






2016
ANNUAL REPORT

To help people and
businesses prosper



Santander

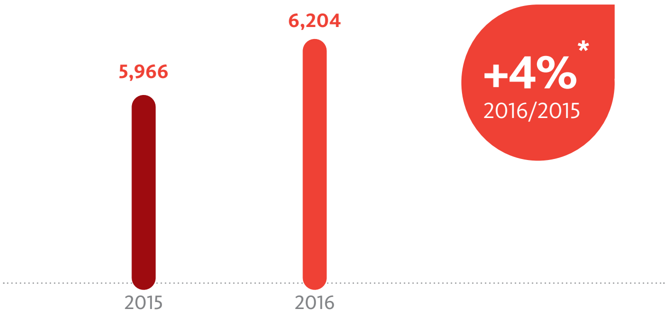
Santander in 2016: We progressed in becoming the best retail

Ana Botín,
Group executive chairman

"In 2016 Santander has achieved strong results, meeting all our business objectives: we increased loyal customers, grew lending and served 125 million people and businesses.

"Santander is one of the most efficient and profitable banks in the world, thanks to the talent and hard work of our teams. We have achieved excellent results by doing things in a simple, personal and fair way.

Attributable profit
Million euros

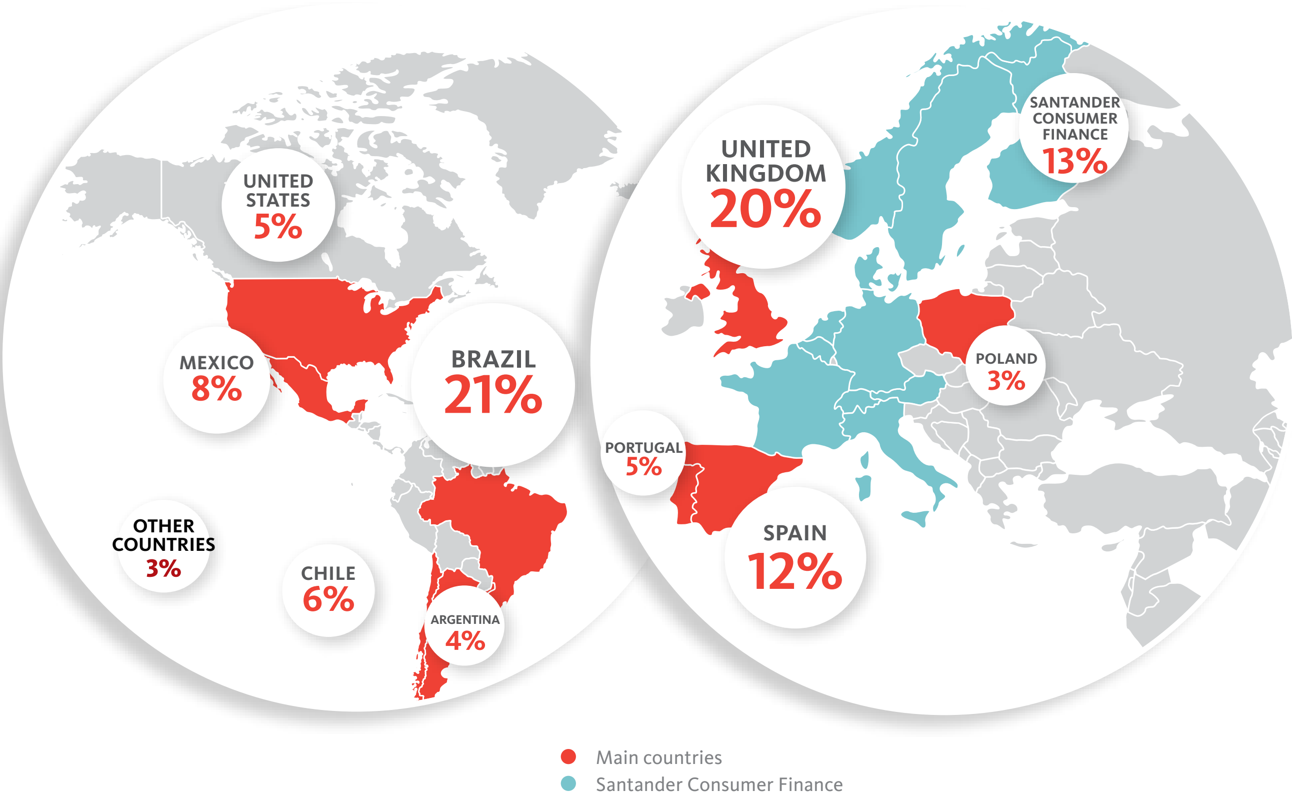


* +15% at constant exchange rates.

Return on Tangible Equity (underlying) **11.1%**

Core Equity Tier1 Capital Ratio fully loaded **10.55%** (+50bp 2016/2015)

Geographic diversification (contribution to underlying Group profit, %)



and commercial bank by helping people and businesses prosper

“Our investment in technology, together with the advantages of working as a Group, make Santander one of the most efficient banks in the world, while also improving the customer experience. Santander now ranks among the top three banks for customer satisfaction in eight of our nine main countries.

“Our balance sheet strength enables us to finance our growth, while increasing the cash dividend and accumulating more capital.

79% of employees perceive Banco Santander as Simple, Personal and Fair

78% employee engagement rate

15.2 (+10%) million loyal customers

20.9 (+26%) million digital customers

People 188,492 employees

Customers 125 million

Our aim is to be the **best retail and commercial bank,** earning the lasting loyalty of our people, customers, shareholders and communities.

Communities 1.7 million people helped in 2016

Shareholders 3.9 million

36,684 scholarships granted in 2016

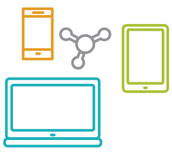
1,183 agreements with universities and academic institutions in 21 countries

3,363 million euros of CET1 capital generated

+8% cash dividend per share

Simple | Personal | Fair

2016
ANNUAL REPORT



Banco Santander's **2016 annual report** is available online.
You can go straight to it on a smartphone or tablet by scanning the QR code.
http://www.santanderannualreport.com/2016/en.html

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

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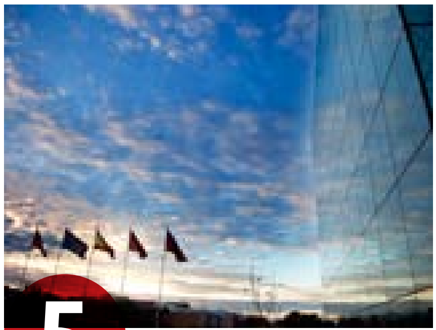

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Message from Ana Botín

Our purpose is to help people and businesses prosper.

Once again, we delivered on all our promises and did so in the right way. We made excellent progress against our long-term strategic goals.

In 2016, we lent more and improved service to our customers, earned more for our shareholders and supported our employees and communities in a sustainable, inclusive way.

Our achievements in 2016 reflect the strength and resilience of the Santander model and the efforts of all 190,000 of our colleagues:

- We increased lending to our customers by €16 billion.
- We continued to invest in technology, maintaining our 'best in class' efficiency while also improving customer service.
- We further strengthened our corporate governance and risk model and increased our Common Equity Tier 1 (CET1 Fully Loaded) capital by 3 billion euros, reaching a ratio of 10.55%, exceeding our target.
- We maintained our position as one of the most profitable banks in the world, with an underlying return on tangible equity of 11.1%, higher earnings per share of €0.41 (up 1%) and a cash dividend per share rising to €0.17 (up 8%). Our total net asset value per share also grew in 2016 by 15c to €4.22.

The market is recognizing our progress, as shown by the total shareholder return of +14% for our shares in 2016.

We also worked hard to improve how we work: Our success at this time of exponential change will depend on an ever stronger culture where customers come first, uniting our banks in Europe and the Americas.

By making better use of technology and collaborating more effectively across the Santander Group, we are making it easier than ever for our clients to travel, to trade and to fulfill their financial needs.

Greater collaboration among countries and people is critically important to increasing prosperity for all.

We made further progress in ensuring that everything we do is more simple, personal and fair.

We are strengthening the links between our core markets and producing tangible benefits of working across the group, both for our customers and for our shareholders.

Our strategic progress in 2016

Our aim is to become the best retail and commercial bank, earning the lasting loyalty of our people, customers, shareholders and communities.

Customers

This year, we earned the trust of 4 million new customers, raising our total number of customers to 125 million. We did this by improving the service and products we offer in every one of our ten core markets.

Our 1|2|3 strategy is based on creating customer value, which leads to attractive financial returns as these customers do more business with us.

It is not a product strategy or market share driven. And it is a profound change from the strategy Santander pursued in the past in Spain. It drives stable long terms relationships, as 1|2|3 customers consider Santander their primary bank. It hence drives stable, current account balance growth.

In the UK the 1|2|3 strategy has fundamentally changed our bank, from relying on volatile and expensive savings customers, to real banking customers, in just 5 years.

As the English say, "the proof is in the pudding". Santander UK current account balances grew from £12 billion to £65 billion, after being stuck at £12 billion for many years, and we have gained an average of 420,000 loyal customers per year during that period.

Within this customer group, among other financial benefits, our cost of credit is a quarter of what it was in 2011. We have also improved savings margins as these customers did more of their business with us at lower cost.

In 2016 we have achieved all our goals

Lending to customers
+ € 16 billion

Best in class efficiency
48%
cost to income ratio

FL CET1
10.55%
(+50bps)

Underlying RoTE
11.1%

Cash dividend per share
€ 0.17
(+8%)

> **Santander now ranks among the top 3 banks for customer service in all but one of our 9 core countries. This was one of our key strategic goals for 2018. We achieved it in 2016.**

A circle

In Spain the strategy is similar but not identical, as our teams and services are able to develop relationships faster and therefore are already growing fees, in a declining market - not by raising fees but by growing the number of customers that bank with us.

In 2016, our 32% loyal customers growth drove a 6% growth in fees, with 50% of the commercial activity concentrated in 1I2I3 customers, who buy 1.7 times more products and services than the rest.

Similar strategies adapted to local conditions have been launched in Mexico, Brazil, Portugal and other markets, based on the same principles of adding value to our customers, transparency and excellence in service, as the way to achieve profitable growth. These principles are the core of our loyal and digital customer strategy.

Thanks to the Group's investment in technology, the number of customers using our digital banking services rose by more than 25% in 2016 to just under 21 million.

Santander now ranks among the top 3 banks for customer service in all but one of our 9 core countries. This was one of our key strategic goals for 2018. We achieved it in 2016.

Our technology is allowing us to improve customer service while ensuring our cost to income ratio, a measure of efficiency, remains among the best in our industry.

Great products, great service and great value lead to loyal customers. In 2016 the number of people who consider Santander their primary bank rose by 1.4 million to 15.2 million. Loyal customers do more business with us, which means our fee income from value-adding services rose by 8.1%.

We also agreed or completed three transactions which will allow us to serve more customers and continue to deliver profitable growth in the medium term in our core markets:

- We integrated Banif in Portugal – a deal that has helped us increase the return on tangible equity in our Portuguese franchise to a best-in-class 13%.
- We reached an agreement to acquire Citigroup's retail assets in Argentina – enabling us to increase our market share and strengthen our franchise in a significant growth market.
- And most recently, we agreed to purchase the outstanding 50% stake in Santander Asset Management. This will allow us to expand our asset management business and the range of our offerings to customers.

