values of the VaR of structural interest rate risk over the last three years:

BALANCE SHEET STRUCTURAL INTEREST RATE RISK (VAR)

Million euros. VaR at a 99% over a one day horizon.

	2017			
	Minimum	Average	Maximum	Latest
Structural interest rate VaR*	**280.9**	**373.9**	**459.6**	**459.6**
Diversification effect	(198.6)	(230.3)	(256.5)	(169.1)
Europe and USA	362.6	433.6	517.8	511.8
Latin America	116.9	170.6	198.4	116.9

* Includes credit spread VaR on ALCO portfolios.

	2016			
	Minimum	Average	Maximum	Latest
Structural interest rate VaR*	**242.5**	**340.6**	**405.8**	**327.2**
Diversification effect	(129.2)	(271.0)	(294.3)	(288.6)
Europe and USA	157.7	376.8	449.3	365.0
Latin America	214.0	234.9	250.8	250.8

* Includes credit spread VaR on ALCO portfolios.

	2015			
	Minimum	Average	Maximum	Latest
Structural interest rate VaR*	**250.5**	**350.0**	**775.7**	**264.2**
Diversification effect	(90.8)	(181.1)	(310.7)	(189.1)
Europe and USA	171.2	275.2	777.0	210.8
Latin America	170.1	255.9	309.3	242.6

* Includes credit spread VaR on ALCO portfolios.

Structural interest rate risk, measured in terms of VaR at one-day and at 99%, averaged EUR 373.9 million in 2017. It is important to note the high level of diversification between Europe and United States balance sheets and those of Latin America.

C.2.3.1.2. 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 hedging of these investments.

This management is dynamic and seeks to limit the impact on the core capital ratio of movements in exchange rates[43]. In 2017, hedging levels of the core capital ratio for exchange rate risk were maintained at approximately 100%.

At the end of 2017, the largest exposures of permanent investments (with their potential impact on equity) were, in order, in Brazilian reais, UK pounds sterling, US dollars, Chilean pesos, Polish zlotys and Mexican pesos. The Group hedges some of these positions of a permanent nature with exchange-rate derivatives.

In addition, the Financial area is responsible for managing exchange-rate risk for the Group's expected results and dividends in units where the base currency is not the euro.

C.2.3.1.3. Structural equity risk

Santander maintains equity positions in its banking book in addition to those of the trading portfolio. These positions are maintained as available for sale portfolios (capital instruments) or as equity stakes, depending on the percentage or control.

The equity portfolio available for the banking book at the end of 2017 was diversified in securities in various countries, mainly Spain, China, USA, Morocco and the Netherlands. Most of the portfolio is invested in financial activities and insurance sectors. Among other sectors, to a lesser extent, are for example the public administrations or the professional, scientific and technical activities.

Structural equity positions are exposed to market risk. VaR is calculated for these positions using market price data series or proxies. At the close of 2017, the VaR at 99% with a one day time frame was EUR 261.6 million (EUR 323 and EUR 208.1 million at the end of 2016 and 2015, respectively).

42. Aggregate gap for all currencies on the balance sheet of the Brazil unit, in euros.
43. In early 2015, the criterion for coverage of the core capital ratio was changed from phase-in to fully loaded.

C.2.3.1.4. Structural VaR

A standardised metric such as VaR can be used for monitoring total market risk for the banking book, excluding the trading activity of Santander Global Corporate Banking (the VaR for this activity is described in section 2.2.1.1.), distinguishing between fixed income (considering both interest rates and credit spreads on ALCO portfolios), exchange rates and equities.

In general, structural VaR is not high in terms of the Group's volume of assets or equity.

STRUCTURAL VAR

Million euros. VaR at a 99% over a one day horizon.

	2017				2016		2015	
	Minimum	Average	Maximum	Latest	Average	Latest	Average	Latest
Structural VaR	**754.9**	**878.0**	**991.6**	**815.7**	**869.3**	**922.1**	**698.5**	**710.2**
Diversification effect	(258.9)	(337.3)	(407.5)	(376.8)	(323.4)	(316.6)	(509.3)	(419.2)
VaR interest rate*	280.9	373.9	459.6	459.6	340.6	327.2	350.0	264.2
VaR exchange rate	471.2	546.9	621.1	471.2	603.4	588.5	634.7	657.1
VaR equities	261.6	294.5	318.4	261.6	248.7	323.0	223.2	208.1

* Includes credit spread VaR on ALCO portfolios.

C.2.3.2. Methodologies

C.2.3.2.1. Structural interest rate risk

The Group analyses the sensitivity of its net interest income and 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.

The financial measures to adjust the positioning to that sought by the Group are agreed on the basis of the positioning of balance sheet interest rates, as well as the situation and outlook for the market. 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 repricing gap, the sensitivities of net interest income and of economic value of equity to changes in interest rate levels, the duration of equity and Value at Risk (VaR), for the purposes of calculating economic capital.

Interest rate gap on assets and liabilities

This is the basic concept for identifying the entity's interest rate risk profile and measures the difference between the volume of sensitive assets and liabilities on and off the balance sheet that re-price (i.e. that mature or are subject to rate revisions) at certain times (called, buckets). This provides an immediate approximation of the sensitivity of the entity's balance sheet and its net interest income and equity value to changes in interest rates.

Net interest income (NII) sensitivity

This is a key measure of the profitability of balance sheet management. It is calculated as the difference which arises in the net interest income during a certain period of time due to a parallel movement in interest rates. The standard period for measuring net interest income sensitivity is one year.

Economic value of equity (EVE) sensitivity

This measures the interest rate risk implicit in equity value (which for the purposes of interest rate risk is defined as the difference between the net current value of assets and the net current value of liabilities outstanding), based on the impact that a change in interest rates would have on those current values.

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 which are 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 NII and EVE sensitivities.

This model requires a variety of inputs:

- Parameters inherent in the product.
- Performance parameters of the client (in this case analysis of historic data is combined with the expert business view).
- Market data.
- Historic data of the portfolio.

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 are at low levels. This risk is modelled in these units, and this can also be applied, with some modifications, 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 borrower pre-payments. As a result, the models for assessing options must be combined with empirical statistical models that seek to capture pre-payment performance. Some of the factors conditioning this performance are:

- **Interest rate:** the differential between fixed rates on the mortgage and the market rate at which it could be refinanced, net of cancellation and opening costs.
- **Seasoning:** trend that the pre-payment is downward at the beginning of the instrument life-cycle (contract signature) and then increases, stabilising as time passes.
- **Seasonality:** redemptions 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: define those loans that have already overcome various waves of interest rate falls as more stable. In other words, when a loan portfolio 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) Other: geographic mobility, demographic, social and 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.

Value at Risk (VaR)

For balance sheet activity and investment portfolios, this is defined as the 99% percentile of the distribution function of losses in equity value, calculated based on the current market value of positions and returns over the last two years, at a particular level of statistical confidence over a certain time horizon. As with trading portfolios, a time frame of two years or at least 520 days from the reference date of the VaR calculation is used.

The Group is working on implementing the guidelines published by the Basel Committee in its review of the treatment of Interest Rate Risk in the Banking Book (IRRBB), published in April 2016, applicable in 2018.

C.2.3.2.2. Structural exchange-rate risk/hedging of results

These activities are monitored via position measurements, VaR and results, on a monthly basis.

C.2.3.2.3. Structural equity risk

These activities are monitored via position measurements, VaR and results, on a monthly basis.

C.2.3.3. System for controlling limits

As already stated for the market risk in trading, under the framework of the annual limits plan, limits are set for balance sheet structural risks, responding to the Group's risk appetite level.

The main limits are:

- Balance sheet structural interest rate risk:
  - Limit on the sensitivity of net interest income to 1 year.
  - Limit of the sensitivity of equity value.
- Structural exchange rate risk:
  - Net position in each currency (for hedging positions of results).

In the event of exceeding one of these limits or their sub limits, the risk management responsibles must explain the reasons it occured and provide an action plan to correct it.

C.2.4. Liquidity risk

C.2.4.1. Key figures and change over time

The Group has a strong liquidity and financing position based on a decentralised liquidity model, where each of the Group's units is autonomous in managing its liquidity and maintains large buffers of highly liquid assets.

As a rule, short-term liquidity metrics, the Liquidity Coverage Ratio (LCR), remains stable, with regulatory ratios above the threshold (the minimum required in 2017 is 80%).

LIQUIDITY COVERAGE RATIO (LCR)

LCR	2017	2016
Group	133%	146%
Spain	130%	134%
UK	120%	139%
Brazil	126%	165%
US	118%	136%

Santander has an effective management of its liquidity buffers to face the challenge of maintaining a proper liquidity profile (regulatory limits) while protecting the profitability of our balance sheet.

Furthermore, most of the Group's units maintain sound balance sheet structures, with a stable financing structure based on a broad customer deposit base, which covers structural needs, with low dependence on short-term financing and liquidity metrics well above regulatory requirements, both locally and at Group level, and within the limits of risk appetite.

Hence, for long-term liquidity, the regulatory metric, Net Stable Funding Ratio (NSFR), remains above 100% for the Group's core units and for the consolidated ratio.

As to structural asset encumbrance risk, i.e. the risk of facing an excess of assets bearing charges or encumbrances in connection with financing transactions and other market dealings, at Group level the risk is in line with our European peers, where the main sources of encumbrance are collateralised debt issues (securitisations and covered bonds) and collateralised funding facilities provided by central banks.

The soundness of units' balance sheets is also demonstrated by stress scenarios constructed in accordance with uniform corporate criteria across the Group. All units would survive the worst-case scenario for at least 45 days, meeting liquidity requirements with their liquid asset buffers alone.

C.2.4.2. Methodologies

The Group measures liquidity risk using a range of tools and metrics that account for the risk factors identified within this risk.

Liquidity buffer
The buffer is a portion of the total liquidity available to an entity to deal with potential withdrawals of funds (liquidity outflows) that may arise as a result of periods of stress. Specifically, a buffer consists of a set of unencumbered liquid resources that are available for immediate use and capable of generating liquidity promptly, without incurring any loss or excessive discount. The Group uses the liquidity buffer as a tool that forms part of the calculation of most liquidity metrics and is also a metric in its own, with specified limits for each entity.

Liquidity Coverage Ratio (LCR)
LCR, or liquidity coverage ratio, is one of the short-term liquidity metrics used by the Group. LCR has a regulatory definition. It is intended to reinforce the short-term resistance of banks' liquidity risk profile by ensuring that they have available sufficient high-quality liquid assets to withstand a stress scenario (idiosyncratic stress or market stress) of considerable severity for thirty calendar days.

Wholesale liquidity metric
This metric takes the form of a liquidity horizon assuming non-renewable wholesale financing outflows; it measures the number of days the entity would survive using its liquid assets to cover that loss of liquidity. The Group uses this figure as an internal short-term liquidity metric which also reduces the risk of dependence on wholesale funding.

Net Stable Funding Ratio (NSFR)
NSFR, or net stable funding ratio, is one of the metrics used by the Group to measure long-term liquidity risk. It is a regulatory metric defined as the coefficient of the available amount of stable funding and the required amount of stable funding. This metric requires banks to maintain a stable funding profile in relation to the composition of their assets and off-balance sheet activities.

Structural funding ratio
The structural funding ratio measures the volume of structural funding sources used by the entity in relation to all assets regarded as structural. This internal metric is used by each Group unit to measure long-term liquidity risk. It is intended to limit recourse to short-term wholesale funding and encourage the use of medium- and long-term instruments to fund requirements arising from the entity's core business.

Asset encumbrance metrics
The Group uses at least two types of metric to measure asset encumbrance risk: (i) the asset encumbrance ratio, which calculates the proportion of total encumbered assets, which are unavailable for raising funds, to the entity's total assets; and (ii) the structural asset encumbrance ratio, which measures the proportion of assets encumbered by reason of structural funding transactions (mainly long-term collateralised issues and funding from central banks).

Other liquidity indicators
Aside from traditional liquidity risk measurement tools for short-term risk and long-term or funding risk, the Group has constructed a range of additional liquidity indicators that supplement the conventional toolset and measure other liquidity risk factors not otherwise covered. Most of these indicators are concentration metrics, such as concentration facing the five largest liability -side counterparties, or concentration of financing by time to maturity.

Liquidity scenario analysis

The Group uses four standard scenarios as liquidity stress tests: (i) an idiosyncratic scenario featuring events that adversely affect the Entity alone; (ii) a local market scenario, which considers events having serious adverse effects on the financial system or real economy of the Entity's base country; (iii) a global market scenario, which considers events having serious adverse effects on the global financial system; and (iv) a combined scenario, coupling idiosyncratic events with severe (local and global) market events arising simultaneously and interactively.

Santander uses the outcomes of the stress scenarios in combination with other tools to determine risk appetite and support business decision-making.

Liquidity early warning indicators

The system of liquidity early warning indicators, or EWIs, comprises quantitative and qualitative indicators that enable us to foresee liquidity stress situations and potential weaknesses in Group entities' funding and liquidity structure. EWIs are both external (environmental), relating to market financial variables, or internal, relating to the Entity's own actions.

C.2.5. Pension and actuarial risk

C.2.5.1. Pension risk

When managing the pension fund risks of employees (defined benefit), the Group assumes the financial, market, credit and liquidity risks it incurs for the assets and investment of the fund, as well as the actuarial risks derived from the liabilities, and the responsibilities for pensions to its employees.

The Group's objective in the sphere of controlling and managing pension risk focuses on identifying, measuring, monitoring, controlling, mitigating and communicating this risk. The Group's priority is thus to identify and mitigate all the focuses of risk.

This is why the methodology used by the Group estimates every year the combined losses in assets and liabilities in a defined stress scenario from changes in interest rates, inflation, stocks markets and properties, as well as credit and operational risk.

C.2.5.2. Actuarial risk

Actuarial risk is produced by biometric changes in the life expectancy of those with life insurance, from the unexpected increase in the indemnity envisaged in non-life insurance and, in any case, from unexpected changes in the performance of insurance takers in the exercise of the options envisaged in the contracts.

The following are actuarial risks:

Risk of life liability: risk of loss in the value of life assurance liabilities caused by fluctuations in risk factors that affect these liabilities:

- Mortality/longevity risk: risk of loss from movements in the value of the liabilities deriving from changes in the estimation of the probability of death/survival of those insured.
- Morbidity risk: risk of the loss from movements in the value of the liabilities deriving from changes in estimating the probability of disability/incapacity of those insured.
- Redemption/fall risk: risk of loss from movements in the value of the liabilities as a result of the early cancellation of the contract, of changes in the exercise of the right of redemption by the insurance holders, as well as options of extraordinary contribution and/or suspending contributions.
- Risk of costs: risk of loss from changes in the value of the liabilities derived from negative variances in envisaged costs.
- Catastrophe risk: losses caused by catastrophic events that increase the Entity's life liability.

Risk of non-life liability: risk of loss from the change in the value of the non-life insurance liability caused by fluctuations in risk factors that affect these liabilities:

- Premium risk: loss derived from the insufficiency of premiums to cover the disasters that might occur.
- Reserve risk: loss derived from the insufficiency of reserves for disasters, already incurred but not settled, including costs from management of these disasters.
- Catastrophe risk: losses caused by catastrophic events that increase the Entity's non-life liability.