These transactions align well with our strategy and allow us to offer better service to customers and strengthen our competitive advantage.

People

The talent and motivation of our 190,000 employees are the foundations for our success. Implementing a strong, common culture and purpose across the Group remains the main priority of the new management team.

We aim to be one of the top 3 banks to work for in the majority of our geographies. We have now achieved that goal in four of our ten core markets.

Our annual employee engagement survey is a valuable tool in listening to the views of our people and ensuring we take action to improve. The results this year show we are on the right path, as more than three quarters of our teams support our Simple|Personal|Fair culture.

We have a clear plan for continuous improvement in corporate behaviors and our remuneration will be significantly determined by our progress.

During 2016 we completed a significant restructuring process in a number of business areas to further improve our efficiency and operational excellence. While these processes are never easy, we have done our best to manage the exits of some of our people in a way that is fair to all, investing for the future.

> **Our critical mass and retail-commercial model, focused in 10 markets in Europe and the Americas, has allowed us to deliver more predictable earnings than our peers across the cycle, even in adverse macro- economic conditions.**

Communities

While delivering for our teams and on our financial and commercial targets is essential, making sure that we achieve our goals in the right way is even more important, as it ensures sustainability and continuous customer value creation.

This means supporting a culture that rewards the behaviors we believe to be right, encouraging colleagues to speak up, actively collaborate and embrace change.

It means building a business that aims high, that our customers, people and shareholders can rely on in the long term. And it means taking our responsibilities to the communities we serve seriously.

This year Santander was recognized by the Dow Jones Sustainability Index as the best bank in Europe for our commitment to sustainability, contribution to social progress and for our protection of the environment.

I am extremely proud of the work we have done in 2016 to support our communities and there are a number of initiatives I would like to highlight:

- In 2016 we further increased our support for universities across all the markets in which we operate. We are now in partnership with 1,200 universities, providing more than 35,000 scholarships and grants.
- Across Latin America we have supported 250,000 micro finance projects.
- More than 60,000 employees took part in volunteering programmes during the year. These ranged from financial education for students, the elderly and people on low incomes in Europe to support for childhood education in Brazil, where 4,000 employees worked to improve learning in 214 schools.
- In Spain, our coaching and mentoring programmes helped the disadvantaged, the socially excluded, and victims of gender violence to improve their skills and find jobs.

Shareholders

Our critical mass and retail-commercial model, focused in 10 markets in Europe and the Americas, have allowed us to deliver more predictable earnings than our peers across the cycle, even in adverse macro-economic conditions.

We proved this yet again in 2016 as we increased our revenues with strong growth in fee income and improvements in credit quality. Together with our focus on costs, this delivered an increase in our attributable net profit of 4%, to €6,204 million.

Our local operating performance was even better, as excluding one-off items and currency movements, our underlying profit before tax in constant euros rose by 12%.

The strength of our business model and our ability to generate profits year after year are starting to be recognized by the European Central Bank. In December, following its Supervisory Review and Evaluation Process (SREP), it decided to reduce the amount of capital we are required to hold as a proportion of our assets.

Strong corporate governance is at the core of prudent risk management. It is critically important to ensuring the sustainability of any business.

In April the Group held the first meeting of its International Advisory Board (IAB), a group of CEO's and leaders with expertise in strategy, technology and innovation. The IAB's focus is on digital transformation, cyber security and how to apply new technologies to improve service and do so efficiently.

And in September we were delighted to announce the appointment of Homaira Akbari as a new independent member of our Board of Directors. Homaira is a distinguished scientist, technologist and business leader. She has deep experience in developing and implementing the most advanced technology at scale and will help us further advance our digital transformation.

Banco Santander's International Advisory Board

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 Francisco 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 Charles Phillips
CEO of Infor and former President of Oracle

Mr Mike Rhodin
Senior Vice President of IBM Watson

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

> **"The Santander business model is built upon strong foundations"**

1
Serving 125 MM customers´financial needs, with critical mass in 10 markets with c.1 Bn people drives profitable growth

2
Geographic diversification drives predictability of earnings=less capital

3
Subsidiary model with strong culture of working together drives efficiency and service excellence

Her appointment strengthens the Board's international and technology expertise and brings the proportion of women on the Board to 40% - one of the highest in international banking.

I would like to take the opportunity to thank Angel Jado for his dedication and outstanding contribution to our Board for many years, and wish him every success for the future.

And I would like to recognize the hard work and commitment of all our Group and Subsidiary banks Board members, and thank them for their continued support throughout the past year.

Our unique opportunities for growth

I am proud of our team's progress this past year. In 2016, we delivered strong operational performance in all our businesses and at Group level, as well as reaching or exceeding our cost of equity in 95% of the group's investments. But we can do much more and much better.

The Santander business model is built upon strong foundations, well suited for the world ahead of us:

- We serve the financial needs of 125 million customers. We have critical mass in 10 markets with one billion people, which drives profitable growth.
- Geographic diversification leads to more predictable earnings and means we require a less capital intensive model than our global peers.
- Our subsidiary model allows us to be close to our customers and our strong culture of working together drives efficiency and service excellence.

The proof is our predictability.

We are one of only three major international banks to remain profitable throughout the crisis.

The European Banking Authority's stress tests this year show Santander to be the most resilient bank among our peers.

We have increased our core capital by €17 billion and have grown our profits by 40% over the past three years.

We have paid dividends consistently for more than 50 years.

And we generate some of the most stable and growing earnings per share among our peers.

But what matters looking forward is our great potential for organic growth. This is why I am confident Santander will be one of the winning companies over the next decade.

Looking forward...

The UK's vote to leave the EU and Donald Trump's victory in the US presidential elections confounded most expert predictions in 2016. And we have considered these and other potential unexpected international outcomes as we develop our plans.

For the next few years the effect of Brexit on our UK business will be as a consequence of anticipated slower growth in the economy as well as the weaker sterling effect on translation of our earnings.

However our strong balance sheet of prime mortgages and primary banking relationships allows us to be confident we will continue to deliver around or above our cost of capital.

Brazil should return to positive growth, after two years of recession, thanks to a sound set of economic reforms. It is a country with 220 million people and a large and growing middle class. Spain is expected to remain at the forefront of Europe's recovery. The UK will continue to play a key role in the global economy. And Mexico's government has shown it can manage through challenging times.

OUR EIGHT CORPORATE BEHAVIORS

Our performance the past year, for example, in Portugal (€399 million profit, +33%) or Argentina (€359 million profit, +52%) shows that we can do very well for our customers and shareholders even when the macro conditions are not ideal. But we would always rather have the macroeconomic winds behind us.

Santander Brazil earned €1.79 billion in profits and is the single largest earnings contributor to Group. For the last two years, we delivered a return on tangible equity of 14%, despite an adverse economic environment: net profit to the Group grew by 15% in 2016 and did so in a sustainable way, adding 500,000 loyal customers and 2 million digital customers.

In the USA we have made regulatory progress, as we committed, we have improved how we manage the business and reduced risk.

At SBNA, we have lowered the cost of deposits, improved service and efficiency.

Our retail and commercial Bank in the USA- which represents 5% of our Group capital invested - will deliver significant growth over the next few years and I remain confident it will deliver considerable value to shareholders.

...through active collaboration

Our model of local subsidiary banks and teams, together with our ability to collaborate across countries gives us our "unfair advantage". In a world which we anticipate being increasingly insular, this is a winning combination.

It leads to better outcomes for customers and value creation for shareholders.

We already do this better than most, as our best-in-class cost-to-income ratio demonstrates. But we can do more.

Allow me to share some examples: our new CRM (Customer Relationship Management) tool in Poland was first developed in Chile and then taken and improved by the UK. It has been deployed through our internal "open services" model and is now being implemented in Mexico.

Santander Wallet is a single global solution for around 400,000 of our commercial clients. It allows them to use a single wallet for all payments and channels, and offers additional, real-time, value added services to help our customers build their business. It has been launched in Brazil and Spain and will soon be available in Mexico and Chile.

Our microcredits programme in Brazil, supported by an equally strong programme of financial education, has helped 129,000 entrepreneurs to start and grow their businesses.

We are now expanding microcredits to Mexico to bring many more people into the financial system and pursue our goal of sustainable, inclusive growth.

As a management team, we are totally committed to embedding our behaviors and leading by example.

Commercial and financial performance is a given.

But what will make us a winner is a culture that allows people to speak up, to embrace change, to accept diversity of all types, so that we can fully realize the potential in our teams and in our markets.

> **"As a management team, we are totally committed to embedding our behaviors and leading by example. Commercial and financial performance is a given. But what will make us a winner is our culture."**

PRIORITIES FOR 2017

- Increase the number of loyal customers by a further 1.8 million to 17 million
- Raise the number of digital customers to 25 million
- Broadly stable cost to income ratio
- Continue to strengthen our capital
- Increase value for our shareholders

...and the trust of 125 million customers, in both developed and developing markets.

As I mentioned, we serve 125 million customers in ten core markets in Europe and the Americas that are home to more than 1 billion people. We have critical mass in all our markets. We have scale and we are in the right places. This represents a huge potential for value creation.

Our biometric technology, a joint project between Mexico and Brazil has made banking easier and more secure for 6 million customers in the past year. In the UK we have reduced the time it takes our customers to complete a mortgage application from up to 3 hours to less than 40 minutes, in a heavily regulated process.

We are collaborating with some of the most innovative FinTech startups through Santander Innoventures. And in H1 we will launch a new platform for Openbank, a digital bank in Spain which serves more than a million customers, with just 100 people and is already profitable.

Looking forward, through active collaboration, we have a unique opportunity for growth. To deliver on this opportunity we will invest in our people and in better use of technology, and we will work across the group to improve the customer experience and our efficiency.

Our strategic priorities and goals for 2017

We have clear goals for 2017: to increase our number of loyal customers by a further 1.8 million to 17 million, and keep developing our value-adding services.

We will continue to invest in technology to raise the number of digital customers to 25 million, while improving service and efficiency, aiming for a broadly stable cost to income ratio. And we will increasingly do it working across geographical boundaries.

Our aim is to continue to grow our capital by another 40bp whilst increasing our earnings and dividend per share and continuing to grow the value of our company, as measured by tangible net asset value per share. The delivery of our 2017 and 2018 goals will keep adding tangible net asset value to our shares.

Conclusion

2016 has not been an easy year, but we have delivered on our promises, and done so in the right way. Once again, we lent more, we earned more, and we became a better bank on every significant measure.

In a changing and complex environment, for the first time in years, we expect positive GDP growth in all of our markets in 2017.

The financial system plays an important role in supporting economic growth. And the Santander model is based on supporting this growth by maintaining appropriate capital levels, strong corporate governance and prudent risk management.

These are uncertain times. Volatility is growing and growth, overall, might slow. Technology is creating disruption. Automation is threatening jobs. In the short term, we need to retrain people, to encourage lifelong education so we

“Going forward, we have many opportunities for profitable growth in Europe and the Americas, in an environment we anticipate will be volatile but generally better than 2016”

can bring everyone with us in this new wave of growth, and ensure it is sustainable.

We have reflected on these trends, what they mean for us, and how to build a business that delivers in a sustainable way, with great performance for shareholders but that also cares about making a difference.

At Santander we are in an extraordinary position to help. Let's start with our 125 million customers. Add in their family members. Then all the businesses we serve, with employees ranging from a few to tens, even hundreds of thousands.

Every action we take to enable inclusive, sustainable growth has a powerful multiplier effect which will help the lives of millions of people. That is the power of our model.

In my first letter to you, only 2 years ago, I set out our strategy. Maintaining our traditional strengths, and foundations, we embarked on a profound process of change.

It is the sort of change that is not fully reflected in the news that generates media headlines. It is not just about acquisitions or appearing at the top of the rankings.

Our transformation is global and goes beyond these metrics. It is mostly about how we organize ourselves, how we behave, to succeed in a world changing at exponential speed all around us.

A more diverse, multicentric world, where being local is a must.

And at the base of our transformation is a culture of being local in each one of our markets while also encouraging a shared way of doing things that is Simple and Personal and Fair; this culture binds us together across our 10 markets, fosters innovation and attracts the best talent.

At our Investor Day in London in September 2016 we set out our 2025 vision: to be an open platform for financial services. Importantly, as we transform the Group to succeed in the medium term, we are delivering today.

As I said when we announced our earnings for 2016, going forward, we have many opportunities for profitable growth in Europe and the Americas, in an environment we anticipate will be volatile but generally better than 2016. The key to our success for 2017 and beyond will be an ever-stronger collaborative culture across the Group and a shared purpose to help people and businesses prosper.

I am confident Santander will continue to deliver because of the 190,000 people who work hard and work together every day, and to whom I would like to say thank you.

And to all of you, to our customers, to our shareholders, our communities, thank you for your trust.

With your continued support, the best is yet to come.

Ana Botín
Group Executive Chairman

“I am confident Santander will continue to deliver because of the 190,000 people who work hard and work together every day, and to whom I would like to say thank you”

Message from José Antonio Álvarez

Our results, for yet another year, underscore the soundness of Grupo Santander and its capacity to provide sustained, quality growth. They are the consequence of positive performance of the main income statement components: revenues, costs and provisions.

Grupo Santander carried out its activity in 2016 in a challenging environment. Global economic growth slowed down slightly, as markets were hit by volatility stemming from concerns about growth in China and the uncertain international political panorama.

However, there are some positive aspects that invite optimism about the near future:

- Financial markets are increasingly resilient, quickly recovering from bouts of volatility.
- Developing economies in general grew at a faster pace, and the worst performers, such as Brazil and Argentina, adopted economic policies that should enable them to emerge from recession in the coming quarters.
- Lastly, mature economies began to recover in the second half of the year. The UK's referendum, in particular, had a limited impact on growth, and the Spanish economy again grew by more than 3%.

Another factor in this environment are the pressures on banks since the onset of the financial crisis, mainly because of new regulatory requirements and low interest rates in mature economies, limiting a more intense recovery in profitability.

I will now set out the Group's performance during 2016, the priorities and main steps taken in each of our markets, and the financial objectives for 2017.

The Group's performance in 2016

We posted an **attributable profit** of €6,204 million, 4% more than in 2015 and 15% higher in constant euros (the exchange rate effect was again negative).

This figure includes some positive and negative **one-off** results which had a net negative effect of €417 million (€600 million negative in 2015).

Profit before extraordinary items, taxes and excluding the exchange rate effect, which is a more appropriate way of assessing our management, **rose 12% to €11,288 million.**

These results, for yet another year, underscore the soundness of Santander Group, its capacity to provide sustained quality growth. They are the consequence of the positive performance of the main P&L lines: revenues, costs and provisions.

The first thing to emphasise in **revenues** is their considerable recurrence in an environment of high volatility. This was made possible by the high relative share (94%) of commercial revenues:

- In an environment of very low interest rates in mature markets, **net interest income** increased 2% in constant euros thanks to management of spreads and our significant exposure to developing countries and to consumer credit business.
- **Fee income** increased 8%, double that in 2015, reflecting the greater loyalty and satisfaction of our customers.

Attributable Profit

€6,204
million
+4%

Underlying Profit before taxes

€11,288
million
+12%*

* Excluding exchange rate.

Commercial Revenues Increase:

- Net interest income +2%
- Fee Income +8%

Operating expenses 2% lower in real terms and on a like-for-like basis

Cost of credit improves and loan-loss provisions 2% down

Spain

Profit **€1,022** million **+5%**

United Kingdom

Profit **€1,681** million **-4%***

*Before taxes and excluding exchanges rates +8%

Costs were 2% lower in real terms and on a like-for-like basis. Seven of our core units registered a rise in costs that was below the inflation rate.

This good performance was the result of efficiency plans and the active management of our business, differentiated in each market, where we adapted the cost base to the business reality. The measures taken to streamline and simplify structures, both in the corporate centre as well as in some units, are enabling us **to continue investing in our commercial transformation while remaining one of the international financial system's most efficient banks.**

More revenues and control of costs were accompanied by a **2% fall in loan-loss provisions** in constant euros. As a result, the **cost of credit dropped** from 1.25% in 2015 to 1.18% in 2016. The improvement in credit quality is closely related to the strengthening of the risk culture across the Group through several initiatives.

Turning to the **balance sheet**, there are two noteworthy aspects:

- We delivered balanced growth in both **lending and funds** (+2% and +5% respectively) and our **liquidity** ratios were well above the minimum required levels.

- The Group continued to generate **capital** quarter after quarter. In fully loaded terms, we attained a capital ratio of 10.55% (+50 basis points), putting us in line with our target of 11% in 2018, while comfortably meeting all regulatory requirements.

Consequently, we combined a sustained generation of capital, which underscored the Group's capital adequacy, with a high level of profitability compared to the sector's average: a **RoTE** (Return on Tangible equity) of around 11% and a **RoRWA** (Return on Risk Weighted Assets) that increased to 1.36%.

Priorities and performance of the business areas in 2016

The units' strategy in mature markets focused on boosting the number of loyal customers, gaining market share, controlling costs and improving the credit quality.

Spain

Santander Spain is building deeper and long-lasting relationship with its customers, underpinned by the 1|2|3 strategy. The number of loyal individual customers rose 27% and companies 48%. Santander remained among the Top 3 in customer satisfaction surveys and increased business activity.

In a sector in which activity is slowing down, the higher profit was supported by an improved risk profile, lower provisions, the efficiency plan and higher fee income.

United Kingdom

Profit was impacted by the new tax on banks. Pre-tax profit, which better reflects the business performance, increased 8% thanks to higher volumes, good management of spreads and control of costs. In addition, lower provisions due to the excellent improvement in the quality of credit risk.

In a demanding environment characterised by greater uncertainty in the second half of the year the solid evolution of our business is worth noting. The number of 1|2|3 customers increased to 5.1 million while lending to companies also saw further growth. We continued to focus on operational excellence: the sustained improvement in our mobile and online channels produced a 25% rise in the number of our digital customers.

> **We combined a sustained generation of capital, which underscored the Group's solvency, with high profitability compared to the sector's average**

Santander Consumer Finance

SCF remains the consumer finance leader in Europe. In 2016 it continued to gain market share and the agreement with Banque PSA Finance (BPF) was completed successfully, expanding activity to 11 countries, strengthening our diversification.

Profit rose for the seventh straight year, demonstrating the robustness of our business model throughout the cycle.

United States

We completed building the holding company, thereby consolidating the management of all operations in the country, and we made progress in meeting regulatory requirements. We continued working on the transformation programme to improve risk management and our technological and operational capacities.

Santander Bank is focusing on driving commercial activity and Santander Consumer USA changed the composition of its portfolio toward a lower risk profile.

All these changes and measures are aimed at building a more profitable business in the medium term. Meanwhile they are temporarily impacting results and are the main reason behind the lower profit.

Portugal

We own the country's strongest bank. Our strategy is centered, on the one hand, on improving the bank´s profitability and, on the other, on the technological and operational integration of Banif's business acquired at the end of 2015. We are well positioned in the country, with market shares of around 14% both in loans and deposits.

Developing markets are in a different stage due to structural reasons. They register stronger growth than that of mature economies in volumes, higher interest rates, a substantial potential for banking penetration and RoTEs between 15% and 20%. Santander has local critical mass, a strong business model and an effective risk management of the credit cycle, which produced very good results in all the units of the Group's developing countries.

Brazil

Santander generated excellent results in an environment of recession, thanks to the improvements achieved in the last few years in the franchise, the good commercial dynamics and progress in the digital strategy, which enabled the number of digital customers to surpass six million (+45%).

In 2016, for the first time, Santander became one of the best companies to work for and launched several commercial offers, such as *Olé Consignado*, in payrolls business. We also announced a commercial agreement with American Airlines so that our customers can accumulate air miles, and created a joint venture between Santander Financiamentos and Hyundai.

All these measures were reflected in our financial variables. We increased deposits, improved the trend in lending in the second half of the year, and profit was 15% higher thanks to the good performance of commercial revenues, improved efficiency and a cost of credit below that of our competitors.

Santander Consumer Finance
Profit
€1,093*
million

United States
Profit
€395
million €
-42%*

Portugal
Profit
€399
million
+33%

Brazil
Profit
€1,786
million
+15%*

* Excluding exchange rate.

"The outlook for 2017 points to a modest upturn in global growth, which could be close to 3.5%. This would be supported by both mature as well as developing economies"

Mexico
Profit
€629
million
+18%*

Chile
Profit
€513
million
+16%*

Argentina
Profit
€359
million
+52%*

Poland
Profit
€272
million
-6%**

Mexico

The strategy was very focused on improving customer retention, commercial transformation and innovation. The year was very active as we launched products and commercial agreements produced a gain in market share in lending, growth in deposits and a sharp increase in loyal and digital customers. Profit rose, spurred by the good performance of revenues, particularly net interest income.

In order to continue improving the franchise and the IT systems, we announced a 15,000 million mexican pesos three-year investment plan, over and above our recurring investments and initiatives.

Chile

Management focused on growing those segments that contribute the most, such as companies, high-income customers and deposits. We also concentrated on improving the quality of customer care, reaching the Top 3 in customer satisfaction.

Santander Chile continues to gain market share in loans and deposits, ranking first in loans and second in deposits. Profit rose thanks to higher net interest income, control of costs and lower provisions.

Argentina

Santander Río wants to exploit the high growth potential of the financial system (which is very transactional), and the improved environment for developing banking business. As a result we decided to strengthen our position in the country by acquiring Citi's retail business, as well as continuing to modernise the network and open new branches.

Poland

We continue to be the leading bank in innovation and digital channels. We increased the number of loyal customers, notably so among companies, and our growth in loans is well above that of the sector.

Excluding the impact of the new tax on assets, profit rose 14% due to the good performance of net interest income and a very significant improvement in credit quality.

Lastly, the units in **Uruguay** and **Peru** increased their profit by 32% and 21% respectively. In Uruguay profit was underpinned by the sharp growth in revenues and in Peru by the decline in provisions.

Financial objectives for 2017

As you can see, in 2016 we achieved our main goals and our financial variables for the Group and for the main units performed well.

The outlook for 2017 points to a modest upturn in global growth, which could be close to 3.5%. This would be supported by both mature and developing economies, which are expected to grow faster in 2017 for the first time in five years, largely thanks to expansive policies in the US and a significant improvement in some large developing countries. US interest rates can be expected to increase again, and could produce a steeper yield curve in Europe.