C.3. Operational risk

C.3.1. Definition and objectives

Following the Basel framework, Santander Group defines operational risk (OR) as the risk of losses from defects or failures in its internal processes, people or systems, or external events, thus covering risk categories such as fraud, and technological, cyber, legal and conduct risk.

Operational risk is inherent to all products, activities, processes and systems and is generated in all business and support areas. For this reason, all employees are responsible for managing and controlling the operational risks generated in their sphere of action.

This chapter refers to operational risks in general (these are also referred to as non-financial risks in Santander). Particular aspects of some risk factors are set out in more detail in specific sections (e.g. section C.4. Compliance and conduct risk).

The Group's target in the area of OR management and control is to identify, assess and mitigate risk concentrations, regardless of whether they produce losses or not. Analysing exposure to OR helps to establish priorities in managing this risk.

During 2017, the Group has sought further improvement in its management model through a number of different initiatives designed by the Risks division. One of these initiatives is to continue the AORM (Advanced Operational Risk Management) transformation project. This programme is designed to enhance operational risk management capacities through an advanced risk measurement approach, helping to reduce future exposure and losses impacting the income statement.

Risk analysis has improved through a range of information quality enhancement initiatives, allocation of the Group's appetite and legal entities to the main business units, and integrated self-assessment of risks and controls.

Santander has been calculating regulatory capital by OR using the standardised approach set forth in the European Capital Directive. The AORM programme helps the Group develop capital estimation models in its main geographic areas, both for economic capital and stress testing, and for potential application as regulatory capital.

The Pilar III disclosure includes information on the calculation of capital requirements for operational risk.

C.3.2. Operational risk management and control model

C.3.2.1. Operational risk management cycle

In Santander Group, operational risk is managed in accordance with the following elements:

The various phases of the operational risk management and control model are the following:

- Identify the inherent risk in all the Group's activities, products, processes and systems.
- Define the target profile for the risk, specifying the strategies by unit and time frame, by establishing the OR appetite and OR tolerance for the annual losses estimation and monitoring thereof.
- Measure and assess operational risk objectively, continuously and consistently with regulatory and sector standards.
- Continuously monitor operational risk exposure, and implement control procedures and improve the internal control environment.
- Establish mitigation measures that eliminate or minimise the risk.
- Develop regular reports on operational risk exposure and its level of control for senior management and the Group's areas and units, and inform the market and regulatory bodies.
- Define and implement the methodology needed to calculate internal capital in terms of expected and unexpected loss.

The following are needed for each of the aforementioned processes:

- Define and implement systems that enable operational risk exposure to be monitored and controlled, taking advantage of existing technology and achieving the maximum automation of applications.
- Define and document policies for managing and controlling operational risk, and implement management tools for this risk in accordance with regulations and best practices.
- Define common tools, taxonomies and metrics for the entire Organisation.

The advantages of Santander's operational risk management and control model include:

- It fosters the development of a risk culture, assigning responsibilities in risk management to all functions within the Organisation.
- It allows comprehensive and effective operational risk management (identification, measurement, assessment, control and mitigation, and reporting).
- It improves knowledge of existing and potential operational risks and assigns them to business and support lines.
- Operational risk information helps to improve processes and controls, and reduces losses and the volatility of revenues.
- It prioritises risks and the associated mitigation measures for decision making.

The Group has put in place a **management structure** for operational risk that complies with all regulatory requirements and is aligned with the Group's risk culture and the risk profile of its activities.

This structure includes the lines of defence and interaction with corporate governance, ensuring the coverage of all operational risks and the involvement of the Group's senior management in managing operational risk.

The Corporate Operational Risk Committee (CORC) is a transversal committee in which all corporate division involved in the management and control of OR participate, and is responsible for the oversight of the identification, mitigation, monitoring and reporting of operational risk in the Group. It ensures compliance with the model, the risk tolerance limits and the policies and procedures set down in this area. The CORC oversees the identification and control of actual and emerging operational risks and their impact on the Group's risk profile, and the integration of the identification and management of operational risk into decision making. This Corporate committee is replicated in the different units of the Group.

The Group has also set up a number of specific committees and forums in response to the scale of this risk and the specifics of each category. These include the Marketing and Anti-money Laundering Committees (for more detail, see chapter C.4 Compliance and conduct risk), the suppliers and Cyber-security Committees, and the fraud management, damage to physical assets and operations forums. These involve the first and second lines of defence. This risk and the mitigation measures implemented in the Organisation are subject to special monitoring.

C.3.2.2. Risk identification, measurement and assessment model

A series of quantitative and qualitative corporate techniques and tools have been defined by the Group to identify, measure and assess operational risk. These are combined to produce a diagnosis on the basis of the risks identified and an assessment of the area or unit through their measurement and evaluation.

The **quantitative analysis** of this risk is carried out mainly with tools that register and quantify the level of potential losses associated with operational risk events. **Qualitative analysis** seek to assess aspects (coverage, exposure) linked to the risk profile, enabling the existing control environment to be captured.

The most important operational risk tools used by the Group are as follows:

- **Internal events database**. The objective is to capture the Group's operational risk events. This is not restricted by thresholds (i.e. there are no exclusions for reasons of amount), and events with both accounting (including positive effects) and non-accounting impact are entered.

  Accounting reconciliation processes have been put in place to guarantee the quality of the information in the databases. The main events for the Group and each operational risk unit are specifically documented and reviewed.

  Internal databases are supplemented by the process of events escalation treated as significant (by reason of their financial impact or other factors, such as number of customers affected, regulatory impact or media coverage), which alerts senior management to the key operational risk events arising across the Group on a timely basis.

- **Operational risk control self-assessment (RCSA)**. Self-assessment of operational risks and controls is a qualitative process that seeks, using the criterion and experience of a pool of experts in each function, to determine the main operational risks for each function, the control environment and their allocation to the different functions of the Organisation.

  The RCSA identifies and assesses the material operational risks that could stop a business or support unit achieving its objectives. Once they are assessed in inherent and residual terms, and the design and working of the controls are evaluated, mitigation measures are identified if the risk levels prove to be above the tolerable profile.

  The Group has put in place an on-going operational risk self-assessment process: this ensures that material risks are assessed at least once a year. This process combines expert judgement and participation in workshops involving all interested parties, particularly the first-line managers responsible for the risks and their control. These workshops are run by a facilitator, who is neutral and has no decision-making authority, helping the Group achieve its desired results.

  The Group also elaborates risk assessments for specific sources of operational risk, enabling transversal identification of risk levels at a greater degree of granularity. These are applied in particular to technological risks, fraud and factors that could lead to regulatory non-compliance, and areas that are exposed to money laundering and terrorism financing risks. The two latter areas, together with the conduct risks factor, are set out in greater detail in section C.4 Compliance and conduct risk.

- **External events database**[44]**.** The use of external data bases has been stepped up, providing quantitative and qualitative information leading to a more detailed and structured analysis of events in the sector, comparison of the loss profile with the wider industry, locally and globally, and the scenario analysis exercises described below have been adequately prepared.

- **Analysis of OR scenarios.** The objective is to identify potential events with a very low probability of occurrence, but which could result in a very high loss for the Bank. The possible effects of these are assessed and extra controls and mitigating measures are identified to reduce the likelihood of high economic impact. Expert opinion is obtained from the business lines and risk and control managers.

- **Corporate indicators system.** These are various types of statistics and parameters that provide information on an institution's risk exposure and control environment. These indicators are regularly reviewed in order to flag up any changes that could reveal risk problems.

  In 2017, Santander evolved its corporate indicators to monitor the main risk concentrations in the Group and the industry. It has also fostered the use of indicators in all levels of the Organisation, from front-line risk managers down. The objective is to incorporate the most relevant risk indicators into the metrics that form the basis for constructing the operational risk appetite.

- **Audit and regulatory recommendations**. These provide relevant information on inherent risk due to internal and external factors, enabling weaknesses in the controls to be identified.

- **Customer complaints**. The Group's increasing systemisation of the monitoring of complaints and their root causes also provides relevant information for identifying and measuring risk levels. In this regard, the compliance and conduct function prepares detailed analysis, as set out in section C.4.5. Product governance and consumer protection.

- **Other specific instruments**. Enable more detailed analysis of technology risk, such as control of critical system incidents and cyber-security events.

- **Internal data model**. Application of statistical models are used to capture the Group's risk profile, mainly based on information collected from the internal loss database, external data, and scenarios. The main application of the model in 2017 was to help determine economic capital and estimate expected and stressed losses, as a tool for specifying operational risk appetite.

The risk profile is part of the appetite of the non-financial risks that are structured as follows:

- A general statement setting out that Santander Group is, in principle, averse to operational risk events that could lead to financial loss, fraud and operational, technological, legal and regulatory breaches, conduct problems or damage to its reputation.

- General metrics of expected loss, stressed losses and overdue audit recommendations.

- An additional statement is included for the most important risk factors, together with a number of forward-looking monitoring metrics. Specifically, these cover: internal and external fraud, technological, cyber, legal, anti-money laundering, commercialisation of products, regulatory compliance and supplier management risk.

44. Santander takes part in international consortiums such as the ORX (Operational Risk Exchange).

C.3.2.3. Implementation of the model and initiativess

Almost all the Group's units are now incorporated into the model with a high degree of homogeneity.

As set out in section C.3.1. Definition and objectives, the Group completed its transformation to an advanced operational risk management (AORM) approach in 2017. The programme has a twofold objective: on one hand, to consolidate the current operational risk model, and, on the other, to adopt the best market practices and to use monitoring of an integrated and consolidated operational risk profile to direct the business strategy and tactical decisions in a proactive way.

This programme involves a number of key areas (risk appetite, self-assessment, scenarios, metrics, etc.) that enable the Group to refine the improvements it is implementing, covering the ten main geographic areas. A monitoring structure has been set up at the highest organisational levels, both at the corporate centre and in the local units, to ensure adequate monitoring of progress.

This programme is supported by the development of a customised and integrated operational risk solution (*Heracles*[45]), and has been implemented in all the Group's geographies.

The main activities and global initiatives adopted in 2017 for an effective operational risk management are:

- Information enhancement, especially the internal loss database, key to ensuring the integration of all instruments and the Bank´s ability to cross-check analysis of the data.
- Creation of a new methodology of objective qualification to evaluate the reporting of the main risks (Top risks) that include risk exposure and the environment control taking into account the actual and forecasted elements.

  This approach constitutes a more detailed process for final determination of risk level and trend. It encourages prioritisation in risk management and the framing of specific mitigation plans, while supporting ongoing communication of risks to senior management.
- Reinforcement of governance and the operational risk instruments in the first lines of defence, among which it is noteworthy the operational risk appetite scope for the most relevant business and support units.
- Incorporation of additional risk appetite metrics related to internal fraud in the market approach, external fraud in cards and with the supplier management control.
- Development of processes for the determination, identification and assessment of critical theoretical controls. The purpose if this initiative is to strengthen and standardize the control environment in the Organisation, by means of analysis of the minimum control aspects that must be covered in the different units of the Group.
- Deployment of more robust cross-checking processes between different operational risk instruments, to ensure a better understanding of the relevant risks of the Organisation.
- Fostering of mitigation plans for aspects of particular relevance (information security and cyber-security in the widest sense, control of suppliers, among others): monitoring of the implementation of corrective measures and projects under development.
- Improvements to contingency, business-continuity and, in general, crisis-management plans (initiative linked to the recovery and resolution plans), also providing coverage to emerging risks (cyber).
- Fostering the control of risk associated with technology (control and supervision over the system design, infrastructure management and applications development).

For the control of suppliers referred to previously, in 2017 a new version of the corporate reference framework, was approved covering the new requirements issued by the regulator in this field, widening the scope of types with relevant third parties, and aligning them with relationship the best practices in the sector. The Bank has also made progress in defining and deploying policies, procedures and tools in the Group entities in order to adapt current processes to the model's principles and requirements. In 2017, the efforts have been focused on:

- Identifying and assigning roles and responsibilities to cover the various activities described in the model to manage the complete life cycle of the relationship with the supplier or other party (decision, approval, contracting, monitoring and termination) and ensure adaptation to the three lines of defence structure, where the first lines are responsible for the management functions and the OR function carries out the control procedure to check that the model's principles are fulfilled.
- Evolving the corporate supplier management system to cover the new framework requirements and anticipate upcoming regulatory changes (e.g. GDPR), particularly regarding:
  - Adding a decision making tool which can be used to discriminate services by their relevance and level of associated risk (e.g. based on the sensitivity of the information processed), so that the most appropriate controls for each can be set up in other phases of the service life cycle.

45. *Heracles* is a GRC (Governance, Risk & Compliance) application for enterprise-wide risk management.

- Reviewing specific questionnaires and criteria used in the supplier approval stage to ensure that adequate controls are in place to cover the risks associated with the service given.
- Setting up approval flows to guide the whole decision-making, approval, negotiations and contracting process.

- Creation of specific committees by geography for the monitoring and decision-making regarding the relevant services and suppliers and the review of the escalation procedures and criteria.
- Including third-party risk as one of the main risks on Risk Committee and senior management agendas at the Group's main entities.
- Definition and monitoring of indicators and dashboard concerning the model implementation. Including specific suppliers metrics in the Group's and the core entities' risk appetite reports.
- Review and enhancing quality of data of inventories of relevant services and associated suppliers.
- Moving forward with implementing a management system that automates the various stages of the supplier management cycle to achieve enhanced process control and higher information quality.
- Training and awareness raising of risks associated with suppliers and other third parties.

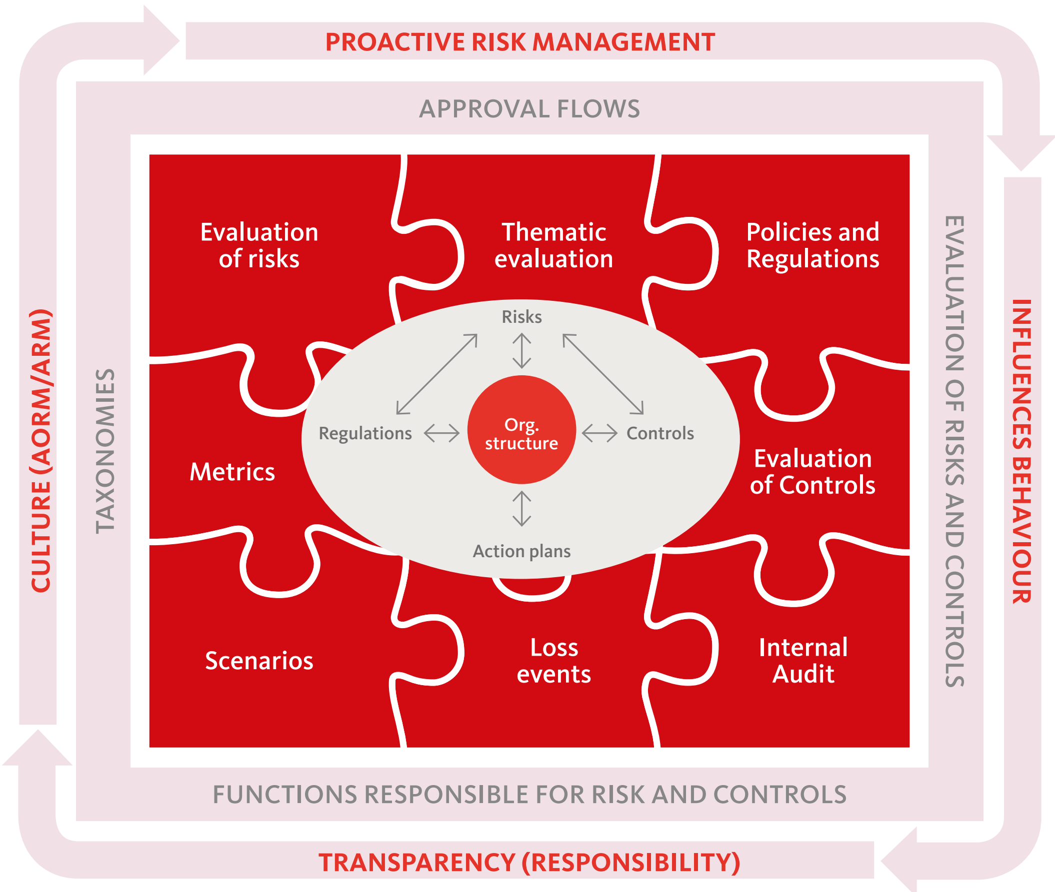
The Group is continuing to work on the implementation and consolidation of the model, reinforcing and standardising the activities to be carried out throughout the management life cycle for suppliers and other third parties.