The risks are primarily of a political nature, such as the impact that the policies in the US could have in some developing countries, the Brexit negotiations and the outcome of elections in France and Germany.

* Excluding exchange rate.

** Excluding the impact of the new tax on assets and exchange rate +14%.

We will continue to make progress in 2017 toward achieving the goals we announced at the Global Strategic Update. In order to do this, we have set the following priorities:

- Accelerate **revenue growth,** particularly in **developing markets**, where we see high one-digit or double-digit growth in all units and where interest rates enable good spreads to be obtained.

- In **mature markets**, where revenues are under pressure, we must increase **our market share,** mainly in companies, and continue to grow in fee income, mainly in cards, insurance and funds. The recent agreement to acquire 50% of Santander Asset Management should be seen in this context.

- Continue to keep **costs under control,** keeping their total increase below the average inflation of the countries, and maintain revenue growth above that of costs.

- Keep on **improving the cost of credit,** with the Group's provisions falling as the cycle improves in some core markets such as Brazil and Spain.

- Grow risk-weighted assets (RWAs) below the increase in the Group's loans and profit in order to improve our RoRWA ratio.

- All these measures should **improve our profitability,** moving us toward the RoTE goal of 11% in 2018, and strengthening our capital ratio.

Lastly, **I would like to thank all the Group's professionals for their efforts in transforming and improving our bank.** The achievements in 2016 and attaining the goals in 2017 would not be possible without the contribution of each and every one of them.

We will continue to work every day to help people and businesses prosper, and to turn Santander into the best retail and commercial bank by earning the lasting loyalty of our people, customers, communities and shareholders.

José Antonio Álvarez
Chief executive officer

FINANCIAL OBJETIVES 2017:

- Accelerate revenue growth
- Gain market share in mature markets
- Costs under control
- Improve the cost of credit
- Grow RWAs below the increase in the Group's loans and profit
- Improve our profitability

Corporate governance

Santander has a solid corporate governance, based on its strong culture and values, a robust control of risks, which assures that management is aligned with the interests of our shareholders, investors, employees, suppliers, customers and other stakeholders.

Balanced Board composition

- Of the 15 directors, 11 are non-executive and 4 executive.
- More than half of the directors are independent.
- Commitment to diversity of knowledge, gender (women make up 40% of the board) and international experience.

Respect for shareholders' rights

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

Maximum **transparency,** particularly in terms of remuneration

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

At the **forefront of international** best governance practices

- Consolidation of the position of lead director and of the role of the board's committees in supporting the board.
- The functions of the innovation and technology committee have been increased to meet the challenges of the new digital environment.

» Board of directors

The board of directors is the Group's highest decision-making body, except for matters reserved for the general shareholders' meeting. Santander has a highly qualified board: experience, knowledge, dedication and diversity are its primary assets.

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, strategy, corporate culture, on defining the Group's structure and on fostering the appropriate policies in matters of corporate social responsibility. In particular, in the exercise of its responsibility and involvement in managing all risks, it must approve and monitor risk appetite and the risk framework and ensure that the "three lines of defence" model (business and risk origination; risk control and compliance; and internal audit) is respected.

Its function and activities are ruled by the principles of transparency, responsibility, fairness and effectiveness, reconciling social concern with our stakeholders' legitimate interests.

All board members are recognised for their professional capacity, integrity and independence and, individually and collectively, provide the knowledge and experience needed to attain Santander's aim of being the best retail and commercial bank. The non-executive directors have extensive financial experience and wide knowledge of the markets in which the Group operates.

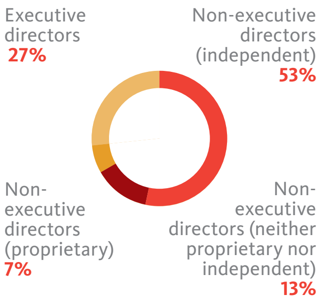
The position of lead director has consolidated since its creation in 2014, playing a significant role in the annual assessment of the chairman of the board and fostering pro-active communication with investors in order to understand their points of view.

The board held
13
meetings
in 2016.

For more information on corporate governance see pages 58 to 95 of Banco Santander's 2016 Annual Report.

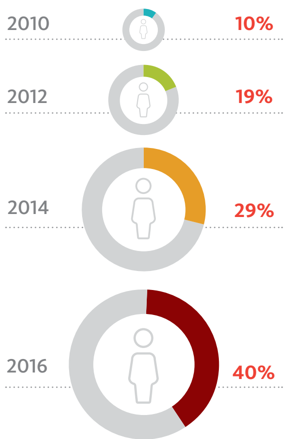
» Banco Santander's board: diverse and balanced

Composition of the board
% of directors

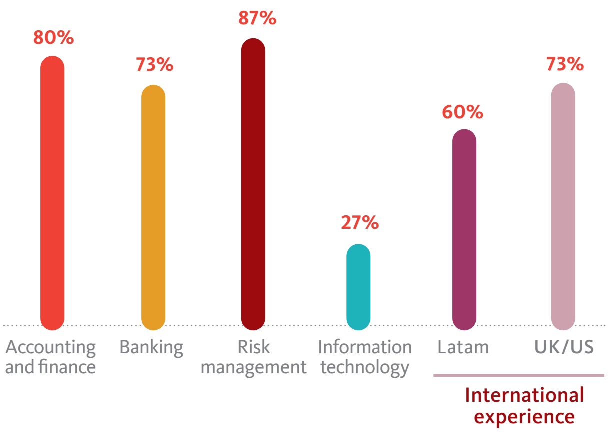


73%
Non-executive directors

Diversity in the board
% of female directors



Relevant expertise of board members
%



» Remuneration policy

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

1. Remuneration must be aligned with shareholders' interests.
2. The fixed element must represent a significant proportion of total remuneration.
3. The variable portion must reward performance in the attainment of agreed targets, reflecting the person's role and responsibilities, in a framework of prudent risk management.
4. The appropriate benefits for supporting employees and their families must be provided.
5. The global remuneration package and its structure must be competitive in order to help attract and retain employees.
6. Conflicts of interest must always be avoided when making remuneration decisions.
7. There must be no discrimination in remuneration decisions.
8. The structure and amount of the remuneration in each country must be in line with the local practices and regulations.

International advisory board

- Banco Santander's new international advisory board, comprising experts in strategy, IT and innovation external to the Group, held its first meeting on 26 April 2016 in Boston (United States).
- The purpose of this board is to provide strategic advice to the Group, focusing particularly on innovation, digital transformation, cyber security and new technologies. It also offers its view on trends in the capital markets, corporate governance, brand and reputation, regulation and compliance, and global financial services with the focus on the customer.

New external auditor

- In line with the corporate governance recommendations regarding rotation of the external auditor, the general shareholders' meeting on March 18, 2016 appointed PricewaterhouseCoopers Auditores, S.L. (PwC) as the Bank's and the Group's external auditor for 2016, 2017 and 2018.

INTERNAL GOVERNANCE

- The Santander Group is structured around subsidiaries, whose parent is Banco Santander S.A., that are autonomous in capital and liquidity. Its internal governance system comprises a governance model and corporate frameworks.
- The model sets the principles that regulate the relationship between the Group and its subsidiaries and the interaction that must exist between them at three levels: the Group's board of directors and the boards of the subsidiaries; the Group and local CEOs; as well as between the relevant executives who exercise internal control, support and business functions in the corporate centre and the subsidiaries.
- The corporate frameworks establish common principles of action in matters that are significant for their impact on the Group's risk profile such as risks, compliance, technology, auditing, accounting, finances, strategy, human resources and communications.

Board of directors of Banco Santander

1. Ms Ana Patricia Botín-Sanz de Sautuola y O'Shea
Group executive chairman

2. Mr José Antonio Álvarez Álvarez
Chief executive officer and executive director

3. Mr Bruce Carnegie-Brown
Vice chairman. Non-executive director (independent) and coordinator of the non-executive directors (lead director)

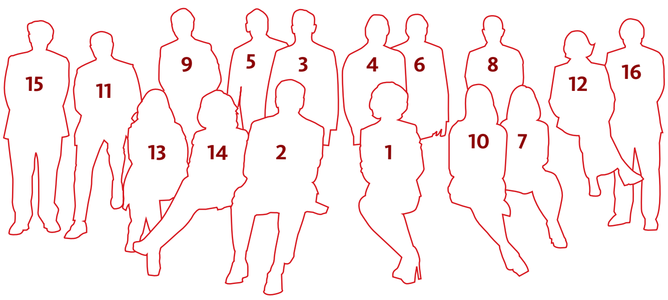
4. Mr Rodrigo Echenique Gordillo
Vice chairman and executive director

5. Mr Matías Rodríguez Inciarte
Vice chairman and executive director

6. Mr Guillermo de la Dehesa Romero
Vice chairman and non-executive director

7. Ms Homaira Akbari
Non-executive director (independent)

8. Mr Ignacio Benjumea Cabeza de Vaca
Non-executive director



- Executive committee
- Audit committee
- Appointments committee
- Remuneration committee
- Risk, regulation and compliance oversight committee
- International committee
- Innovation and technology committee

Pereda building. Santander Group city, Boadilla del Monte, Madrid, Spain, 20 December 2016.

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

10. Ms Sol Daurella Comadrán
Non-executive director (independent)

11. Mr Carlos Fernández González
Non-executive director (independent)

12. Ms Esther Giménez-Salinas i Colomer
Non-executive director (independent)

13. Ms Belén Romana García
Non-executive director (independent)

14. Ms Isabel Tocino Biscarolasaga
Non-executive director (independent)

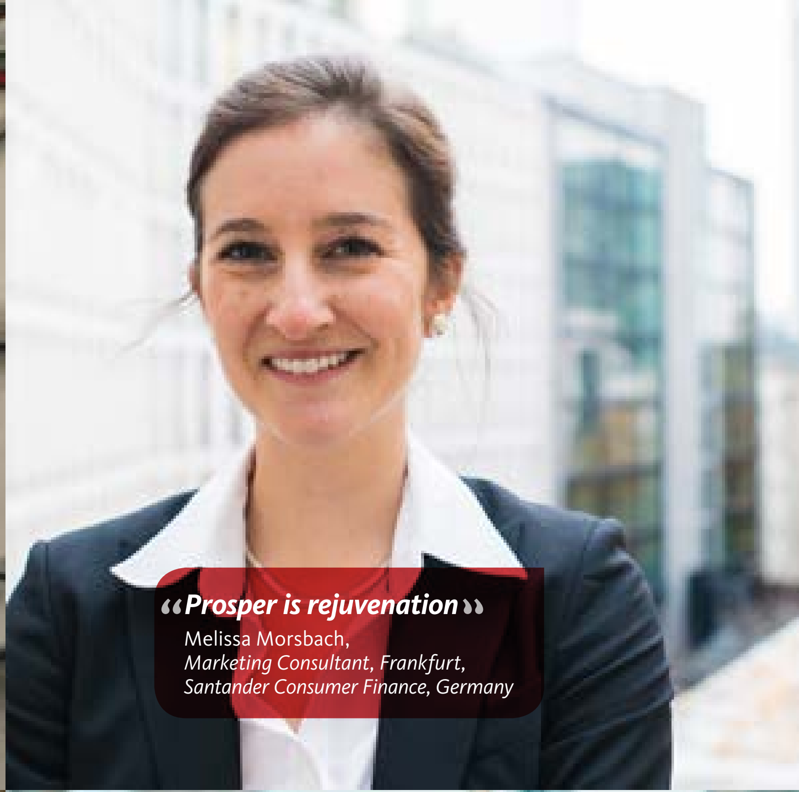
15. Mr Juan Miguel Villar Mir
Non-executive director (independent)