C.3.2.4. Operational risk information system

The Group's corporate information system, called Heracles, supports operational risk management tools, providing information for reporting functions and needs at both local/corporate levels. The objective of *Heracles* is to improve decision making for OR management throughout the Organisation.

This objective will be achieved by ensuring that those responsible for risks in every part of the Organisation have a comprehensive vision of the risk, and the supporting information they need, when they need it. This comprehensive and timely vision of risk is facilitated by the integration of various programmes, such as assessment or risks and controls, scenarios, events and metrics, using a common taxonomy and methodological standards. This integration provides a more accurate risk profile and significantly improves efficiency by cutting out redundant and duplicated effort.

Heracles also enables the interaction of everybody involved in operational risk management with the information in the system with specific needs or limited to a particular level based on the premise of only one source of information.



In 2017, the Group achieved the aim of having fully fledged functionality, through the incorporation of the metrics, thematic assessment and scenario modules. In addition, the decision-making capacity has been improved through the definition of approval flows. Work was also done on improving the reporting capacity, to comply with regulations on Risk Data Agreggation.

In order to achieve this last goal, a reference technological architecture has been developed, providing solutions for information capture and feeding an integrated and reliable database (Golden Source) that is used for the generation of operational risk reports.

In addition, furhter work has been carried out by the Group regarding the data supply automatization from the local systems of the units.

C.3.2.5. Training initiatives and risk culture

The Group fosters awareness and knowledge of operational risk at all levels of the Organisation through its risk-pro culture. During 2017, a number of different training sessions were conducted using the e-learning format, and which addressed general knowledge of OR. These sessions have been designed for all the Group's employees and are explicitly aimed at directors.

To raise consciousness of cyber-security issues, "phishing" awareness campaigns were launched among all employees to enhance their ability to identify and report this form of malicious conduct.

The compliance and conduct function has prepared and launched a number of training actions, as described in section C.4.9. Transversal corporate projects in this report.

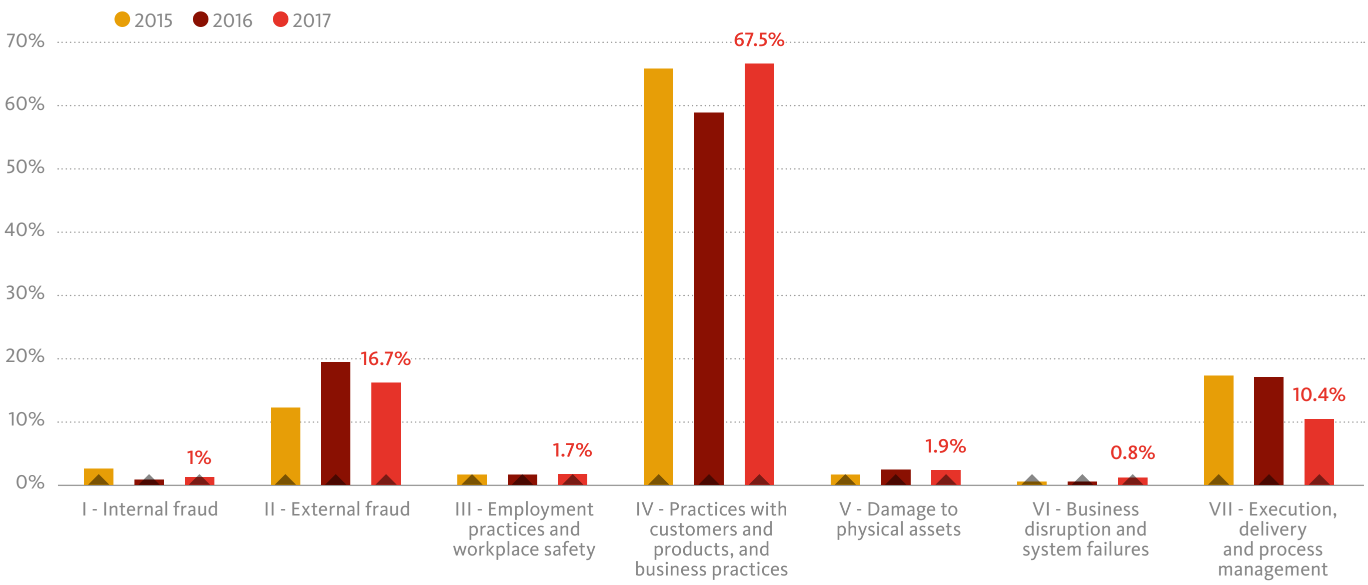
Further, in 2017 training initiatives were developed such as dissemination sessions and specific face-to-face sessions (Executive Operational Risk programme, training for the Heracles tool, etc.).

Likewise, the Group uses an number of different initiatives to enhance its implementation of a better operational risk culture, one of which is the OR newsletter, with the aim of raising awareness about the importance of this risk, distribution of procedure and guidelines, significant external events, related subjects of interest and events which have occurred in the Group.

C.3.3. Evolution of the main metrics

The evolution of net losses (including both incurred loss and net provisions) by Basel[46] risk category over the last three years is the following:

DISTRIBUTION OF NET LOSSES BY OPERATIONAL RISK CATEGORY (EXCL. POPULAR)[47]



46. The Basel categories include the risks set out in chapter C.4. Compliance and conduct risk.

47. In accordance with local practices, the remuneration of employees in Brazil is managed as personnel expenses for the Entity, without prejudice to its treatment under the Basel operational risk framework, and is therefore not included.

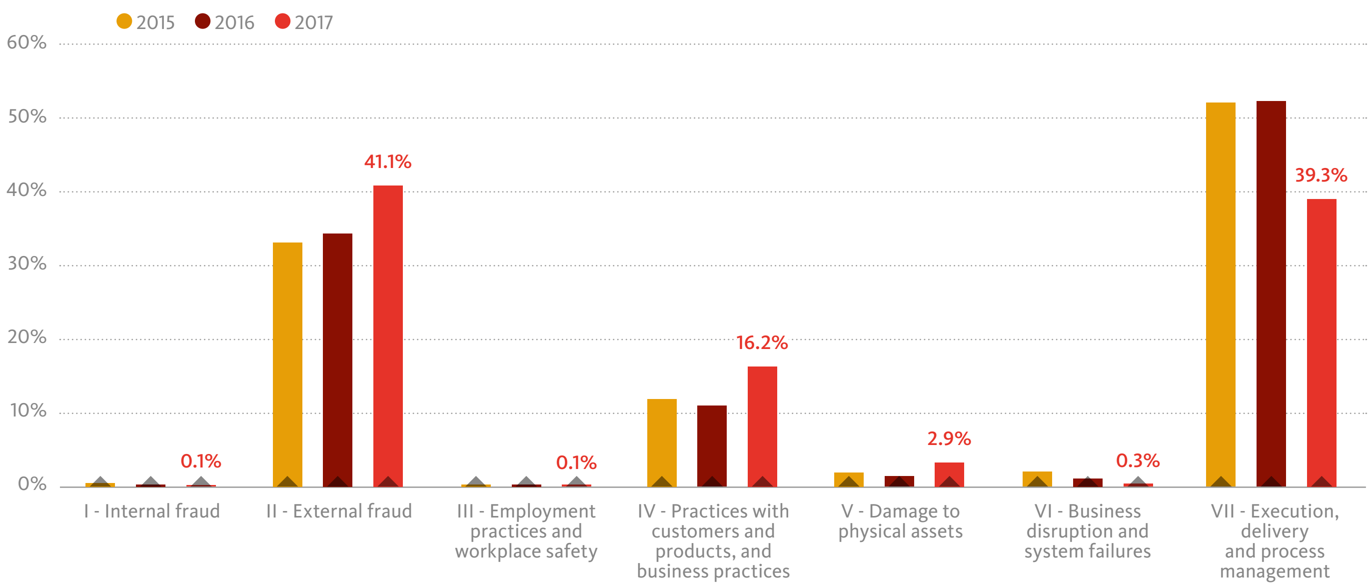
In general terms, the losses in the category of practices with customers and products, and business practices increase regarding the previous year, although for external fraud and processes failures they have reduced.

During 2017, the most relevant losses by category and geography correspond to judicial causes in Brazil where a group of measures to improve customer service (gathered in a complete mitigation plan, as descried in section 4.3 Mitigation measures) is maintained. On the other hand, in 2017 the volume of losses in the UK has decreased due to the decrease of provisions to cover future complaints by the sale of the Payment Protection Insurance (PPI) and other cases of product commercialisation.

The main risk concentrations in external fraud still concern the fraudulent use of debit and credit cards, with a significant rise in fraud in card not present, and distance channels (Internet banking and mobile banking).

The chart below shows 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 (EXCL. POPULAR)[48]



C.3.4. Mitigation measures

The Group uses the model to monitor the mitigation measures for the main risk foci which have been identified through the internal OR management tools (internal event database, indicators, self-assessment, scenarios, audit recommendations, etc.) and other external information sources (external events and industry reports).

Active mitigation management became even more important in 2017, with the participation of the first line of defence and the operational risk control function, through which specialist business and support functions exercise additional control. Furthermore, the Group continued to move forward with pre-emptive implementation of operational risk management and control policies and procedures.

The most significant mitigation measures have been centred on improving the security of customers in their usual operations, management of external fraud, continued improvements in processes and technology, and management of the sale of products and adequate provision of services.

Regarding the reduction of fraud, the main specific measures were:

Card fraud:
Use of EMV-standard chip cards based on advanced authentication technology in the geographies where Santander Group is present.

- Card protection against electronic commerce fraud attacks (the fastest-growing fraud pattern in the industry):

48. In accordance with local practices, the remuneration of employees in Brazil is managed as personnel expenses for the Entity, without prejudice to its treatment under the Basel operational risk framework, and is therefore not included.

- Implementation of a secure e-commerce standard (3DSecure), with reinforced robustness via two-step authentication based on one-time passwords.

- Innovative solutions based on mobile applications that let users deactivate cards for e-commerce use.

- Issue of virtual cards using dynamic authentication passwords.

- Use in Brazil of a biometric authentication system in ATMs and branch cashier desks. Customers can use this new system to withdraw cash from ATMs using their fingerprint to sign off their transactions.

- Integration of monitoring and fraud detection tools with other systems, internally and externally, to enhance suspicious activity detection capabilities.

- Reinforced ATM security by incorporating anti-skimming devices to prevent card cloning.

Online/mobile banking fraud:

- Validations of online banking transactions through a second security factor based on one-time use passwords. Evolution of technology, depending on the geographic area (for example, based on image codes (QR) generated from data for the transaction).

- Enhanced online banking security by introducing a transaction risk scoring system that requests further authentication when a given security threshold is crossed.

- Implementation of specific protection measures for mobile banking, such as identification and registration of customer devices (Device Id).

Cyber-security and data security plans:

Throughout 2017, Santander continued paying full attention to cyber-security risks, which affect all companies and institutions, including those in the financial sector. This situation is a cause of concern for all entities and regulators, prompting the implementation of preventative measures to be prepared for any attack of this kind.

One particularly noteworthy technical improvement has been in protection measures to cope with service denial attacks.

The Group has evolved its cyber regulations by adopting a new Cyber Security Framework and the Cyber Risk Supervision Model, along with a range of related policies.

A new organisational structure has been specified and Group governance for management and control of this risk has been reinforced. Specific committees have been set up and cyber-security metrics have been included in the Group's risk appetite. These metrics have been monitored and reported in the geographies and at global level.

The Group's intelligence and analysis function has also been reinforced, by contracting Bank threat monitoring services. In addition, progress is being made in mitigation activities related to the identification and access management in all geographies, with the backing of senior management.

Progress has also been made in the incident registration, notification and escalation mechanisms for internal reporting and reporting to supervisors.

Additionally, the Group units take part in different coordinated cyber-exercises in the different countries with public bodies, and also carrying out internal cyber-security and crisis management scenarios such as risk assessment mechanisms, and response capacity tests when faced with these kinds of events.

Also, observation and analytical assessment of the events in the sector and in other industries enables Santander to update and adapt its models for emerging threats.

Other relevant mitigating measures:

The Group sets as a priority the establishment of mitigation measures in order to optimise the processes management according to the Bank's customer needs.

With regard to mitigation measures relating to customer practices, products and business, Santander Group is involved in continuous improvement and implementation of corporate policies on aspects such as the selling of products and services and prevention of money laundering and terrorism financing.

In particular and in general terms, during 2017, two policies that develop the corporate framework for commercialization of products and services and consumer protection were approved, in regard to the Fiduciary risk management and Consumer Protection. In addition, the risk identification processes and the development of mandatory training regarding this matter has been strengthen in the Group. Further detail is available in section C.4.5. Product governance and consumer protection.

Furthermore, it is noteworthy the analysis of incidents and customer complaints made by local units, establishing root-cause working groups with permanent monitoring (as an illustrative example, Chile during 2017 established 12 root-cause working groups where 157 initiatives were discussed regarding customer problems mitigation and the improvement of user experience, from which 100 have been implemented).

It is also significant, the continuous customer relation improvement in Brazil, where with focus on electronic channels fraud, an executive first level quorum was established in which all the Bank's areas participate with two work streams: one tactical (customer communication, contact centre attention reinforcement, customer training adaptation to processes changes, concepts and behaviours) and other structural (changes in systems and processes security to reduce the fraud events).

C.3.5. Business continuity plan

The Group has a business continuity management system (BCMS), which ensures that the business processes of the Bank's entities continue to operate in the event of a disaster or serious incident.

The basic objective is to:

- Minimise the possible damage from an interruption to normal business operations on people, and adverse financial and business impacts for the Group.
- Reduce the operational effects of a disaster, providing predefined and flexible guidelines and procedures to be used to re-launch and recover processes.
- Restart time-sensitive business operations and associated support functions, in order to achieve business continuity, stable profits and planned growth.
- Protect the public image of, and confidence in, the Santander Group.
- Meet the Group's obligations to its employees, customers, shareholders and other stakeholders.

During 2017, the Group continued to advance in implementing and continuously improving its business continuity management system. The Bank has reviewed the methods and approaches to reinforce governance of the review and approval of continuity strategies and plans, to ensure that this process is implemented at the appropriate level within the Organisation, to comply with new regulatory requirements and to cover emerging risks (such as cyber-risk).

Throughout the year Santander conducted several crisis simulation exercises based on scenarios that might affect the continuity of critical business operations (including cyber-attacks), involving the Group's various crisis management committees and senior management. The Group has worked towards reinforcing response protocols facing these scenarios and ensuring that the required logistics capabilities will be available to respond effectively and in a coordinated way to crisis situations.

The Group has also updated the corporate application which is used to register and store the Group's continuity plans, improving integration with other repositories housing significant Group assets (people, applications and suppliers).

C.3.6. 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 continuously improve operational control procedures to keep them in line with new regulations and best practices in the market. Throughout the year, the Bank has accordingly continued to cement the integration of OR management with business strategy, through holistic follow-up of business risks and their mitigating controls. This has considerably enhanced the control environment, with a focus on:

- Implementing a new model to deal with unauthorised trading and developing a specific risk appetite metric to the trading business to measure the robustness of the environment in each geography.
- Adapting the control model to new regulatory requirements, such as MiFID II, EMIR, PRIIPS and GDPR, among others.
- Reviewing compliance in the core geographies with the principles of the Global FX Conduct Code, involving the entire Organisation.
- Strengthening business continuity plans by incorporating – among other improvements – new scenarios reflecting new risks in the industry.
- Reinforcing the controls ensuring appropriate functional separation in market operation systems.
- Intensified scrutiny of markets-related suppliers, given the critical nature of this topic in view of market trends in online trading.

For more information on issues relating to regulatory compliance in markets, refer to section C.4.4. Regulatory compliance.

Lastly, it is important to note that the business is also undertaking a global transformation that involves modernising its technology platforms and operational processes to incorporate a robust control model, enabling a reduction of the operational risk associated with its business.

Corporate information

The OR function has a management information system that provides data on the Group's main elements of risk. In 2017, Santander introduced the operational risk consolidation and reporting procedure with the goal of defining the minimum requirements of information, frequency, as well as validation, consolidation and its use in the reporting to the Entity's governance bodies.

The information available at the operational risk level is consolidated to give a global vision with the following features:

- Two levels of information: corporate with consolidated information, and individual for each country or unit.

- Dissemination among Santander Group's units of the best practices identified through a combined study of the results of qualitative and quantitative analysis of operational risk.

Information on the following aspects is developed:

- The Santander Group's operational risk management model and the Group's main units and countries.

- The scope of operational risk management.

- Operational risk regulatory capital.

- Monitoring of risk appetite metrics.

- The consolidated operational risk profile, through identifying, assessing and prioritising the key foci of risk.

- The risk profile by country and risk category, and the main aspects of operational risk monitoring in each of these dimensions.

- The action plans associated with each risk source.

- Distribution of losses by geographic area and risk category.

- Evolution of losses and provisions (accumulated annual, deviation on previous year and against budget).

- Analysis of significant external events.

- Analysis of the most relevant risks detected by self-assessment exercises for operational and technological risk and operational risk scenarios.

- Assessment and analysis of risk indicators.

- Mitigating measures/active management.

- Business continuity and contingency plans.

This information forms the basis for complying with reporting requirements to the Executive Risk Committee, the Risk Supervision, Regulation and Compliance Committee, the Operational Risk Committee, senior management, regulators, rating agencies, etc.

Insurance in the management of operational risk

Santander Group regards insurance as a key element in the management of operational risk. In 2017, the Group has continued to develop procedures with a view to achieving better coordination between the different functions involved in management cycle of insurance policies used to mitigate operational risk. Once the functional relationship between the own insurance and operational risk control areas is established, the primary objective is to inform the different first line risk management areas of the adequate guidelines for the effective management of insurable risk. The following activities are particularly important:

- Identification of all risks in the Group that can be covered by insurance, including identification of new insurance coverage for risks already identified in the market.

- Establishment and implementation of criteria to quantify the insurable risk, backed by loss analysis and the scenarios that enable the Group's level of exposure to each risk to be determined.

- Analysis of coverage available in the insurance market, as well as preliminary design of the conditions that best suit the identified and assessed needs.

- Technical assessment of the protection provided by the policy, its costs and the elements retained in the Group (franchises and other elements at the responsibility of the insured) in order to make contracting decisions.

- Negotiating with suppliers and contract in allocation accordance with the procedures established by the Group.

- Monitoring of incidents declared in the policies, as well as of those not declared or not recovered due to an incorrect declaration, establishing protocols for action and specific monitoring forums.

- Analysis of the adequacy of the Group's policies for the risks covered, taking appropriate corrective measures for any shortcomings detected.

- Close cooperation between local operational risk executives and local insurance coordinators to strengthen operational risk mitigation.

- Active involvement of both areas in the own insurance forum, the Group's highest technical body for defining coverage strategies and contracting insurance, (replicated in each geography to monitor the activities mentioned in this section), the claim monitoring forum, and the Corporate Operational Risk Committee.

The own insurance area has also played a more active role in different Group forums (damages in physical assets, fraud, scenarios, special situation management, etc.), thereby increasing its interaction with other Group functions and its capacity to properly identify and assess insurable risks and optimise the protection of the income statement.

C.4. Compliance and conduct risk

C.4.1. Scope, aim, definitions and objective

The compliance and conduct function fosters the adherence of Santander Group to the rules, supervisory requirements, principles and values of good conduct, by setting standards, and discussing, advising and reporting in the interest of employees, customers, shareholders and the community as a whole.

This function addresses all matters related to regulatory compliance, prevention of money laundering and terrorism financing, governance of products and consumer protection, and reputational risk.

Compliance and Conduct has cemented progress made in the two previous years. In 2017, the function has taken a leap forward at the corporate level and in the various units of the Group, as part of the strategic compliance programme now underway.

Under the current corporate configuration of the three lines of defence at Santander Group, compliance and conduct is an independent second-line control function under the CEO, reporting directly and regularly to the board of directors and its committees, through the GCCO (Group Chief Compliance Officer). This configuration is aligned with the requirements of banking regulation and with the expectations of supervisors.

The following are defined as compliance risks:

- Conduct risk: risk arising from practices, processes or behaviours that are inappropriate or in breach of internal regulations, the law or the supervisor's requirements.
- Reputational risk: risk of current or potential negative economic impact to the Bank due to damage to the perception of the Bank on the part of employees, customers, shareholders/investors and the wider community.

The Group's objective is to minimise the probability that irregularities occur and that any irregularities that should occur are identified, assessed, reported and quickly resolved.

Other control functions (risks and audit) also take part in controlling these risks.

C.4.2. Compliance risk control and supervision

The first lines of defence have the primary responsability for managing compliance and conduct risks jointly with the business units where such risks originate, as well as the compliance and conduct function. This is performed either directly or through assigning compliance and conduct activities or tasks.

The function is also responsible for setting up, fostering and ensuring that units begin to use the standardised frameworks, policies and standards applied throughout the Group. For this purpose, in 2017 a standard regulatory tree has been developed throughout the Group, as well as a process for its monitoring and systematic control.

The GCCO is responsible for reporting to Santander Group's governance and management bodies, and must also advise and inform, as well as promote the development of the function. This is independently of the Risks function's other reporting to the governance and management bodies of all Group risks, which also includes compliance and conduct risks.

In 2017, the Bank has reinforced and evolved the new compliance and conduct model, especially at the Group's units. The Corporation has put in place the necessary components to ensure ongoing control and oversight by creating robust governance schemes, and systems for reporting and interacting with units in accordance with the parent/subsidiaries governance model operated by the Group.

Furthermore, Internal Audit - as part of the third line of defence functions - performs the tests and audits necessary to verify that adequate controls and oversight mechanisms are being applied, and that the Group's rules and procedures are being followed.

In 2017, the Bank has reviewed, updated and streamlined corporate frameworks for the compliance and conduct function. These are first-level documents that regulate the function, with which the management bodies of the various units must comply.

- General compliance framework.
- Products and services marketing and consumer protection framework.
- Anti-money laundering and anti-terrorist financing framework.

The General Code of Conduct enshrines the ethical principles and rules of conduct that govern the actions of all Santander Group's employees. It is supplemented in certain matters by the rules found in other codes and their internal rules and regulations.

In addition, the General Code of Conduct sets out:

- Compliance functions and responsibilities.
- The rules governing the consequences of non-compliance with it.
- A whistle-blowing channel for the submission and processing of reports of allegedly irregular conduct.

The compliance and conduct function, under the supervision of the Risk Supervision, Regulation and Compliance Committee (RSRCC), is responsible for ensuring effective implementation and oversight of the General Code of Conduct, as the board is the owner of the Code and the corporate frameworks that implement it.

A highlight of 2017 was the development of a reputational risk model that captures the key elements for managing risk in this area. The model is being gradually implemented in the units.

This model identifies the main sources of reputational risk, establishing a preventive approach for its correct management, determines the functions involved in the management and control of this risk and its governance bodies.

C.4.3. Governance and the organisational model

In accordance with the mandate entrusted by the board to the compliance and conduct function, in 2017, great strides were made in the strategic compliance programme. In the two previous years, the scope and objectives of the model were defined, and the initiative was implemented at Corporate level. In 2017, it was implemented at the Group's various units, so that by the end of 2018 the Bank will have achieved compliance and conduct function in line with the highest standards of the finance industry.

C.4.3.1. Governance

The following corporate committees - each of which has a corresponding local replica - are collegiate complaince and conduct governance bodies:

The **Regulatory Compliance Committee** is the collegiate body for regulatory compliance matters. It has the following key functions:

i) Controlling and overseeing regulatory compliance risk in the Group, as a second line of defence;

ii) Specifying the regulatory compliance risk control model throughout the Santander Group, based on common regulations applicable to several countries where the Group operates.

iii) Deciding on significant regulatory compliance issues that might pose a risk to the Group.

iv) Fixing the correct interpretation of the General Code of Conduct and specialised codes, and making proposals for improvement.

In 2017, the Regulatory Compliance Committee held four meetings.

The **Corporate Commercialisation Committee** is the collegiate governance body for the approval of products and services. It has the following key functions:

i) Validating new products or services proposed by the parent company or by any subsidiary/Group unit, prior to their launch.

ii) Establishing the commercialisation risk control model in the Group, including risk assessment indicators, and proposing the commercialisation and consumer protection risk appetite to the Compliance Committee.

iii) Establishing interpretation criteria and approving the reference models to develop the corporate product and service marketing and consumer protection framework, and its rules, and to validate the local adaptations of those models.

iv) Assessing and deciding which significant marketing questions might pose a potential risk for the Group, depending on the authorities granted or the powers required to be exercised under legal obligations.

The Corporate Commercialisation Committee met 12 times in 2017 and presented a total of 148 proposals of new products/services and models or other reference documents regarding commercialisation, having validated all of them except one.

The **Monitoring and Consumer Protection committee** is the Group's collegiate governance body for the monitoring of products and services, and the assessment of customer protection issues in all Group units. It has the following key functions:

i) Monitoring the marketing of products and services by country and by product type, reviewing all the available information and focusing on products and services under special monitoring, and costs of conduct, compensation to customers, sanctions, etc.

ii) Monitoring the common claim measurement and reporting methodology, based on root-cause analysis, and the quality and sufficiency of the information obtained.

iii) Establishing and assessing how effective corrective measures can be when risks are detected in the governance of products and consumer protection within the Group.

iv) Identifying, managing and reporting preventively on the problems, events, significant situations and best practices in commercialisation and consumer protection in a transversal way across the Group.

The Monitoring and Consumer Protection committee met 23 times in 2017.

The **Anti-money Laundering/Anti-terrorism Financing Committee** is the collegiate body in this field. It has the following key functions:

i) Controlling and overseeing the risk of anti-money laudering and anti-terrorism financing (AML/ATF) in the Group, as second line of defence.

ii) Defining the AML/ATF risk control model in Santander Group.

iii) Creating the reference models for the develoment of the AML/ATF frameworks and their development regulations.

iv) Monitor projects for improvement and transformation plans for AML/ATF and, where appropriate, set in motion supporting or corrective measures.

During 2017, this committee met four times.

The **Reputational Risk Steering committee.** This governance body was created in September 2016 to safeguard proper implementation of the reputational risk model.

The committee is chaired by the Group Chief Compliance Officer, whose main functions are:

i) Supporting implementation of the corporate reputational risk model.

ii) Evaluating sources of reputational risk, and their criticality.

iii) Defining action plans to prevent reputational risk.

iv) Analysing reputational risk events.

v) Specifying processes for escalation and reporting to senior management in matters of reputational risk.

The committee met four times in 2017.

The **Corporate Compliance and Conduct Committee** is the high-level collegiate body of the dompliance and conduct function, bringing together the objectives of the committee's referred to above.

Its main functions are as follows:

i) Monitoring and assessing compliance and conduct risk which could impact Santander Group, as the second line of defence.

ii) Proposing updates and modifications to the general compliance framework and corporate function frameworks for ultimate approval by the board of directors.

iii) Reviewing significant compliance and conduct risk events and situations, the measures adopted and their effectiveness, and proposing that they be escalated or transferred, whenever the case may be.

iv) Setting up and assessing corrective measures when risks of this kind are detected in the Group, either due to weaknesses in established management and control, or due to new risks appearing.

v) Monitoring new regulations which appear or those modified, and establishing their scope of application in the Group, and, if applicable, the adaptation or mitigation measures necessary.

The Corporate and Conduct Committee met nine times in 2017.

C.4.3.2. Organisational model

Derived from the strategic compliance programme and with the objective of attaining an integrated view and management of the different compliance and conduct risks, the function is structured using a hybrid approach in order to combine specialised risks (vertical functions) with an aggregated and homogenised overview of them (transversal functions).

This functional structure was cemented at the Corporate level in the course of 2017.

Transversal functions

Governance, planning and consolidation

a) Governance. Governing and managing the functioning of the compliance and conduct function at the corporate level. Development of training, culture, talent and professional development initiatives and elements in the function, with a long-term approach. Interacting and ensuring the consistency of the relationship with other control and support functions.

b) Planning. Planning and fostering the definition of the compliance and conduct strategy and the necessary resources, carrying out the corresponfing annual planning. Maintaining the compliance and conduct regulatory map and policies. Managing and coordinating the function's internal organisational and human resources processes.

c) Consolidation. Consolidating the various compliance and conduct risks at global level, in coordination with the Risks function. Supervising the application of the mitigation measures and risk assessment plans defined, and monitoring responses to, and the implementation of, requests from regulators. Developing compliance and conduct risk appetite proposals for the Group's risk appetite, through the integration of different local level proposals, as well as coordinating and integrating the different risk assessments carried out. In addition, supervising the monitoring of Internal Audit recommendations.

d) Regulatory radar. Developing and coordinating the creation and administration of the policies and regulation global repository applicable to all units, through a multi-disciplinary process in which different functions participate. Manages the governance aimed at assigning regulatory implementation responsibilities, making the appropriate monitoring.

Coordination with units
Supporting the relationship among compliance and conduct functions of the corporation and of the different units of Santander Group in accordance with its Group/Subsidiaries Governance Model.