16. Mr Jaime Pérez Renovales
General secretary and secretary of the board

CHANGES IN THE COMPOSITION OF THE BOARD AND ITS COMMITTEES

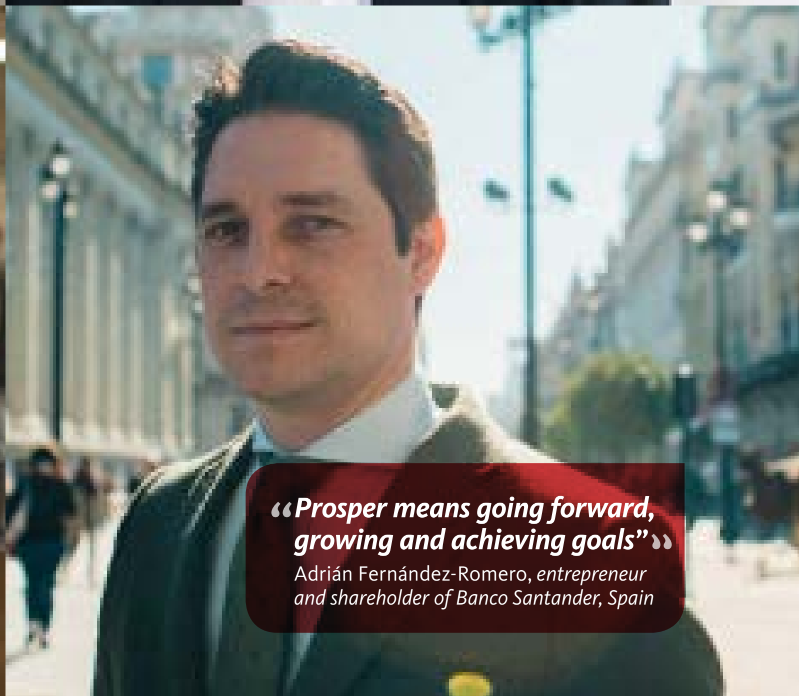
- On 27 September 2016, Ms Homaira Akbari was appointed as a non-executive director (independent) and a member of the Bank's innovation and technology committee, filling the vacancy left by Mr Ángel Jado Becerro de Bengoa, who resigned from the board.
- On 26 April 2016, Ms Belén Romana García was appointed chairman of the audit committee in place of Mr Juan Miguel Villar Mir, who continued to be a member of the committee. Ms Romana is regarded as a financial expert given her education and experience in accounting, auditing and risk management.
- The board, at the request of the appointments committee, decided at its meeting on 28 October 2016 to appoint Ms Romana to the risk, regulation and compliance oversight committee.

«Prosper is knowing how to look»
Rafael Rey, *Microcredit, Paraisópolis, Santander Brazil*



«Prosper is rejuvenation»
Melissa Morsbach, *Marketing Consultant, Frankfurt, Santander Consumer Finance, Germany*

«Prosper is helping to improve people's lives»
Ian Carson, *Branch Director, Liverpool Old Swan, Santander UK*



«Prosper means going forward, growing and achieving goals"»
Adrián Fernández-Romero, *entrepreneur and shareholder of Banco Santander, Spain*

«Prosper is spending time with my grandkids»
Ringo Francis, *Corporate Customer, Santander UK*

«Prosper is innovation for everyone»
Roselly Kimura, *IT, São Paulo, Santander Brazil*

«Prosper is collaboration»
Justin Hannemann, *Customer and Innovation, London, Santander UK*

1 Business model and strategy

«Prosper is to insist»
Katarzyna Surowiec
General Manager, Grandpa's Garden, Poland

Our purpose is to help people and businesses prosper

«Prosper is inclusion»
Lorena López and Sabrina Escalante, *Representatives of Customer Service, La Juanita, Santander Río, Argentina*

« Prosper is change »
Teresa Sáenz-Díez, *Senior Legal Advisor, Santander Group Corporate Centre, Madrid, Spain*

Purpose and business model

Our purpose

to **help people** and **businesses prosper**

Our aim

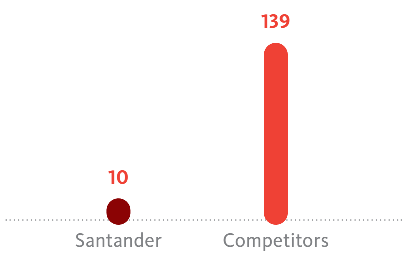
to be the **best retail** and **commercial bank,** earning the **lasting loyalty** of our **people, customers, shareholders and communities**

Our way of doing things

Simple | Personal | Fair

Predictable, stable profit throughout the cycle

Average volatility of the quarterly EPS
(%, 1999-2016)



+

Sustainable, high profitability enabling growth opportunities to be exploited

11.1% Ordinary RoTE

Top 3 vs. our global peers

+

Cash dividend per share growth

+8% in 2016

A differential business model

1 Serving 125 million customers with critical mass in 10 core markets drives profitable growth.

125
million customers in markets with a total population of one billion

- Banco Santander aims to satisfy the needs of **all types of customer:** individuals with different income levels; companies of any size and sector; private corporations and public institutions.
- Santander is a **strong brand** that has **great recognition** in the Group's main markets and globally.
- The foundation of our business is long-term customer relations. **Innovation** is enabling Santander to transform its commercial model in order to attain a larger number of loyal and digital customers, which is fuelling more **profitable and sustainable business**.
- Santander has **high market shares** in retail and commercial banking in Argentina, Brazil, Chile, Spain, Northeast of the United States, Mexico, Poland, Portugal and the United Kingdom and in the consumer finance business in Europe.

2 Our geographic diversification generates predictable profit, meaning lower capital needs

3,363
million euros of capital generated in 2016. CET1 capital ratio of 10.55%

- Santander's business is well **balanced** between mature and developing markets, which generates **predictable and growing profit** over the economic cycle.
- Santander's **capital** position is **strong** and appropriate for its business model, geographic diversification, balance sheet structure, risk profile and regulatory requirements.
- Santander's balance sheet strength and profitability enable it to finance its **growth**, distribute a **higher cash dividend** and continue to **accumulate capital**.

45%
Contribution of the Americas to profit

55%
Contribution of Europe to profit

3 The subsidiary model, with a strong culture of working together, drives efficiency and service excellence

48%
efficiency ratio: one of the most efficient international banks

- The Group is structured around a **model of subsidiaries, autonomous in capital and liquidity**, that are subject to regulation and supervision by each country's authorities. The subsidiaries are managed by local teams with considerable customer knowledge in their respective markets.
- Santander strives for **operational excellence** through the digitalisation and improvement of all its operations and commercial channels, streamlining processes and optimising costs, enhancing customers' experience and their **degree of satisfaction.**
- The **Corporate Centre** (which has reduced its costs by 23% in the past two years so that they now represent 2.1% of the Group's total costs) contributes value and maximises subsidiaries' competitiveness, developing collaboration, helping them to be more efficient, strengthening the Group's governance and fostering the exchange of best commercial practices. This enables the **Group to generate a higher result than the sum of each of the local banks** acting in isolation.

Aim and value creation

Our aim is to be the best retail and commercial bank, earning the lasting loyalty of our employees, customers, shareholders and communities.

We have set ambitious targets ...

	Strategic priorities	Key indicators
Employees	Be the **best bank** to work for and have a strong internal culture	Number of core markets where the Bank is among the top 3 best banks to work for (according to the relevant local rankings)
Customers	Earn the **lasting loyalty** of our individual and corporate customers: improve our franchise	Loyal individual customers (million) Loyal corporate banking customers and SMEs (thousand) Growth in customer loans (%) [5]
	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 (million) Growth in fee income (%)[5]
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 (%) Return on tangible equity (RoTE, %)[4] Dividend pay-out as a percentage of attributable profit
Communities	Santander Universities	Number of scholarships (thousand)
	Support people in the **local communities** in which the Bank operates	Number of people helped by the Bank's social investment programmes (million)

1. 2015-2018 average.
2. Except in the US where it will likely be close to competitors.
3. Total amount 2016-2018.
4. As percentage of operating profit.
5. Constant Euros.

... and we know how to attain them.

2015	2016	Targets 2018	More info
3	4	most countries	pp. 30-31
12.7	13.9	17	pp. 32-33
1,049	1,356	1.646	PP. 32-33
6%	2%	> com-petitors	P. 48
5	8	All [2]	p. 35
16.6	20.9	30	p. 34
4.3%	8.1%	c. 10%[1]	p. 47
10.05%	10.55%	>11%	p. 48
1.25%	1.18%	1.2%[1]	p. 48
47.6%	48.1%	45-47%	p. 47
-15,9%	1.0%	double digit	p. 46
11.0%	11.1%	>11%	p. 47
38%	40%	30-40%	pp. 36-37
35	37	130[3]	p. 39
1.2	1.7	4.5[3]	pp. 38-39

Simple | Personal | Fair

Simple, Personal and Fair is the essence of the Bank's corporate culture. These are the principles that define how all Santander's employees think and act and they guide us in our relations with colleagues, customers, shareholders and communities.

CORPORATE BEHAVIOURS

Corporate behaviours are the basis for becoming a bank that is more Simple, Personal and Fair. In 2016, knowledge and application of these behaviours were fostered in day-to-day work, as was the recognition of employees who best represent these values.

- Show respect
- Truly listen
- Talk straight
- Keep promises
- Actively collaborate
- Bring passion
- Support people
- Embrace change

RISK CULTURE: RISK PRO

Santander also has a solid risk culture, called *risk pro*, which defines the **way in which we understand and manage risks from day to day.** It is based on making all employees responsible for the risks they generate and on other principles that must be known and integrated into the way of working throughout the Group.

risk pro
All the Santander team engaged in risk

>90%
of employees know and are responsible for the risks in their daily work

SANTANDER BRAND

The Santander brand expresses a corporate culture and a unique international positioning, and consistent with a way of banking that helps people and businesses prosper in a Simple, Personal and Fair way.

Santander

Employees

In order to help people and businesses prosper, it is vital that Santander's 188,492 employees are motivated and engaged.

"Prosper is collaboration"

Justin Hannemann , Customer and Innovation, UK

THE STRATEGY FOR MANAGING PEOPLE FOCUSES ON SIX MAJOR CHALLENGES

6 challenges

1 Talent management
Help people to grow professionally in a global environment.

2 Expertise and development
Provide continuous training and development that strengthens employees' capacities and skills.

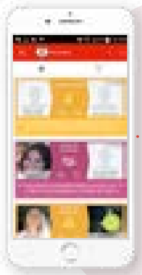
3 Remuneration and benefits
Set clear targets and reward not only the results attained but also the way they are achieved.

4 Employee experience
Foster teams' commitment and motivation with measures that encourage listening, a more flexible way of working which enhances the work-life balance, as well as a healthy environment.

5 Technology
Exploit the advantages of digitalisation for managing people in a more simple, personal and fair way.

6 Culture
Ensure that the whole Group shares a common culture focused on its purpose, aim and way of doing things, which helps us to be the best bank for our employees, customers, shareholders and communities.

2018 target:
Top 3
best bank to work for in our core countries.

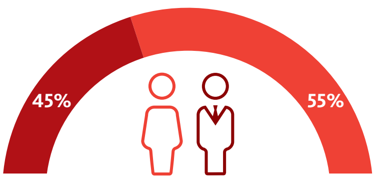


***Star Me UP:* the first global recognition network**

It arose in order to promote collaboration and recognise those who apply the corporate behaviours in their day-to-day work

>65,000 users

Our professional team



188,492 employees

49% Graduates

38 Average age (years)

9 Average years with Santander

"My work enables me to help local communities and businesses"

Ian Carson,
Branch Director, Liverpool Old Swan, Santander UK

Ian Carson is director of the Santander UK Old Swan branch in Liverpool. For several years, his branch has collaborated on various local charity initiatives and projects. For Ian "it is a great privilege to form part of a large family which is the Bank" because thanks to his work he can improve other people's lives.

GLOBAL ENGAGEMENT SURVEY

85% record participation

78% employees are engaged

91% know the corporate Simple, Personal and Fair culture

78% of employees say their line manager helps them attain a better work-life balance

The 2016 results were better, particularly in two aspects: extensive knowledge of the corporate Simple, Personal and Fair culture and motivation to make the Bank more SPF; and better work-life balance.

There are also areas of improvement in simplifying the way of working and having more innovative means to work.

Initiatives developed by HR in 2016

- **SPF (Simple, Personal, Fair) behaviours**. A plan was launched with communication, awareness raising, training and adaptation of the performance assessment and recognition processes in order to help employees apply the behaviours every day, to make Santander a more Simple, Personal and Fair bank.

- **Recognition**. Chile, Mexico, Argentina, Spain and the corporate centre installed platforms enabling those employees who set outstanding examples in corporate behaviours to be recognised. At the Group Convention in December, there was an event for the 100 SPF ambassadors – employees chosen by their colleagues as exponents of the corporate behaviours. The Star Me Up app, the first global recognition network, was also launched.

- **New corporate segmentation.** More dynamic, with entries and exits being reviewed every six months. It is based on transparency and meritocracy according to objetive (contribution, results) and individual (performance, potential) criteria.

- **Succession plans.** The succession policy approved will enable planning for the replacement of leaders, providing continuity to the business, with a common and structured methodology for key positions of senior management and control functions.

- **Global Assessment Process (GAP).** This process was launched to help leaders contribute to the Bank's transformation with a leadership style appropriate to the new phase that Santander is living.

- **360 appraisal.** This is the first phase of the corporate model for performance assessment, in which executives are appraised by their peers, direct reports and by their line manager regarding their adoption of the eight corporate behaviours in their day-to-day work.

- **Flexiworking: new spaces.** Further progress was made in this programme, the first phase of which focused on promoting more flexible working hours, through the creation of new, open-plan areas that enhance co-operation and the exchange of knowledge, and tools that enable teams to be in continuous contact with those in other countries.

- **Be Healthy, the global health and wellbeing/wellness programme.** This programme, which is already operating in Chile, Poland, Mexico, Brazil, Spain, Portugal, United Kingdom, Argentina and Santander Consumer Finance, aims to make Santander the world's healthiest organisation. The first initiative was a challenge for the Group's employees to walk, in total, the equivalent of once around the world. Santander donated €44,000 to Unicef, a euro for each kilometre covered.

- **We are Santander Week.** The 2016 week focused on corporate behaviours. Town hall meetings, conferences and volunteering activities were held to foster team and family living in all the Group's countries.

- **Knowledge.** Solaruco Pop Up was launched in June to extend the knowledge imparted at the **Corporate Centre of Knowledge and Development** to all the Group's employees. A cycle of Santander Business Insights conferences was launched, dedicated to sharing good practices.

Customers

We want to help our customers prosper day by day and we know that this means something different for each of them. We aim to meet the needs of our different customer profiles so that every day they are more loyal, use digital channels more and are more satisfied with the Bank.

“Prosper is loyalty”
Alfredo Candela, CEO Bodegas Barahonda, Spain

Simple, tailor-made solutions to strengthen the lasting loyalty of our customers.

2018 target:
18.6 million loyal customers

1|2|3 WORLD: one of the preferred options for retail customers.

This commercial relationship model rewards balances and gives cashback on household bills and purchases, among other advantages. It was extended to new segments in 2016, such as the 1I2I3 Mini Account in Spain for children and those under the age of 18, and in new countries, such as Mexico, where the offer was launched under the name of Santander Plus.

Number of customers (millions)

United Kingdom	Spain	Portugal	Mexico
5.1	2.0	0.3	1.1

SANTANDER SELECT: the differentiated value proposal for high income customers.

New proposals were developed in 2016 such as Select Global Value, which covers the needs of those customers who travel or work and live abroad. This forges customer loyalty, as customers benefit from Santander's international branch and ATM network.

SANTANDER PRIVATE BANKING: a specialised service model for higher income customers.

Santander was recognised by Euromoney as the “Best Bank in Wealth Management” in Latin America in 2016.

SANTANDER SMEs: a global solution to support the development of SMEs.

This model, which operates throughout the Group, provides a strong financial offering and other solutions to spur internationalisation, training, employment and digitalisation of SMEs.

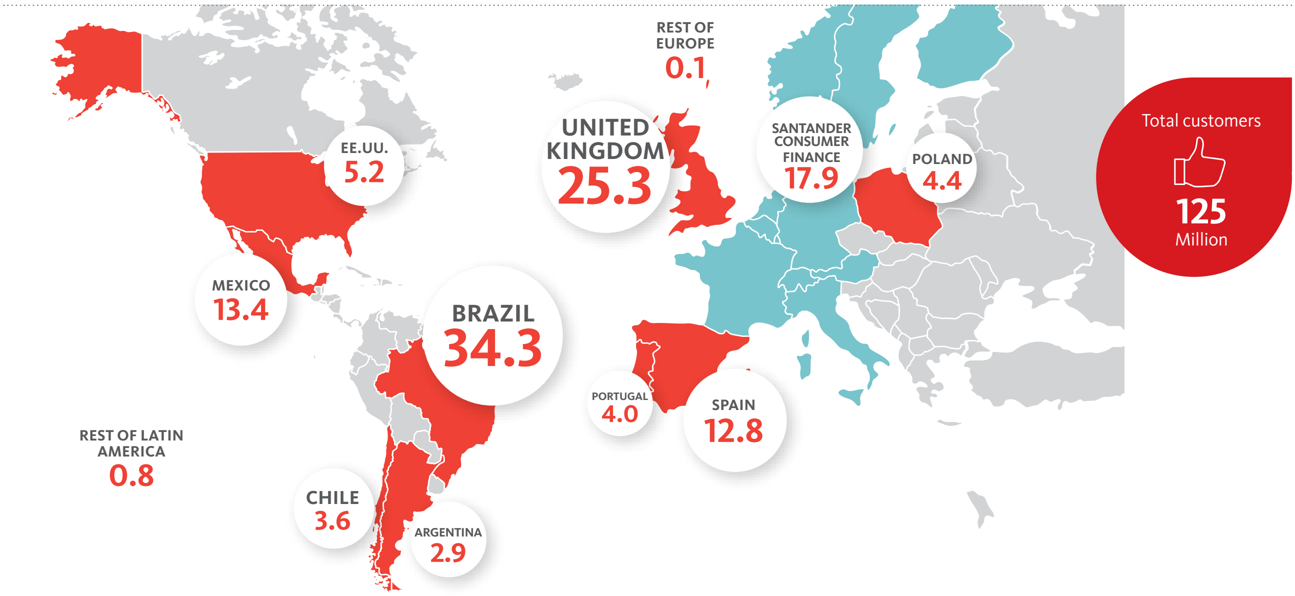
#1 Euromoney award for Best Bank in the World for SMEs

New developments in 2016 in the Santander SME strategy

POLAND	BRAZIL	PORTUGAL	URUGUAY
Firmowe Ewolucje (Business Evolutions)	*Atendimento Digital*	*Box Santander Advance*	*CRM Celestium (SMEs)*

Group customers

Million



Solutions to support the internationalisation and growth of companies.

SANTANDER TRADE NETWORK: a network of services suppliers certified by Santander to help internationalise businesses.

- This solution is part of Santander Trade, Santander's online platform that supports foreign trade with various services.

+68,000 exporters and importers

GLOBAL TREASURY SOLUTIONS: a service that helps multinational companies manage their treasuries remotely.

- It provides multinationals with centralised reporting of their accounts with any institution and enables them to order payments from Santander Group accounts, on a centralised basis using various channels and a standard format.

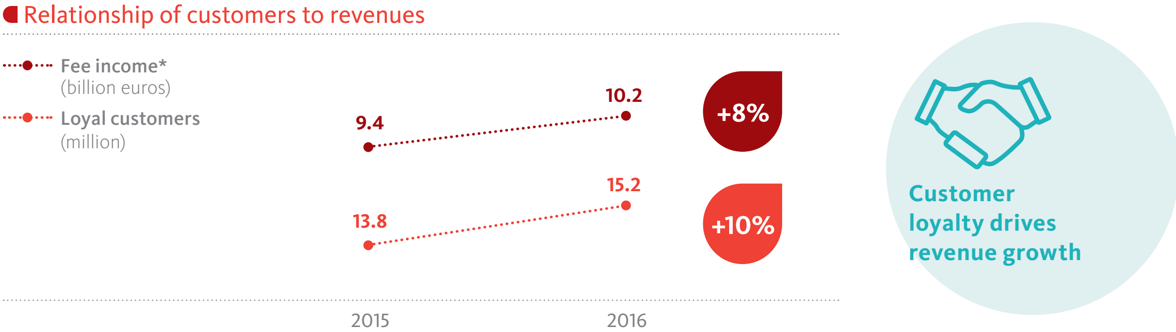
+60 multinational companies

SANTANDER FLAME: an online platform to execute and manage foreign exchange transactions and risk.

- These transactions are essential for importing and exporting. They are already functioning in the United Kingdom and Mexico, and will soon be available in Chile and the United States.

+20% growth in income

Relationship of customers to revenues



* Excluding exchange rate effects

“ Prosper is innovation for everyone ”

Roselly Kimura, IT, Santander, Brazil

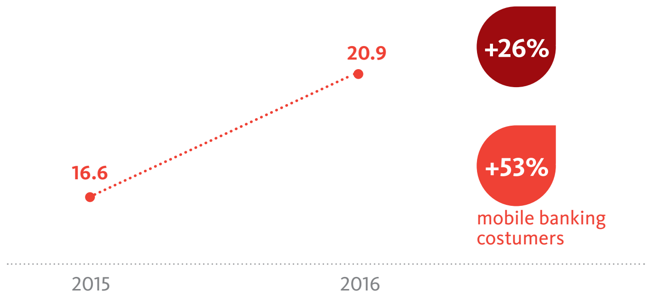
We are transforming our commercial model because we know our customers demand greater availability and proximity via digital channels, while strengthening the personal service that has always been Santander’s hallmark.

2018 target:
30 million digital customers

NEW DIGITAL SOLUTIONS: with simple access to the range of banking services and personalised advice.