This task is carried out through the involvement in the appointment of the CCO of each unit, the establishment of his or her functional goals; coordination, together with specialist teams, of the framing and follow-up of annual compliance and conduct programmes, as well as encouraging an exchange of knowledge and best practices related to the function.

Compliance processes and information systems

a) **Compliance and conduct information systems.** Defining the information management model for the function and developing key indicators.

b) **Information quality, systems and operations.** Defining the function's systems plan, providing a comprehensive compliance and conduct approach to system needs, and prioritising these. Acting as the main channel with the technology and operations function.

c) **Improving processes.** Identifying the map of the function's key processes and associated metrics. Defining and supervising application of the continuous improvement methodology for the processes identified.

d) **Projects.** Leading the function's projects and other projects related to the transformation plan. Coordinating management of requirements with technology and operations teams. Implementing the execution methodology and monitoring projects.

Vertical functions

Regulatory compliance
Control and supervision of regulatory compliance risk events related to employees, organisational aspects, international markets and securities markets, developing policies and regulations, ensuring the units compliance.

Governance of products and consumer protection
Management, control and supervision of governance of products and services in the Group, and risks relating to marketing conduct with customers, consumer protection, and fiduciary and custody risk for financial instruments, developing specific policies and regulations in this regard.

Anti-money laundering and anti-terrorism financing
Management, control and supervision of the application of the anti-money laundering and anti-terrorism financing framework, coordinating analysis of local and Group information to identify new risks that might attract domestic or international sanctions. Analysis of new suppliers and participants in corporate transactions for approval and ensuring units comply with the rules and policies established in this regard.

Reputational risk
Defines, controls and oversees the reputational risk model through prevention and early detection of risks and events and mitigation of any potential impact on the Group's reputation or any impairment to how the Group is perceived by stakeholders (customers, shareholders, investors, employees, public opinion and the wider community).

C.4.4. Regulatory compliance

Functions

The following functions are in place for adequate control and supervision of regulatory compliance risks:

- Implement the Group's General Code Of Conduct and other codes and rules developing the same. Advise on resolving doubts that arise from such implementation.

- Receive and handle the accusations made by employees or third parties via the whistle blowing channel.

- Direct and coordinate investigations into non-compliance, being able to request support from Internal Audit and proposing the sanctions that might be applicable in each case to the Irregularities Committee.

- Control and oversee compliance risk relating to: (i) employee-related events (Corporate Defence); (ii) regulations affecting the Organisation (General Data Protection Regulation – GDPR – and Foreign Account Tax Compliance Act –FATCA); (iii) compliance with specific regulations on international markets (Volcker Rule, EMIR, Dodd-Frank); (iv) publication of relevant Santander Group information; and (v) implementation of policies and rules to prevent market abuse.

- Report significant Group information to the Comisión Nacional del Mercado de Valores, Spain's securities market regulator, and the regulators of other exchanges on which Santander is listed.

- Oversee mandatory training activities on regulatory compliance.

The most relevant areas of the regulatory compliance function are described below:

Employees

The objective - based on the General Code of Conduct - is to establish standards for the prevention of criminal risks and conflicts of interest and from a regulatory perspective, to cooperate with other areas in setting guidelines for remuneration and dealings with suppliers.

In corporate defence (prevention of criminal risks), the responsibility is undertaken to minimize the impact of the criminal responsibility of legal persons for any crimes committed on their account or for their benefit, by their administrators or representatives and by employees as a result of a lack of control.

The Group has in place a corporate defence model designed to implement awareness-raising activities as to the main crime risks across the Organisation. The corporate model began to be introduced in 2016, in the Argentina, Brazil, Chile, Mexico, Poland, Portugal, Consumer (Germany and Headquarters) units, and in the Private Banking units (Bahamas and Switzerland). In 2017, the model was approved locally in Spain, UK and US units.

In June 2017, the Group hosted the First Global Corporate Defence Summit to encourage networking among Group subject matter experts and create a broadly based forum for sharing criminal risk prevention best practices and conduct guidelines for employees across the Group.

In accordance with the General Code of Conduct, Santander Group has whistleblower channels in place in all its geographies. Specifically, in the Group's 10 core units and in Banco Popular there are in place a total 14 whistleblower channels available to employees, with some countries having more than one channel.

Furthermore, in 2017 the Bank created whistleblower channels available to the Group's suppliers in six geographies (Argentina, Brazil, Chile, Spain, Mexico and Portugal). Via these channels, Group suppliers can report conduct breaches in the context of their contractual relationship.

As a rule, whistleblower channels are managed by the compliance and conduct function. Confidentiality is assured and whistleblowers are protected reprisals against the complainants. Santander Group employees can access the whistleblower channels by email, over the web or using an app.

Whistleblower complaints are reported to the relevant governing bodies. In the course of 2017, the management of Compliance and Conduct reported on two occasions on the general state of whistleblower channels and on the irregularity committees attached to the Bank's Audit Committee.

In 2017, a total of 1.300 whistleblower complaints were received across the Group. The main topics of complaint were employment relationships (61%), operational irregularities (23%) and mis-selling (9%).

Approximately 30% of whistleblower complaints led to disciplinary sanctions for at least one of the persons complained of.

A key aspect of the model is mandatory training for all Group employees. In 2017, Santander continued to teach the mandatory training course on the General Course of Conduct and corporate defence.

Finally, in the light of the experience of the compliance and conduct function in managing and applying the General Code of Conduct, over the course of the year, the Bank identified areas for improvement, and the Code has been revised accordingly. Such modifications in this review were presented to and approved by the Bank´s board of directors in November.

Organisational aspects

In response to the launch in 2016 of the European General Data Protection Regulation, throughout 2017 the regulatory compliance function has advised on and supported the processes of adapting to the new rules underway at the Group's different units to ensure compliance with the new requirements, which will become effective in May 2018.

The European General Data Protection Regulation brings about a paradigm shift as to the protection of data on individuals (customers, employees, shareholders, etc.). Entities must collect, store and process personal data in accordance with the principle of proactive accountability.

This new regulatory approach has given rise to new requirements and renewed emphasis on existing ones, including:

- Introduction of technical and organisational measures in the collection, storage and processing of data based on detailed analysis of risks to individuals.
- New rights for data subjects (customers, employees, shareholders, etc.), such as rights of portability and the "right to be forgotten".
- Appointment of a Data Protection Officer (DPO), in charge of overseeing compliance with the rules and acting as a point of contact with the controlling authority.
- Security incident communication to the control authority within 72 hours since its acknowledgement and in case they entail a high risk for individuals.
- Consent obtained tacitly for the treatment of personal data is invalid.

The regulatory compliance function has accordingly taken steps to mobilise and raise awareness among affected units, such as:

- Identifying the scope of companies affected by the rules.
- Communication by the Group's Chief Compliance Officer to the various Country Heads of the need to adapt to the new regulation in their respective jurisdictions.
- Support for countries and units to launch their own projects for adaptation to the European General Data Protection Regulation.
- Monthly monitoring governance of local adaptation projects execution, presided by the Group's Chief Compliance Officer.
- Initiatives for raising awareness among employees by alerting them to the main new features of the European General Data Protection Regulation by producing and launching a training video.

In this domain, regulatory compliance also focuses on reporting and due diligence duties relating to financial accounting in the context of automated exchange of tax data among sovereign states (FATCA and Common Reporting Standard Regulation –CRS). The following were key areas of action in 2017:

- Timely and formally correct fulfilment of all units' reporting duties owed to their local authorities.

- The entry into force of CRS regulations in late-adopter countries (Brazil, Chile, Uruguay, Panama, China and Singapore) has prompted follow-up of adaptation efforts.

- Popular´s Group units units have been included in the FATCA Expanded Affiliated Group Santander.

The role of the compliance and conduct function focuses on ensuring fulfilment of the different units' reporting duties. For this purpose, the Bank has in place a detailed compliance programme that has been adapted by local compliance officers to the specific features of their respective arrangements. The programme is regularly monitored by the corporate team. In addition, the relevant regulatory developments are updated and advised to the units on an ongoing basis.

Market regulations

In 2017, the Group create policies, procedures and processes as required by MIFID II, which entered into force on 3 January 2018, focusing on harmonising the rules on securities markets, trading platforms, algorithmic trading, direct electronic access, tradable financial instruments, organisational matters, transparency and investor protection.

In addition, throughout 2017 the regulatory compliance function was involved in the separation of retail banking and investment banking in the United Kingdom – the ring-fencing process – which is part of the banking reforms in that country. We analysed the regulatory impacts on UK-based entities by reason of this change in business model.

Once the corporate project for adaptation to the US Volcker Rule was implemented, the next stage has been to supervise the compliance with this regulation which limits proprietary trading to very specific cases that the Group controls by means of a compliance programme. Compliance with other specific securities market regulations are also monitored: e.g. in the field of derivatives, the provisions of Title VII of the US Dodd Frank Act or its European counterpart, EMIR (European Market Infrastructure Regulation).

Regulatory compliance is responsible for disclosing relevant Group information to the markets. Banco Santander made public 75 relevant facts in 2017, which are available on the Group's web site (www.santander.com) and the National Securities Market Commission (CNMV) web site (www.cnmv.es). Standouts among these relevant facts were the acquisition of Banco Popular and the rights issue launched in June and August 2017.

Code of Conduct in Securities Markets (CCSM)

The CCSM, supplemented by the Code of Conduct for Analysis Activity, and another series of regulations, contains Group policies in this field and defines, inter alia, the following responsibilities in regulatory compliance:

- Register and control sensitive information known and generated by the Group.

- Maintain the lists of securities affected and related personnel, and watch the transactions conducted with these securities.

- Monitor transactions with restricted securities according to the type of activity, portfolios or collectives to whom the restriction is applicable.

- Receive and deal with communications and requests to carry out proprietary trading.

- Control own account trading of the relevant personnel and manage possible non-compliance of CCSM.

- Identify, register and resolve conflicts of interest and situations that could give rise to them.

- Analyse activities suspicious of constituting market abuse and where appropriate, report them to the supervisory authorities.

- Solve questions on the CCSM.

In 2017, the role of the regulatory compliance function in this area focused mainly on improving coordination with various local compliance units to safeguard Group standards as to market abuse prevention measures. The Bank made considerable strides in implementing corporate procedures supplementing the CCSM (sensitive information, lists of insiders, soundings, Chinese walls breaches, inter alia), distributing training courses and installing in-house CCMS management tool in Mexico and Chile, and of Treasury dealing control in Brazil, Mexico and Chile.

C.4.5. Product governance and consumer protection

The products and consumer protection governance function defines the key elements needed for adequate management and control of commercialisation and consumer protection risks, which are defined as risks arising from inadequate practices in customer relations, the customer treatment and the products offered to customers and their suitability for each specific customer.

This function promotes an appropriate culture in the Santander Group, fostering transparency and a Simple, Personal and Fair approach that protects the interests of customers. To do so, the following functions have been established, and organised based on the commercialisation of products and services and consumer protection corporate framework and a set of policies setting out the basic principles and guidelines in this field.

The corporate framework for the commercialisation of products and services and consumer protection defines the key items for adequate management and control of compliance, conduct and reputational risks arising from commercialisation/distribution, encompassing all phases (design, sale and post-sale). The revised version of this framework was approved by the board of directors in July 2017.

Functions

The following functions are in place for adequate control and supervision of these risks:

- Foster units' adherence to aforementioned corporate framework.
- Facilitate the functions of the corporate commercialisation committee, ensuring correct validation of any new product or service proposed by any Group subsidiary or the parent prior to the launch thereof.
- Gather from local units - and analyse and report to the Group's governance bodies - the information needed to adequately monitor and analyse product and service commercialisation risk throughout the entire life cycle, with a twofold purpose: possible impact on customers and over the Group. Identify and follow up on actions taken to mitigate the detected risks.
- Establish and apply methodologies to assess conduct risks in commercialisation and follow up on such assessments.
- Support internal consumer protection with the objective of improving relations with the Group, effectively preserving their rights, following up customer claims, complaints, survey responses and requests and encouraging good practices. Enhance the Bank's customers's financial knowledge and focus the function on the new challenges posed by innovation in the industry by implementing rules and standards.
- Identify, analyse and control fiduciary risk generated by Private Banking, asset management, insurance and outsourced activity of custody services for customers' financial instruments. Fiduciary risk arises from liability for mismanagement of third-party assets causing loss to the customer, with the concomitant financial or reputational impact.
- Identify and disclose the best practices for commercialisation and consumer protection.

The main activities carried out by this function in 2017 were as follows:

- Developing and strengthening the consumer protection function in the Group. The function is governed by the consumer protection policy approved by the Commercialisation and Compliance Committees in April 2017, and sets specific criteria for identifying, regulating and exercising principles for the protection of consumers in their relationship with the Group, and frames specific guidelines for overseeing compliance with the policy.
- Developing and strengthening the fiduciary risk function in the Group. The function is governed by the fiduciary risk acceptance, monitoring and control policy approved by the Commercialisation and Compliance committees in April 2017.
- Updating corporate procedures for approving products and services, monitoring the marketing of products and services, and managing complaints and root-cause analysis.
- Approving the manual that formally documents the methodology for the commercialization conduct risk self-assessment exercise carrying out an annual exercise having a scope of 17 geographies within the Group and 26 legal entities, where the first line of defence functions assess the main conduct risks relating to marketing and the effectiveness of risk mitigation controls, and set in motion action plans where assessed risk exceeds specified risk appetite.
- In addition to the 148 proposals submitted to the Corporate Commercialisation Committee, the product governance function also analysed:
  - 48 products or services considered to be not new.
  - 55 structured notes issued by Santander International Products Plc. (subsidiary fully owned by Banco Santander), for which the compliance with applicable agreement is reviewed.
  - 123 consultations from different areas and countries for resolution.
- Fiduciary risk management includes the following processes:

  Analysis and processing for corporate validation in the fiduciary risks subcommittee of:

  - 572 requests for the launch, renewal or modification of product characteristics (397 collective investment vehicles and profile discretionary management portfolios, 13 saving/investment insurance, 113 products distributed by Private Banking and 49 structured notes/deposits for Commercial Banking).
  - 64 requests relating to policies, fund and ETF distribution focus lists and requests for opinion from other areas.

  Monitoring of products, and the exposure and performance of the assets of customers managed by the Santander Group or whose management is delegated to a third party. This management includes collective investment vehicles, profiled discretionary management portfolios, and saving and investment insurance products, and involves:

  - The regular assessment of compliance of products' mandates, such that the risk associated to customers' position is always handled in the customer's best interest.
  - The monitoring of the final result of the investments both with regard to the fiduciary relations with the client who expects the best result as well as with regard to competitors.

- Analyse and consolidate complaint information and management thereof from 28 local units and 36 business units and 9 branch offices of SGCB.

- In the custody risk management scope, the function has carried out the following activities:

  - The review of 28 custody services files, approved by different custody services demanding units of the Santander Group, for presentation and validation in the Executive Risk Committee.

  - Monitoring the volume and situation, according to corporate procedures regarding the monitoring of providers of custody services, of more than the 51 current providers (42 of them external to Santander Group) that provide custody services for Santander Group in its own or its clients.

Corporate projects

Analysis of the governance and systems of remuneration of the sales force to assess the degree of implementation of the corporate policy on remuneration and identify areas for improvement and introduction of good practices across the Group.