This year has seen the reinforcement of the remote customer services, such as Gestor Digital in Brazil and Santander Personal in Spain, which offer customers a qualified adviser to help them with their finances, without the need to go to their branch. Financial management tools have also been enhanced, such as those in the UK, Spain and Poland for checking and classifying spending, and further improvements have been made to mobile banking, with new payment and card management solutions available in several countries.

Digital customers
Million



Digital solutions

UNITED KINGDOM
Investment centre, spendlytics (Android) and mobile payments

SPAIN
Control of personal finances in MoneyPlan. Mobile payments with Wallet and ApplePay

BRAZIL
ContaSuper solutions and SantanderWay.

MEXICO
Supermóvil +900,000 users. Mobile onboarding of university student customers

ARGENTINA
Best digital bank according to Global Finance for seventeenth year running

POLAND
Best mobile banking app in the country and third in Europe according to Forrester. Enhanced offering in mobile payments (Android).

SANTANDER NEO CRM: this commercial intelligence tool offers a 360º view of customer behaviour and preferences.

We worked in 2016 to integrate the information from all channels (branches, contact centres, digital media, etc.) and to add new transactional functionalities. This information enables the Bank’s value proposals to be improved, based on the customers’ experience and needs, and helps to generate cost savings and increase productivity (+24%).

SMARTRED: an initiative to transform the customer experience at branches.

The aim is to incorporate new technological advances and create differentiated spaces for services that help to streamline processes and enhance personalised attention. Spain, United Kingdom, Brazil, Argentina, Portugal, Mexico and Chile inaugurated new branches in line with this model.

472 branches renovated in 2016 and 1,000 more expected in 2017

“Thanks to the Bank’s programme to support SMEs, we have the advice of experts in promoting our brand and business”

Katarzyna Surowiec,
General Manager, Grandpa’s Garden, Poland.

Grandpa’s Garden is a family-run company that processes and prepares tinned vegetables in Poland. When the global crisis hit the company’s business, it sought the support of Bank Zachodni WBK (Santander Group). Thanks to *Firmowe Ewolucje (Business Evolutions)* programme, it was able to access not only funding for new investments in the plant, but also other high value-added services that helped to strengthen its brand, capture new customers and multiply sales by 10.

OPERATIONAL EXCELLENCE: to increase customer satisfaction by offering the best service at the lowest price possible.

Various initiatives are under way throughout the Group to transform the customer experience in the main relationship processes with the Bank (customer journeys).

Initiatives that enhance the customer experience

SPAIN
Santander ID
Digital identification of customers and signing of contracts in a single process

POLAND
Loans via mobile phones in 60 seconds

UNITED KINGDOM
Digital processes for mortgages
The time needed to make a request has been cut from 3 hours to less than 40 minutes (-75%)

CHILE
Neoclick
Online Request for loans in 3 clicks. 93% of the process is electronic, saving commercial teams 200,000 hours

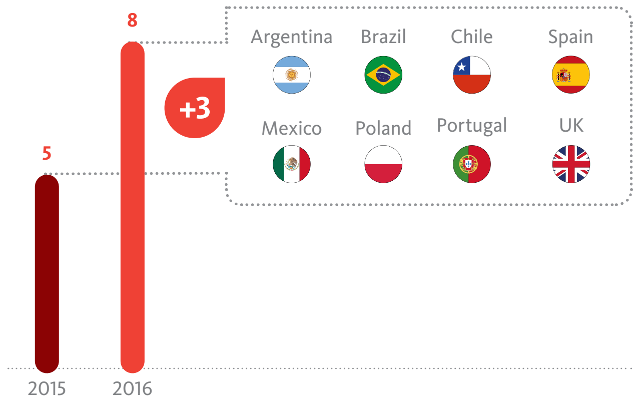
BRAZIL AND MEXICO
Biometrics
Customers are identified by fingerprint, voice or face recognition. This system is used in Mexico for around 30% of active customers

Santander is one of the most efficient international banks and it aims to keep on improving its efficiency ratio through greater process efficiency in technology and operations and in corporate centres, as well as from greater digitalisation of the commercial distribution model.

2018 target:
45-47%
efficiency ratio

We are among the Top 3 in customer satisfaction in countries accounting for close to 80% of our pre-tax profit

Number of countries where Santander is Top 3 in customer satisfaction[1]



(1) Corporate benchmark of customer satisfaction.

Shareholders and investors

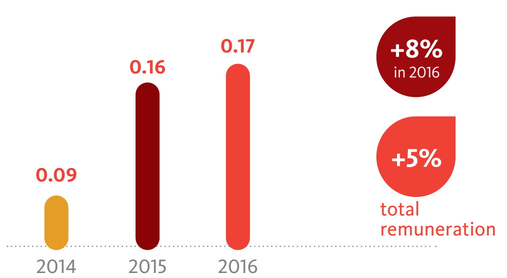
At Banco Santander we offer our shareholders an attractive sustainable return to maintain their lasting confidence. In 2016, the bank met all its financial targets and made significant progress in its strategic priorities.

Main milestones related to investors and shareholders in 2016

1. Increased remuneration and payment of the four usual dividends maintained:

- The total shareholder remuneration against 2016 profit was €0.21 per share (+5% vs 2015). Three of these dividends have already been paid: two of them in cash of €0.055 per share and one via the scrip dividend of €0.045 per share. The fourth and final dividend is scheduled to be paid in May 2017.
- The dividend yield was 5.2% in 2016 (2016 dividend/Average 2016 price).

Remuneration in cash
Euros per share



2. Increase in the number of shareholders:

- Banco Santander had 3.9 million shareholders in more than 100 countries at the end of 2016.

3.9 million shareholders

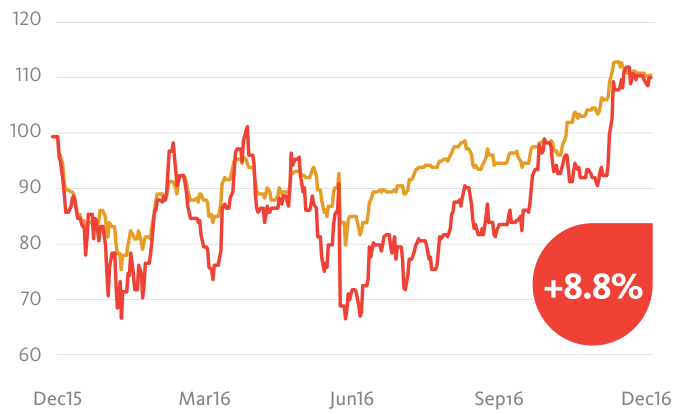
3. Improved risk indicators

- Santander's robust governance of the risk function facilitates appropriate and efficient decision-taking, effective control of risks and ensures that they are managed in accordance with the level of risk appetite set by senior management.
- Following full implementation of the *Advanced Risk Management* (ARM) programme, Santander's advanced risk management is a reality and we are regarded as best-in-class in the banking industry. The Group also has a solid risk culture, which enables it to respond to complex environments.

3.93% NPL ratio (down 43 bp in 2016)

The Santander share in 2016

Comparative performance
Dec 15 vs. Dec 16



SHARE PERFORMANCE

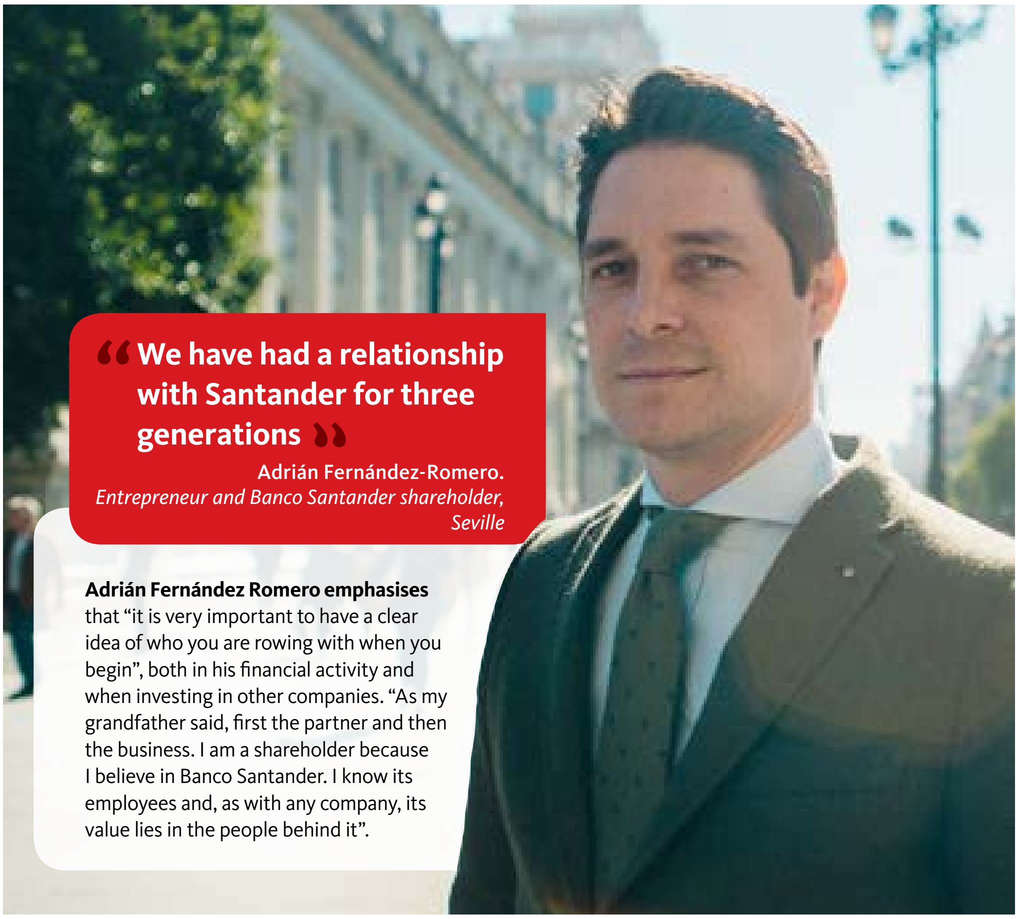
- Stock markets were very volatile in 2016 due to the uncertainty over the Chinese economy, the evolution of commodity prices, the solvency of the financial sector in some countries, interest rate policies and central banks' stimulus policies, the referendum in the UK and the US presidential election.
- In this context, the Santander share performed better than the Ibex 35, the benchmark Spanish stock market index, and the European banking index.

€4,959 share price at the end of 2016

€ 72,314 millon of Market Capitalisation

Shareholder base and capital
(31 December 2016)

	Dec. 2016	Dec. 2015
Shareholders (number)	3,928,950	3,573,277
Outstanding shares (number)	14,582,340,701	14,434,492,579
Average daily trading (number of shares)	100,707,234	103,736,264



“We have had a relationship with Santander for three generations”

Adrián Fernández-Romero.
Entrepreneur and Banco Santander shareholder, Seville

Adrián Fernández Romero emphasises that “it is very important to have a clear idea of who you are rowing with when you begin”, both in his financial activity and when investing in other companies. “As my grandfather said, first the partner and then the business. I am a shareholder because I believe in Banco Santander. I know its employees and, as with any company, its value lies in the people behind it”.