C.4.6. Anti-money laundering and anti-terrorism financing

One of Santander Group's strategic objectives is to maintain an advanced and efficient anti-money laundering and anti-terrorism financing system, constantly adapted to international regulations, with the capacity to confront the development of new techniques by criminal organisations.

Money laundering and terrorism financing are pervasive, globalised phenomena that leverage the opportunities of the international economy and the gradual removal of barriers to worldwide exchange and trade for unlawful purposes. Santander Group acknowledges the importance of the fight against money laundering and terrorism financing, which affect vital aspects of the life of the community. The Group actively cooperates with the competent authorities, in this matter.

- Management and control of money laundering and terrorism financing prevention in the Group is based on the principles set out in the general compliance and conduct framework and in the corporate AML/ATF framework, on the rules, standards and recommendations issued by a range of international bodies and institutions, such as the Basel committee on Banking Supervision and the Financial Action Task Force (FATF), and the duties and obligations arising from EU directives.

- The corporate AML/ATF framework sets out principles of action in this domain, and sets minimum standards of application for local units. Local units are responsible for managing and coordinating the systems and procedures of prevention of money laundering and terrorism financing in the countries in which the Group operates. They also investigate and process communications relating to suspicious transactions and information requirements from supervisory bodies. Each local unit has appointed an officer with responsibilities for this function.

- The Bank has in place a technological infrastructure supporting ongoing improvement of systems and processes in all units, based on technological systems that enable the Corporate function to obtain local management information and data, as well as of reporting, monitoring and control. These systems allow for active and preventive management in the course of analysis, identification and monitoring of activities that might be linked to money laundering or terrorist financing.

- The Santander Group is a founding member of the Wolfsberg Group, with other major international financial entities, which works to establish international standards and develop initiatives to improve the effectiveness of programmes in this area. Supervisory 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. The Group's key actions in this domain include:

  - Participation in a range of working groups and/or sessions regarding different topics.

  - Collaboration and elaboration of the Wolfsberg Knowledge Questionnaire and several best practice guidelines.

  - Participation in consultations with the private sector initiated by international organisations (FATF, UNODC, EU, etc.) and private institutions (FSB, SWIFT, FFIS, etc.).

The prevention organisation covers 167 different Group units established in 34 countries. Over one thousand Group professionals currently carry out the anti-money laundering/anti-terrorism financing function.

The main activity data in 2017 are as follows:

- Subsidiaries reviewed: 167

- Investigations: 152,253

- Disclosure to authorities: 41,204

- Employee training: 166,322

The Group has training plans in place at both local and corporate level, in order to cover all employees. Specific training plans are also in place for the most sensitive areas from the perspective of anti-money laundering and anti-terrorism financing.

C.4.7. Reputational risk

In 2017, the Group made significant progress implementing the corporate reputational risk model, which is now embedded in the Corporation.

The specific characteristics of reputational risk are a vast number of sources that requires a unique approach and control model, separate from other risks. The reputational risk management requires for a global interaction with both first and second lines of defence functions and with management functions in relation to the stakeholders in order to ensure a consolidated supervision of the risk, efficiently supported on the current control frameworks. The aim is for reputational risk to be integrated into both business and support activities, and internal processes, thus allowing the risk control and oversight functions to integrate them in their activities.

The reputational risk model is accordingly based on a prominently preventive approach to risk management and control, and also on effective processes for identification and early warning management of events, and subsequent monitoring of events and detected risks.

So as to achieve suitable control and oversight of reputational risks, the function – as a second line of defence – is in charge of the following:

- Defining and implementing the reputational risk model and related methodologies, highlighting the development and update of the model, the development of a specific methodology for this risk identification, setting reputational risk appetite, and developing reputational risk policies and controls.
- Preventive risk management, highlighting the monitoring of external and internal sources to identify reputational risk events, and advising, monitoring and challenging the first and second lines of defence and decision-making bodies (for decisions carrying reputational risk). In connection with reputational risk-related topics, assess the analysis of stakeholder perceptions and action plans, and validate and challenge risk management action plans.
- Safeguard and support reputational risk event management, offering specialised advice to any function or working group that might be affected by reputational risk.
- Information and reporting management.

Key actions:
Within the reputational risk management and control activities developed during the year, together with its daily management, the following are highlighted:

- Launch and development in the adoption and implementation of the model in the Group's various geographies.
- Coordination with all corporate and local units to implement socio-environmental policies.
- Implementation and development of policies relating to specific sectors (mining, soft commodities, defence and energy).
- Development of specific processes to detect and report risks and events in the Group's various geographies and use of specific management indicators.
- Definition and reporting of risk appetite metrics.
- The Bank has moved forward with identifying and monitoring reputational risk events, focusing on mitigating the effect, as well as a preventive approach when managing reputational risks.
- In conjunction with the relevant functions, development of other reputational risk-related policies, such as financing policy for sensitive sectors.
- Implementation of general training on reputational risk: general training for local CCO´s, and development of an awareness video regarding the implementation of the social-environmental policies featuring top management.

C.4.8. Risk assessment model of Compliance and Conduct and risk appetite

The Group sets out the type of compliance and conduct risks that it is not willing to incur - for which it does not have a risk appetite - in order to clearly reduce the probability of any economic, regulatory or reputational impact occurring within the Group. Compliance risk is organised by a homogeneous process in units, by establishing a common taxonomy, according to the standards of the Risks function, which consists of setting a series of compliance risk indicators and assessment matrices which are prepared for each local unit, as well qualitative statements.

With this objective, during 2017 the development and implementation of said appetite has been carried out in the Group's units within the established perimeter. Likewise, the annual formulation of the risk appetite has been carried out at the end of the year, with the objetive to verify that the current model is adequate to measure the function's risk appetite. To this end, the corporate thresholds of three of the indicators were adjusted, reducing them, in order to provide a more accurate image and be able to show an alignment with the strategy of the function and its risk tolerance. These adjustments were approved in the corresponding committees and transferred to the different units.

As in previous years, the compliance and conduct function carried out a regulatory risk assessment exercise in 2017, focused on the main units of the Group. Annually, this exercise is carried out, following a bottom-up process, where the first lines of the local units identify the inherent risk of those rules and regulations that apply to them. Once the consistency of the controls mitigating this inherent risk is assessed, the residual risk of each of these obligations is determined, establishing, as the case may be, the corresponding action plans.

Similarly, the risk assessment exercise regarding conduct was carried out in the marketing and execution of the annual exercise with a scope of 17 geographies of the Group and 26 legal entities, where the first line defence functions evaluate the main risks of conduct in marketing, the suitability of the controls that mitigate said risks and establish action plans in those cases where risk assessments exceed the defined risk appetite.

In addition, in 2017, the compliance and conduct function carried out the annual money laundering and terrorism financing (ML/TF) risks self-assessment exercise, on the units considered as Obligatory Subjects in this matter (or equivalent) in the Santander Group. This annual self-assessment exercise is carried out by the business units and the local ML/TF prevention officers, under the supervision of the corporation's ML/TF prevention function. In this regard, the methodology adopted by the Group for the assessment of ML/TF risks of each of the units is based on a three-phase process: 1. Evaluation of the unit's inherent risk (derived from its activity), 2. Evaluation of the control environment (as a mitigating element of the inherent risk) and 3. Calculation of the net residual risk (obtained by combining the previous 2 according to a predefined scale). Where appropriate, and depending on the result obtained, the corresponding action plans are linked.

In addition, and in coordination with the risk function, a convergence plan has been established to integrate the joint vision of non-financial risks into a common tool called *Heracles*. To this end, work has been carried out throughout the year on a plan to jointly coordinate all the risk assessments carried out in 2017 for the first line of defence (Regulatory Risk Assessment, Risk Assessment of Conduct and Risk Assessment of Operational Risk) in such a way that they were carried out simultaneously in the same period of time; supported by Heracles, the corporate tool; and their results being jointly presented to the different corporate committees in the first quarter of 2018.

C.4.9. Transversal corporate projects

In accordance with the organisational principles defined in the TOM, transversal functions support specialised vertical functions, providing them with methodologies and resources, management systems and information and support in executing multi-disciplinary projects.

In 2016 -first year of these transversal functions existance- a great deal of progress was made in the four main areas:

- Development of the organisational structure of the function and the necessary needs for its correct functionality and its impact monitoring.
- Development of a new compliance and conduct culture based on the Simple, Personal and Fair culture and aligned with the spirit of the TOM.
- Promoting data systems to support and implement a continuous improvement methodology in the processes of the Bank.
- Organisational development and monitoring TOM's degree of maturity in units.

During 2017, special efforts have been made to recruit new human resources profiles for the compliance and conduct function who promote and assist in transforming the function.

One of the key pillars of all the corporate functions is monitoring the units' deployment of models. To that end, a methodology is currently being developed:

- To acquire an objective knowledge of the TOM's degree of deployment in each one of the units.
- Regularly follow up on progress in deploying the model.
- Be used as a source for joint identification (Group-units) of the work plans defined every year.

At the corporate centre over the course of 2017, documentation was completed on the processes of the compliance and conduct function, identifying teams' core activities and the related risks and operational controls. After the documentation stage, over the course of the year we held meetings for ongoing improvement via a "process enhancement community" involving the "owners" of the processes addressing the various risks, so as to identify and implement improvements in the productivity and effectiveness of compliance activities.

Against this background, in the first quarter of 2018 new digitised processes will be deployed for financial intelligence and corporate transactions. The compliance and conduct function is pioneering the use of BPM (Business Process Management) methods to improve its processes. The Bank plans to extend this practice to the main compliance and conduct processes at the corporate centre and local units over the next two years.

As to Information Systems, the technology strategy agreed with the Technology and Operations unit, continue to roll out. In 2017, the digital compliance and conduct strategy was updated, focusing resources and priorities on the following lines of action:

- Online cooperation with Group units, fostering platforms and structured spaces for information exchange, such as the "Compliance Portal" and the "VERUM platform for TOM maturity assessment".
- Risk assessment, completing existing functionalities on the *Heracles* platform, to which in 2017 we added risk assessment for the AML and corporate defence domains.
- Access to external information sources to enhance compliance control processes (regulatory sources, online media, stakeholder perceptions, etc.).
- Digitalization of internal processes to improve productivity and effectiveness.
- Management information and analytical environments, leveraging new Big Data and Multidimensional Reporting capabilities to enhance generation and distribution of compliance and conduct management reports and optimise the response to money laundering and terrorist financing alerts.

At the corporate centre, compliance and conduct is now rolling out the regulatory management system (Regulatory Radar), which will lead to integration on a single platform of new regulation capture, analysis of applicability and materiality for the Group, break-down into actionable duties and obligations, and follow-up of the process of implementing required changes. The system is expected to be deployed to local units in 2018, along with automatic integration of regulatory sources.

Finally, the implementation and deployment of the APAMA system is being carried out in the Group's units, in order to control market abuse scenarios.

As to information management, the Bank has implemented new report templates that support the governance and reporting of all risk families, and the respective consolidated view of compliance and conduct risks. The new reporting templates are organised into common chapters (executive summary, risk profile, appetite, management metrics, etc.), with dimensions by family (admission of products, sale and after-sale, customer on-boarding, AML alerts, etc.), and combine quantitative metrics and expert qualitative analysis. As mentioned in the systems chapter, Santander is working on automating the generation and distribution of these reports.

As in previous years, the development of these new reporting tools are part of the data governance model spearheaded by the Chief Data Officer (CDO). This assures the quality of information supplied to senior management.

In 2018, a common compliance and conduct risks report template across the Group's various units will be rolled out.

Finally, throughout 2017 the compliance and conduct function continued to drive forward the implementation of MiFID II rules throughout the Group's units attracting the application of this regulation. Headed by the GCCO, the Project Management Office (PMO MiFID) has continued its role of planning, coordinating and monitoring local implementation programs, focusing on the regulatory, business, operational and technology dimensions. Monthly project follow-up meetings have been held (SteerCo), attended by the GCCO and local unit sponsors. A progress report on the project has been submitted to the Group's management committee and the RSRCC. Lastly, within the MiFID II training programme, training sessions are scheduled for compliance governance bodies and the board.

C.5. Model risk

The Santander Group has far-reaching experience in the use of models to help make all kinds of decisions, and risk management decisions in particular.

A model is defined as a system, approach or quantitative methods which applies theories, techniques or statistical, economic, financial or mathematical hypotheses to convert input data into quantitative estimates. The models are simplified representations of real world relationships between observed characteristics, values and observed assumptions. By simplifying in this way, the Group can focus attention on the specific aspects which are considered to be most important to apply a certain model.

Use of models entails model risk, defined as the risk of loss arising from inaccurate predictions that prompt the Bank to take sub-optimal decisions, or misuse of a model.

According to this definition, the sources of Model Risk are as follows:

- the model itself, due to the utilisation of incorrect or incomplete data, or due to the modelling method used and its implementation in systems,

- improper use of the model.

The materialisation of model risk may prompt financial losses, inadequate commercial and strategic decision making or damages to the Group's reputation.

Santander Group has been working towards the definition, management and control of model risk for several years. Since 2015, a specific area has been put aside to control this risk, within the Risk division.

Model risk management and control functions are performed in the Corporation and in each of the Group's core entities. These functions are guided by the model risk management model, with principles, responsibilities and processes that are common across the Group. The model addresses organisation, governance, model management and model validation, among other matters.

The Model Risk Control Committee, chaired by the Deputy Chief Risk Officer, is the collegiate body responsible for supervision and control of model risk at Santander. The aim of the Committee is to effectively control model risk, advising the Chief Risk Officer and the Risk Control Committee to ensure that model risk is managed in accordance with the Group risk appetite approved by the board of directors, which includes identifying and monitoring current and emerging model risk and its impact on the Group's risk profile.

The responsibility of authorising the models use falls under the local model committees and its ratification is provided by the corporate model approval subcommittee. Currently there is a delegation scheme whereby certain models, according to their tier, do not require corporate ratification, being the corporate model approval subcommittee periodically informed.

Senior management at Santander has an in-depth knowledge of the key models. In addition, senior management regularly monitors model risk in a set of reports that provide a consolidated view of the Group's model risk and enable decisions to be taken in this regard.

Model risk management and control is structured around a set of processes regarded as the model life cycle, as described below:

1 Identification → 2 Planning → 3 Development → 4 Validation → 5 Approval → 6 Implementation and use → 7 Monitoring and control

1. Identification

As soon as a model is identified, it is necessary to ensure that it is included in the control of the model risk.

One key feature of proper management of model risk is a complete exhaustive inventory of the models used.

The Group has a centralised inventory, created on the basis of a uniform taxonomy for all models used at the various business units. The inventory contains all relevant information on each of the models, enabling all of them to be properly monitored according to their relevance. One of the key data points in the inventory that determines the management approach to the model is the tier to which the model belongs. The tier reflects the relevance of a model taking into account quantitative criteria and other significant qualitative criteria.

The inventory enables transversal analyses to conducted on the information (by geographic area, types of model, importance etc.), thereby easing the task of strategic decision-making in connection with models.

2. Planning

All parties who take part in the model life cycle play a role in this phase (owners and users, developers, validators, data suppliers, technology, etc.), agreeing on and setting priorities regarding the models which are going to be developed, reviewed and implemented over the course of the year.

This planning takes place once a year at each of the Group's main entities, and is approved by local governance bodies, and ratified by the Corporation.

3. Development

This is the model's construction phase, based on the needs established in the model plan and with the information provided by the model owners for that purpose.

Most of the models used by Santander Group are developed by internal methodology teams, though some models are also outsourced from external providers. In both cases, the development must take place using common standards for the Group, and which are defined by the corporation. By this means, we can assure the quality of the models used for decision-making purposes.

4. Independent validation

Internal validation of models is not only a regulatory requirement in certain cases, but it is also a key feature for proper management and control of the Santander Group’s model risk.

Hence, a specialist unit is in place which is independent of both developers and users, draws up a technical opinion of the suitability of internal models to their purposes, and sets out conclusions concerning their robustness, utility and effectiveness. The validation opinion takes the form of a rating which summarises the model risk associated with it.

The internal validation encompasses all models under the scope of model risk control, from those used in the risk function (credit, market, structural or operational risk models, capital models, economic and regulatory models, provisions models, stress tests, etc.), up to types of models used in different functions to help in decision making.

The scope of validation includes not only the more theoretical or methodological aspects, but also IT systems and the data quality they allow, which determines their effectiveness. In general, it includes all relevant aspects of management in general (controls, reporting, uses, senior management involvement etc.).

This corporate internal validation environment at the Bank is fully aligned with the internal validation criteria of advanced models produced by the financial regulators to which the Group is subject. This maintains the criterion of a separation of functions for units developing and using the models, internal validation units and internal audit as the ultimate layer of control, checking the effectiveness of the function and its compliance with internal and external policies and procedures, and commenting on its level of effective independence.

5. Approval

Before being deployed and thus used, each model has to be presented to be approved in the appropriate bodies, as established in the internal regulations in force at any given time, and in the approved delegation schemes.

6. Deployment and use

This is the phase during which the newly developed model is implemented in the system in which it will be used. As indicated above, this implementation phase is another possible source of model risk, and it is therefore essential that tests be conducted by technical units and the model owners to certify that it has been implemented pursuant to the methodological definition and functions as expected.

7. Monitoring and control

Models have to be regularly reviewed to ensure that they function correctly and are adequate for the purpose for which they are being used, or, otherwise, they must be adapted or redesigned.

Also, control teams have to ensure that the model risk is managed in accordance with the principles and rules set out in the model risk management model and related internal regulations.

C.6. Strategic risk

Strategic risk is the risk of loss or harm arising from strategic decisions or poor implementation of decisions affecting the long-term interests of the Group's main stakeholders, or inability to adapt to changes in the environment.

The Entity's **business model** is a key factor for strategic risk. It has to be viable and sustainable, and capable of generating results in line with the Bank's objectives and over time. Within the strategic risk, three components are differentiated:

- **Business model risk:** the risk associated with the Entity's viability business model. This risk is caused both by external factors (macroeconomic, regulatory, social and political questions, changes in the banking industry, etc.) and also internal ones (strength and stability of the income statement, distribution model/channels, revenue and expenses structure, operational efficiency, adequacy of human resources and systems, etc.).

- **Strategy design risk:** the risk associated with the strategy set out in the entity's five-year strategic plan. Specifically, it includes the risk that the strategic plan may not be adequate per se, or due to its assumptions, and thus the Bank will not be able to deliver on its unexpected results. It is also important to consider the cost of opportunity of designing another more adequate strategy.

- **Strategy execution risk:** the risk associated with executing long-term three-year strategic financial plans. The risks to be taken into account include both the internal and external factors described above, the inability to react to changes in the business environment, and, lastly, risks associated with corporate development transactions (those which imply a change in the entity's perimeter and activity, acquisitions or disposals of significant shareholdings and assets, joint ventures, strategic alliances, shareholders' agreements and capital operations) which may also affect the strategic execution.

For Santander, strategic risk is considered to be a transversal risk, and counts with a strategic **risk control and management model** which is used as a reference for Group subsidiaries and contemplates procedures and tools for its adequate monitoring and control:

- **Long-term strategic plan and three-year plan:** the strategic risk function, with the support of different areas of the Risk division, monitors and challenges, in an independent way, the risk management activities performed by the strategy function, incorporating an integrated section, although independent, of the long-term strategic plan and three-year financial plan (risk assessment).

- **Corporate development operations:** the strategic risk function, with the support of different areas of the Risk division, ensures that the corporate development operations consider an adequate risk valuation and its impact in both risk profile and appetite.

- **Top Risks:** according to section B. Background and upcoming challenges, the Group identifies, evaluates and monitors those risks that have a significant impact on the Entity's results, liquidity or capital, or risks that might involve undesirable concentrations affecting the entity's financial health, differentiating four main categories: i) macroeconomic and geopolitical, ii) competitive environment and customers, iii) regulatory environment, and iv) internal factors.

  Awareness of these risks is a necessary input to strategic risk management and control, with the support of all business areas in partnership with the Bank's risk areas. These risks are reported regularly to senior management via a governance process that allows for appropriate monitoring and mitigation.

- **Strategic Risk report:** it is a report performed jointly by the strategy function and strategy risk, as a combined tool for the monitoring and strategy valuation, as well as associated risks. This report is sent to the board of directors and contains: strategy execution, strategical projects, corporate development operations, business model performance, main threats (Top risks) and risk profile.

C.7. Capital risk

C.7.1. Introduction

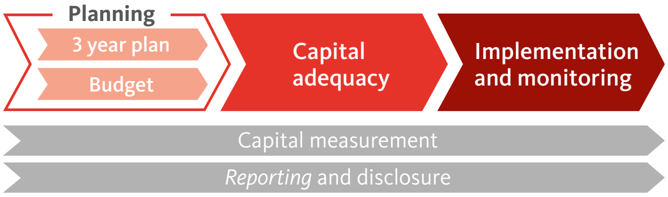
Santander Group defines capital risk as the risk that the Entity does not have sufficient capital, in quantitative or qualitative terms, to fulfil its internal business objectives, regulatory requirements, or market expectations.

The capital risk function, in its capacity as second line of defence, controls and oversees the activities of the first line of defence chiefly by means of the following processes:

- Supervision of capital planning and adequacy exercises through a review of all their components (balance sheet, profit and loss account, risk-weighted assets and available capital).
- Ongoing supervision of the Group's capital measurement activities, including single operations with capital impact.

The function is designed to carry out full and regular monitoring of capital risk by verifying that capital is sufficient and adequately covered in accordance with the Group's risk profile.

Capital risk control focuses on the capital management model established in the Group, bringing together a range of processes, such as capital planning and adequacy and the subsequent budget execution and monitoring, alongside the ongoing measurement of capital and the reporting and disclosure of capital data, as described in the following chart:



C.7.2. Implementation of functions

Supervision of capital planning and adequacy exercises

The review by the Risks function of capital planning and adequacy exercises ensure that capital is consistent with the established risk appetite and risk profile.

With this objective, the process of all significant risks to which the Group is exposed in the course of its business is evaluated. In addition, it contributes to ensure that the methods and assumptions used in capital planning are appropriate and that the capital forecast calculations are reasonable with the scenarios used, volumes forecast, coherence between exercises, among others.

This function is implemented in stages, according to the following scheme:

Definition of scope
The process starts by deciding which units are to be assessed on the basis of their significance for the Group, and which lines of business or portfolios are to be evaluated having regard to their importance within the strategy undertaken by the subsidiary or by the Group, so as to attain an appropriate level of materiality.

Qualitative analysis
At this stage, the overall quality of the process in generating forecasts is assessed. This involves a review of the models used and the macroeconomic scenarios, scope, metrics, granularity, consistency with previous periods, etc.

Quantitative analysis

The specified metrics and components that affect forecasts of pre-provision net revenue (PPNR), of provisions, of risk-weighted assets and available capital are quantitatively assessed. The tests conducted include analysis of volumes, trends, reasonableness and cross-checks against the development of macroeconomic variables and historic data series.

This stage calls for the involvement and appropriate coordination of all subsidiaries within the scope of the process, to conduct analysis of local projections, which in turn underpin Group-level projections.

Conclusions and disclosure

Based on the outcomes from the capital planning and adequacy stages, the Group conducts a final assessment, at least encompassing the scope of analysis and the areas for improvement detected in the course of the supervision process, reporting to senior management in accordance with the established governance.

Ongoing supervision of capital measurement

As mentioned before, another function of capital risk control is the supervision and control of the integrity of the capital measurement process, in order to ensure a suitable capital risk profile.

For this purpose, Santander Group conducts qualitative analysis of the regulatory and supervisory framework and ongoing review of capital metrics and specified thresholds.

Moreover, ongoing compliance monitoring of the capital risk appetite is carried out, maintaining capital above the regulatory requirements and market demands.

To fulfil this function, the following stages have been established, in accordance with the process described below:

Definition of metrics and thresholds

A set of metrics and thresholds that are used in the supervision process and provide the capital risk monitoring and control vision are annually specified.

Preliminary analysis

At this stage of the control process, the qualitative issues, such as process governance and the regulatory framework are analysed.

In addition, the steps taken in connection with capital to fulfil recommendations and instructions issued by supervisory authorities in the exercise of their powers and by the Internal Audit function are examined.

Measurement assessment

At this stage, the scope of the exercise in accordance with the significance of subsidiaries' contribution to the Group is delimited. Moreover, these subsidiaries and/or portfolios are included, despite not being material in themselves, but are regarded by the Group as requiring analysis at that specific juncture.

After delimiting the scope, the specified metrics and thresholds are reviewed, analysing any excess over stipulated thresholds, with a statement of the reasons for the deviation. This allows for detailed review of the reliability of capital measurement.

Furthermore, to ensure the capital measurement integrity, more in-depth analysis of specific aspects of the process are carried out, if deemed necessary.

Conclusions and disclosure

Based on the outcomes of the capital measurement stages, a final assessment is conducted that will include the scope of analysis and the improvement aspects detected in the course of the supervision process, reporting to senior management.

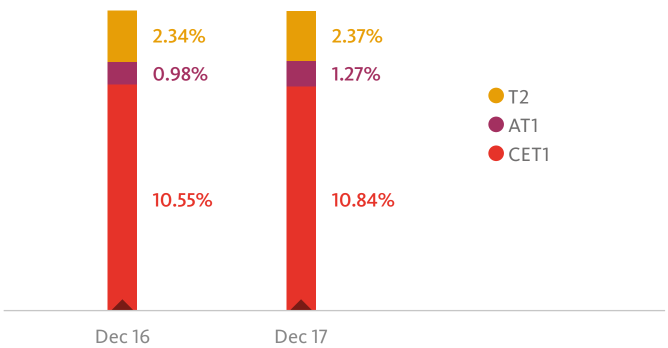
Within the capital measurement control process, the Bank uses the following **metrics:**

Capital ratios evolution

During 2017 the Group ratios evolved positively achieving a total capital ratio of 14.48%, demonstrating the Group's ability to generate capital organically.

KEY REGULATORY CAPITAL FIGURES (FL)

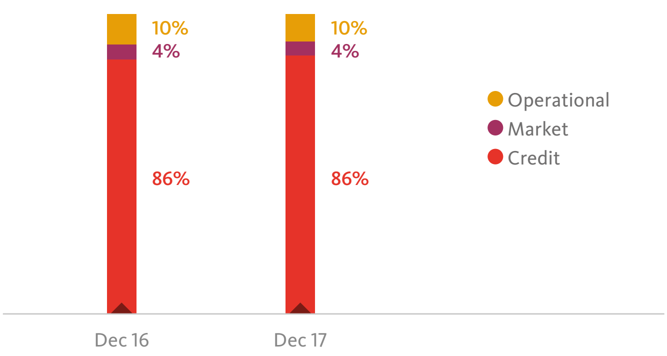
%	2017	2016	Variation bp
CET1 Ratio	10.84%	10.55%	+29
Tier 1 Ratio	12.11%	11.53%	+58
Total Capital Ratio	14.48%	13.87%	+61
Leverage Ratio	5.02%	4.98%	+4
Million euro			Variation %
CET1	65,563	62,068	+5.6%
Tier 1	73,293	67,834	+8.0%
Total capital	87,588	81,584	+7.4%
RWA	605,064	588,089	+2.9%



Change in RWAs by risk type

The composition of the Group's RWAs did not change significantly in 2017. A key component was the contribution of credit risk, exceeding 86% in 2017. Market risk was relatively immaterial.

RWA BY RISK TYPE

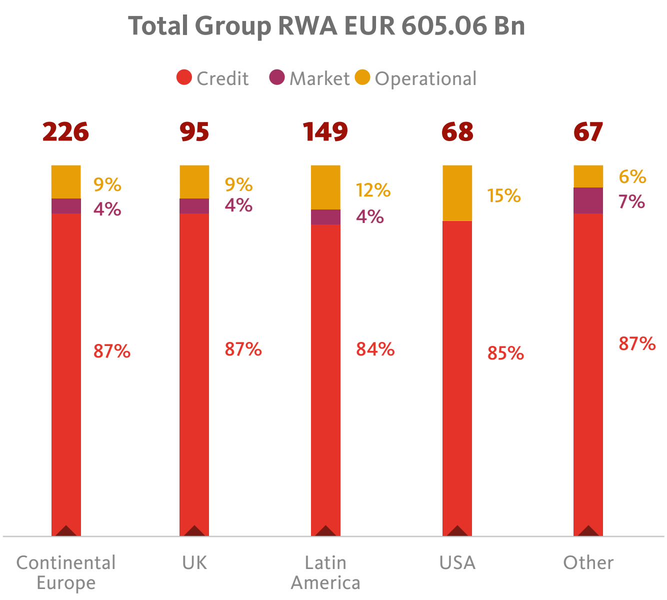


Breakdown of RWAs by core geographies and risk types

The Group's credit portfolio as of December 2017 stood at 519,643 million euros of RWAs, accounting for 86% of the Group's RWAs. By the main geographies, in which the Group operates, the Group's RWA contribution percentage is the following:

RWA BY GEOGRAPHY

Billion euros



6

ANNEX


BIENVENUE
BIENVENIDO
WELCOME
BEM-VINDO
WILLKOMMEN
WIFI
WORK
CAFÉ
SANTANDER

HISTORICAL DATA. 2007 - 2017

Balance sheet	US$ Mill.	2017 € Million	2016 € Million	2015 € Million	2014 € Million	2013 € Million
Total assets	1,732,155	1,444,305	1,339,125	1,340,260	1,266,296	1,134,128
Net customer loans	1,018,103	848,914	790,470	790,848	734,711	684,690
Customer deposits	932,732	777,730	691,111	683,142	647,706	607,836
Total customer funds	1,182,154	985,703	873,618	849,403	809,494	743,750
Total equity	128,124	106,832	102,699	98,753	89,714	80,298

Income statement						
Net interest income	38,661	34,296	31,089	32,189	29,548	28,419
Gross income	54,552	48,392	43,853	45,272	42,612	41,920
Net operating income	28,716	25,473	22,766	23,702	22,574	21,762
Profit before taxes	13,630	12,091	10,768	9,547	10,679	7,378
Attributable profit to the Group	7,461	6,619	6,204	5,966	5,816	4,175

Per share data*	US$	2017 Euros	2016 Euros	2015 Euros	2014 Euros	2013 Euros
Attributable profit to the Group	0,46	0,40	0,40	0,40	0,47	0,38
Dividend	0,26	0,22	0,21	0,20	0,59	0,59
Share price	6,571	5,479	4,877	4,483	6,881	6,399
Market capitalisation (million)	76,226	88,410	72,314	65,792	88,041	73,735

Euro / US$ = 1.199 (balance sheet) and 1.127 (income statement)
(*) Figures adjusted to capital increases

2012 US$ Mill.	2011 € Million	2010 € Million	2009 € Million	2008 € Million	2007 € Million
1,282,880	1,251,008	1,217,501	1,110,529	1,049,632	912,915
731,572	748,541	724,154	682,551	626,888	571,099
626,639	632,533	616,376	506,976	420,229	355,407
756,375	763,989	761,923	651,289	551,291	515,393
81,747	80,813	80,914	73,871	60,001	57,558

31,914	28,883	27,728	25,140	20,019	14,443
44,989	42,466	40,586	38,238	32,624	26,441
24,753	23,055	22,682	22,029	17,807	14,417
3,565	7,858	12,052	10,588	10,849	10,970
2,283	5,330	8,181	8,943	8,876	9,060

2012 US$	2011 Euros	2010 Euros	2009 Euros	2008 Euros	2007 Euros
0,23	0,59	0,93	1,03	1,20	1,31
0,59	0,59	0,59	0,59	0,62	0,60
6,000	5,773	7,798	11,360	6,639	13,563
62,959	50,290	66,033	95,043	53,960	92,501

Glossary

Additional Tier 1: capital mainly constituted by debt instruments convertible into shares (hybrids) in case of a contingent event (usually when the CET1 ratio drops below a certain value).

Advanced IRB approach: all the risk parameters are internally estimated by the bank, including CCF (credit conversion factors) to calculate the EAD.

Advanced Risk Management: programme to accelerate the implementation of strategic projects to improve risk management capacity and control.

ALM (Asset liability management): a series of techniques and procedures to ensure correct decision-making on investments and funding at the entity, taking into consideration the interrelation between the various on- and off-balance sheet items.

AQR (Asset Quality Review): asset quality review exercise performed by the European Central Bank.

Attributable profit: the portion of consolidated profit that corresponds to owners of the Group's ordinary shares.

Back-testing: the use of historical data to supervise the return on risk models.

Basel III: a set of amendments to the Basel II regulations, published in December 2010, which came into force in January 2013 and will be gradually implemented until January 2019.

Basic IRB approach: all the risk parameters are determined by the regulator except for the probability of default, which is internally estimated by the bank. The credit conversion factors required for calculating the EAD are determined by the regulator.

BCBS: Basel Committee on Banking Supervision.

BIS: Bank for International Payments.

BRRD (Bank Recovery and Resolution Directive): approved in 2014, it establishes the European framework for bank recovery and resolution in order to minimise the cost for taxpayers.

CB (Conservation buffer): a capital buffer equal to 2.5% of risk-weighted assets (and comprised fully of high quality instruments) to absorb losses generated from the business.

CCAR (Comprehensive capital analysis review): the Federal Reserve's evaluation of the planning and capital adequacy process of the US's main banks.

CCB (Counter cyclical buffer): buffer whose objective is to mitigate or prevent cyclical risks arising from excessive growth in lending at aggregate level. Accordingly, the CCB is designed to build up capital buffers during expansionary phases with a dual objective: to bolster the banking system's solvency and stabilise the credit cycle.

CCP (Central Counterparty Clearing House): responsible for clearing and settlement, facilitating trading in shares and derivatives in international markets.

CDS (Credit default swap): a derivatives contract that transfers the credit risk of financial instrument from the buyer (who receives the credit protection) to the seller (who guarantees the instrument's solvency).

CoCos (Contingent convertible bonds): debt securities convertible into capital if a specified event occurs. AT1 instruments are a type of CoCo.

Common equity: a capital measure that takes into account, among other components, ordinary shares, the share premium and retained earnings. It does not include preferred shares.

Common Equity Tier 1: an entity's highest quality capital, consisting of equity mainly constituted by ordinary shares and retained earnings and excluding preferred shares.

Concentration risk: the risk of loss due to large exposures to a small number of debtors to which the entity has lent money.

Cost of credit: a measure of credit quality, calculated as the ratio between loan-loss provisions and total lending

Coverage of non-performing loans: a risk quality indicator, expressed as the percentage of loans considered as doubtful which are covered by loan-loss provisions.

Credit risk mitigation: a technique to reduce the credit risk of a transaction by applying coverage such as personal guarantees or collateral.

Credit risk rating: the result of the objective evaluation of the future economic situation of the counterparties based on current features and assumptions. The methodology for assigning ratings depends largely on the type of customer and on the available data. A wide range of methodologies to assess credit risk is used, such as expert systems and econometric methods.

CRM (Customer Relationship Management): systems to manage customer relations.

CRR (Capital Requirements Regulation) and CRD IV (Capital Requirements Directive): these incorporate European rules to the legal framework of Basel III.

CSP (Commercial Strategic Plan): management model for coordinating the planning and control of loan portfolios at Santander Group, in which all those areas involved in managing portfolios (risk, business, management control, capital, financial management) participate in a comprehensive and coordinated way.

CVA (Credit Valuation Adjustment): valuation adjustment of over-the-counter (OTC) derivatives as a result of the risk associated with the credit exposure assumed by each counterparty.

Derivatives: financial instruments that derive their value from the performance of an underlying asset or index, e.g. bonds, currencies or stock market indices.

Digital customers: for Santander a digital customer is an individual or a company who, being a customer of a retail bank, has started to use online banking, mobile banking or both, in the last 30 days.

DTA: Deferred tax assets.

DVA (Debt Valuation Adjustment): valuation adjustment similar to the CVA, but in this case as a result of the risk with the Group assumed by its counterparties in OTC derivatives.

EAD (Exposure at default): the amount that the entity could lose in the event of counterparty default.

EBA (European Banking Authority): created in 2010, it began to operate in 2011. The EBA acts as a coordinator between the national entities responsible for safeguarding values such as the financial system's stability, transparency of markets and financial products, and the protection of bank customers and investors.

ECB Governing Council: the main decision-making body of the European Central Bank, consisting of all the members of the Executive Board and the governors of the national central banks of the euro zone countries.

Economic capital: the figure that demonstrates to a high degree of certainty the quantity of capital resources the Group needs at a given point in time to absorb unexpected losses arising from its current exposure.

EDTF (Enhanced Disclosure Task Force): task force that issues recommendations to enhance the transparency of information that banks disclose to the market.

Efficiency ratio: calculated as the ratio between operating costs and gross income. It measures how many euros an entity needs to spend in order to generate €1 of revenue (an efficiency ratio of 50% means an entity needs to spend €0.5 to generate €1 of revenue).

EL (Expected loss): a regulatory calculation of the average amount expected to be lost on an exposure, using a 12-month time horizon. EL is calculated by multiplying probability of default (a percentage) by exposure at default (an amount) and LGD (a percentage).

EPS (earnings per share): calculated by dividing a company's profits for the period by the number of shares comprising its share capital.

ESRB (European Systemic Risk Board): the body that has been charged with macroprudential supervision of the European Union's financial system in order to contribute to preventing or mitigating the systemic risk to financial stability.

Exposure: the gross amount that the entity could lose if the counterparty is unable to meet its contractual payment obligations, without taking into consideration the impact of any guarantees, credit enhancements or credit risk mitigation transactions.

Fully-loaded: denotes full compliance with Basel III capital adequacy requirements (mandatory in 2019).

FSB (Financial Stability Board): international institution that monitors and makes recommendations on the global financial system.

GHOS (Group of Governors and Heads of Supervision): supervisory body of the Basel Committee.

G-SIB (Global Systemically Important Bank) or SIFI (Systemically Important Financial Institution): a framework is in place to mitigate the possible impact of the insolvency of this type of bank on international financial stability and particular economies.

ICAAP: Internal Capital Adequacy Assessment Process.

ICAAR: Internal Capital Adequacy Assessment Report.

IFRS: International Financial Reporting Standards.

ILAAP (Internal Liquidity Adequacy Assessment Process): internal process to identify, measure, manage and control liquidity implemented by the entity in accordance with article 86 of Directive 2013/36/EU.

IRB (Internal Ratings-based) approach: based on internal ratings to calculate risk-weighted exposures.

IRP: initials in Spanish for the Pillar III disclosures report.

ISDA (International Swaps and Derivatives Association): the organisation that establishes the framework contracts for over-the-counter (OTC) derivative transactions between financial institutions.

JST (Joint Supervisory Team): one of the main forms of cooperation between the ECB and the national supervisors.

LCR (Liquidity Coverage Ratio): a ratio that ensures that a bank has an adequate stock of unencumbered high quality liquid assets that can be converted, easily and immediately, into cash in private markets, in order to meet its liquidity needs for a 30 calendar day liquidity stress scenario.

Leverage ratio: a complementary (non-risk based) regulatory capital measure that attempts to guarantee the financial resilience and strength of entities in terms of indebtedness. The ratio is calculated by dividing Tier 1 eligible capital by exposure.

LGD (Loss Given Default): that part of EAD not recovered at the end of the loan recovery process. It is equal to 1 minus the recovery rate (i.e: LGD=1-recovery rate). The definition of loss used to estimate the LGD must be a definition of economic loss, not an accounting loss.

Loyal customers: customers who consider Santander as their main bank.

LTD (loan to deposits): the ratio of loans to deposits, which measures a bank's liquidity.

LTV (loan to value): amount of credit extended/value of guarantees and collateral.

Mark-to-market approach: in regulatory terms, an approach for calculating the value of the counterparty credit risk exposure of derivatives (present market value plus a margin, i.e. the amount that takes into account the potential future increase in market value).

MiFID (Markets in Financial Instruments Directive): European rules on investor protection in financial products.

MREL (Minimum Requirement for Eligible Liabilities): minimum requirement of eligible liabilities with loss absorbing capacity. It applies to European banks in the same way as total loss-absorbing capacity (TLAC) applies to systemic banks.

Multiple Point of Entry: resolution by multiple points of entry. It entails applying various powers of resolution, both of the local authorities of the subsidiaries of a bank as well as the authorities of the parent.

Netting: a bank's ability to reduce its credit risk exposure by setting off the value of the rights against its obligations with the same counterparty.

Non-performing loan ratio: risk quality indicator. The relation between loans considered as doubtful and total lending.

NSFR (Net stable funding ratio): this requires banks to have a stable funding profile in relation to the composition of its off-balance sheet assets and activities a ratio of net stable funding that ensures a bank has a balanced balance sheet structure, in which stable funding requirements are funded by stable liabilities.

Ordinary profit: profit excluding extraordinary results.

OTC (over-the-counter): bilateral transactions (e.g. derivatives) that are not traded on an organised market.

PD (Probability of default): this represents the likelihood that a customer or transaction will fall into default. It is the probability than an event (the default) will occur within a given time horizon.

Phased-in: denotes compliance with current capital adequacy requirements, taking into account the transition schedule for Basel III compliance.

Pillar 1: Minimum Capital Requirements: the part of the new capital accord that establishes the minimum regulatory capital requirements for credit, market and operational risk.

Pillar 2: includes the supervisory review process. Internal capital adequacy assessment process reviewed by the supervisor with possible additional capital requirements for risk that are not included in Pillar 1, and the use of more sophisticated methodologies than Pillar 1.

Pillar 3: includes market discipline. This pillar is designed to complete the minimum capital requirements and the supervisory review process and, accordingly, enhance market discipline through the regulation of public disclosure by the entities.

QIS (Quantitative Impact Study): ad hoc requests by the EBA for studies analysing and calibrating the impact of new changes in regulation.

RDL: Royal Decree Law.

Repurchase agreement (repo): contract whereby the seller temporarily transfers ownership of securities to the buyer, and undertakes to repurchase these assets at a future date and at a pre-set price.

Risk appetite: the amount and type of risks considered as reasonable to assume when implementing the Group's business strategy.

Risk premium: credit risk management metric that relates the VMG to lending.

RoA (return on assets): this measures an entity's return, calculated as consolidated profit as a percentage of average total assets.

RoE (return on equity): this measures an entity's return, calculated as attributable profit as a percentage of average stockholders's equity excluding minority interests.

RoTE (return on tangible equity): this measures an entity's return, calculated as attributable profit as a percentage of average stockholders' equity excluding minority interests - Intangible assets.

RoRWA (return on risk-weighted assets): this measures an entity's return, calculated as consolidated profit as a percentage of average risk-weighted assets.

RWA (Risk-weighted Assets): calculated by assigning a level of risk, expressed as a percentage (risk weighting) to an exposure in accordance with the relevant rules under the standardised approach or the IRB approach.

SREP (Supervisory Review and Evaluation Process): the European Central Bank's process for supervising and evaluating banks.

SRF: Single Resolution Fund.

SRMR: Single Resolution Mechanism Regulation.

SSM (Single Supervisory Mechanism): banking supervisory system in Europe, consisting of the ECB and the relevant supervisory authorities of the participating EU countries.

Standardised approach: used to calculate credit risk capital requirements under Basel Pillar 1. The risk weightings used to calculate capital are determined by the regulator.

TNAV (Tangible Net Asset Value) per share: indicator of capitalisation. Tangible equity, calculated as the sum of equity and accumulated other comprehensive income deducting goodwill attributable and other intangible assets/number of shares (deducting treasury shares).

TLAC (Total Loss Absorbing Capacity): loss absorbing capacity of global systemic banks. It enables a bail-in: investors, not taxpayers, assume the losses.

Unexpected loss: unexpected losses (not covered by allowances) must be covered by capital.

VaR (Value at Risk): metric that establishes the maximum expected loss with a level of confidence and a certain time horizon.

VMG (management of non-performing loans variation): credit management metric defined as the final balance less the initial balance of non-performing loans for the period, plus write-offs, less loan loss recoveries for the same period.

In addition to the financial information prepared under International Financial Reporting Standards ("IFRS"), this annual report includes certain alternative performance measures as defined in the Guidelines on Alternative Performance Measures issued by the European Securities and Markets Authority on 5 October 2015 (ESMA/2015/1415es) as well as non-IFRS measures ("Non-IFRS Measures") . The APMs and Non-IFRS Measures are performance measures that have been calculated using the financial information from the Santander Group but that are not defined or detailed in the applicable financial information framework and therefore have neither been audited nor are capable of being completely audited. These APMs and Non-IFRS Measures are been used to allow for a better understanding of the financial performance of the Santander Group but should be considered only as additional information and in no case as a replacement of the financial information prepared under IFRS. Moreover, the way the Santander Group defines and calculates these APMs and Non-IFRS Measures may differ to the way these are calculated by other companies that use similar measures, and therefore they may not be comparable. For further details of the APMs and Non-IFRS Measures used, including its definition or a reconciliation between any applicable management indicators and the financial data presented in the consolidated financial statements prepared under IFR, please see 2017 Consolidated Directors' Report, published on February 16, 2018, Section 26 of the Documento de Registro de Acciones for Banco Santander filed with the CNMV on July 4, 2017 and Item 3A of the Annual Report on Form 20-F filed with the U.S. Securities and Exchange Commission on March 31, 2017 (the "Form 20-F"). These documents are available on Banco Santander's website (www.bancosantander.com).

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-39000013. 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 Pereda, numbers 9 to 12, Santander.

Corporate center

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Santander

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