CONTRIBUTING SHAREHOLDER VALUE IN 2016

Total shareholder return
+14%

Tangible book value per share
4.22 euros
(+4%)

We strengthened our capital (+50 bp)
10.55%
CET1 fully loaded ratio

Commitment to shareholders via the Shareholder and Investor Relations area

The Shareholder and Investor Relations area implemented various initiatives in 2016 in order to:

1. **Foster constant communication with retail shareholders, institutional investors, analysts and rating agencies in order to strengthen the relationship and trust.** A Group Strategy Update was held in London in September, attended by more than 130 investors and analysts.

The application enables shareholders to vote, or delegate their vote, at the general meeting

2. **Strengthen personalised attention for shareholders.** 183 forums and meetings were held with shareholders, and 186,953 consultations were handled via remote channels.

3. **Facilitate the participation of shareholders.** Another rise in the number of shareholders who participated in the annual meeting at which 57.63% of the share capital voted or delegated its vote on the board’s proposals.

4. **Encourage innovation in the various Shareholder and Investor Relations channels.** Using the latest technologies, the corporate website, the commercial website and the Santander Shareholders and Investors app were revamped.

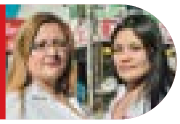
5. **Offer exclusive products and services** via the website www.yosoyaccionista.santander.com

Communities

At Banco Santander we ensure the integration of ethical, social and environmental criteria in the development of our business, contributing to the economic and social prosper of people and businesses in a responsible and sustainable way. Fostering higher education is the hallmark of our social commitment.

"Prosper is inclusion"

Lorena López y Sabrina Escalante, customer service representatives, La Juanita, Santander Río, Argentina



Santander has various policies, codes and internal rules that ensure that its activity is developed responsibly. They emanate from the best international practices and protocols, codes of conduct and international guidelines applicable in each case.

The Bank develops and promotes products and services that foster, among other things, **financial inclusion**, such as **microcredits**. Santander also has a special social commitment to the communities in which it operates, via **Santander Universities** and its investment in numerous support programmes that promote aspects such as education and social well-being. These include:

- **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, as *Amigo de Valor* in Brazil.
- **Financial education programmes** that transmit 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** that tackle poverty, vulnerability and marginalisation, as for example *Convocatoria de Proyectos Sociales* in Spain and *Discovery Grants* in the UK.

The Paris agreement on climate change represents a major step towards a less carbon-intensive economy. The financial sector has a significant role to play in this transition, which involves risks and opportunities. The Bank has strengthened this area by creating a new Climate Finance working group that aims to set the strategy, identify the risks and opportunities derived from climate change and incorporate the later into its management.

2018 target: **4.5** million people helped in 2016-2018.

1st bank in Europe and 6th in the world in the *Dow Jones Sustainability Index (DJSI),*

ROBECOSAM Sustainability Award Silver Class 2017

Santander has been present since 2000 in the DJSI, one of the main indexes that analyze and assess companies' activities in the sphere of corporate social responsibility

1.7 million people helped in 2016

209 million social invested in communities in 2016

7,082 megawatts financed in renewable energy projects in 2016

-8.5% reduction in electricity consumption in 2016

"Thanks to Santander Microcredits I can help thousands of entrepreneurs fulfil their dreams. It is very gratifying"

Rafael Rey, Paraisópolis, *Santander Brazil*

Santander Microcredits spurs the growth of small businesses without access to formal loans. So far, it has supported 250,000 people in Latin America. Rafael says that this programme enables him "to better know people's needs, what are their dreams and help them to develop." Santander aims to support close to 300,000 new customers in the coming years by extending the programme to Mexico.

SANTANDER UNIVERSITIES IN FIGURES

36,684 scholarships and grants in 2016

1,183 agreements with universities and academic institutions in 21 countries

157 million invested in higher education in 2016

universia

1,407 universities in 23 countries form part of Universia

Santander Universities

Banco Santander, which stands out from the rest of 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.

Keys of the support for universities

- **University entrepreneurship,** a vital factor in social progress. We provided support, advice and training for more than 2,400 young people via programmes as the Santander *YUZZ 'Jóvenes con ideas'*. Competitions with prizes for entrepreneurship were held in seven countries – Brazil, Argentina, Chile, Mexico, Portugal, Spain and United Kingdom – with 25,000 participants. Santander has a target of supporting 80,000 entrepreneurs in 2017-18.

- **Scholarships and social impact:** scholarship programmes for national and international mobility, academic training and internships in companies, in Spain, United Kingdom, Puerto Rico, Brazil, Chile and Uruguay. The Santander Impact project was created, with information on the effect of these initiatives on communities.

- **Digitalisation and modernisation of universities:** in order to streamline academic processes and services with tools such as the *University Smart Card* (USC) which evolves with technology (new supports and uses). There are 9.1 million USCs in 279 universities in 11 countries.

Universia

- Sponsored by Banco Santander, **Universia** is Ibero-America's largest network of universities and an international reference in university relations. It focuses on fostering employment of graduates, online training via resources such as MOOCs (massive open online courses) and on facilitating digital tools.

More information is available in the corporate website's section on sustainability and in the 2016 sustainability report.


Te ayudamos
a hacer realidad
tus proyectos

2

2016 Results

Santander met its strategic financial targets for 2016, in a very demanding economic and financial environment. Attributable profit grew by 4%, buoyed by a good performance in commercial revenue, cost control and enhanced credit quality.

Economic, banking and regulatory environment

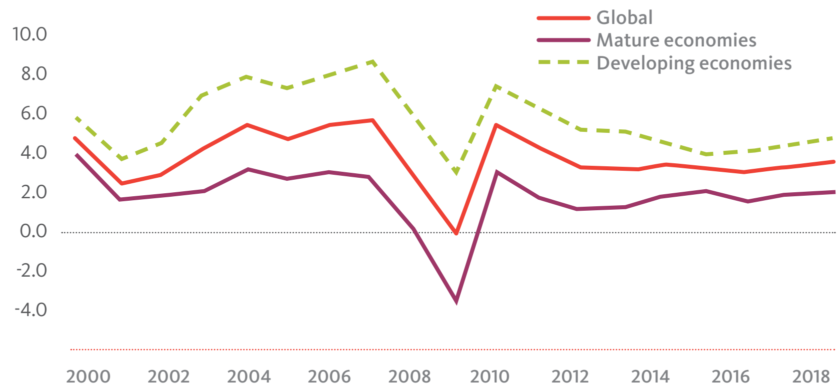
2016 was characterised by volatility in capital markets, which reacted to unexpected economic and political news, while the competitive environment and a demanding regulatory agenda continued to restrain the recovery in banks' profitability.

» International economic context

The global economy grew slightly less than in 2015 (3.0% vs. 3.2%), due to slower growth in mature economies, which began the year weakly due to a series of one-off factors including financial instability and weather conditions.

GDP

% annual change



Source: IMF World Economic Outlook

Economic performance by country

Country	% annual change GDP 2015	% annual change GDP 2016	Economic performance
United States	2.6	1.6	Fall in unemployment rate (to 4.7%), a level that is almost full employment, rise in underlying inflation to 1.8%. Increase of 25 b.p. in the Federal funds rate in a context of economic revitalisation, which points to gradual rises in 2017.
United Kingdom	2.2	1.8	Lower than expected initial impact of the Brexit referendum. The jobless rate continued to fall (to 4.8%), which is virtually full employment. Despite the rise in inflation and sterling's depreciation, the Bank of England cut its base rate by 25 b.p. to 0.25% and took new measures to support lending.
Eurozone	1.9	1.7	Moderate but resilient growth. Uneven performance by country, with the largest economies registering positive growth. The risk of deflation abated, but inflation was still far from the 2% target, which led the European Central Bank to reduce rates to new lows and adopt new quantitative easing measures.
Spain	3.2	3.2	Broadly based growth, mainly underpinned by domestic demand. Job creation was dynamic and lowered the unemployment rate to 19%. Balanced recovery and sustained growth with moderate inflation, a current account surplus and a reduced fiscal deficit.
Portugal	1.6	1.3	The unemployment rate continued the downward trend of the last few years and was just above 10%. Inflation was similar to 2015 at 0.6%.
Poland	3.9	2.8	Slower growth, unemployment rate at historic low (5.9%), inflation again positive in December (0.8%) and the key interest rate stable at 1.5% throughout the year.
Brazil	-3.8	-3.5	As the year progressed, the recession weakened. The new government is clearly reformist and has the capacity in parliament to approve reforms. The central bank brought inflation (6.3%) below the upper limit of its target band (6.5%), which enabled it to cut the key rate from 14.25% to 13.75% at the end of the year with a downward bias.
Mexico	2.6	2.3	Slower growth due to a more challenging external environment, which produced a fiscal policy adjustment and a tightening of monetary policy. The peso depreciated and its impact on inflation led the central bank to raise its key rate from 3.25% to 5.75%.
Chile	2.3	1.5	Slower growth, due to the international context and the mining industry adapting to an environment of moderate prices. Inflation fell to 3% and the key interest rate remained at 3.5% (same level as at the end of 2015).
Argentina	2.4	-2.0	The government faced the macroeconomic imbalances and microeconomic distortions with determination, and strengthened the institutional framework. It began to lay the groundwork for controlling inflation and the public finances, for commercial and financial integration and for recovering growth.

> Going forward, we have many opportunities to grow profitably in Europe and the Americas in an environment that we expect to be volatile but, in general, better than 2016 in our main markets.
>
> **Ana Botín**,
> *Presentation of Santander Group's 2016 results (25 January 2017)*

MSCI World index
+5%
in 2016

€/$ exchange rate
1.05
(-3% in 2016)

10-year US bond yield
2.43%
(+16 bp in 2016)

» Financial markets and exchange rates

As soon as the year started, signs of economic slowdown in China and doubts on the soundness of mature economies sparked a sharp rise in risk aversion that caused stock markets to tumble and oil prices to reach their lowest levels since 2003. Financial markets sentiment recovered as of the middle of February, reducing volatility, thanks to signs of stabilisation in the Chinese economy, some recovery in oil prices and improvement in the US economy.

In March, the European Central Bank cut its key rates and increased the programme for buying public and private sector debt, which produced a sharp decline in the yield on fixed income securities in euros. Public debt was placed at negative interest rates for the short and medium term maturities of many eurozone countries.

The vote in the **UK's referendum** in June to leave the European Union triggered another bout of volatility, particularly in exchange rates, with falls in stock markets, a safe haven flight into quality assets and the depreciation of sterling and the euro. The impact was not lasting, as volatility declined in the following months, share prices recovered and risk aversion abated.

The result of the **US presidential election** in November produced a new bout of volatility in the currencies of emerging markets, with rises in stock markets and in long-term interest rates in the expectation that fiscal policy in the short term would be more expansive. The dollar appreciated against the euro.

At the end of the year, the rise in the Federal Reserve's key rates and in oil prices, as well as the improved growth in the main economies, strengthened the rising trend in long-term interest rates. Even so, monetary policies in mature economies at the end of 2016 were markedly expansive.

The Mexican peso depreciated 15% to 1€=21.8MXN, hit by the evolution of oil prices in the first months of the year and by uncertainty over a possible change in US trade and migration policy in the last part of 2016. As the political uncertainty cleared in Brazil, the Brazilian real recovered notably to end the year at 1€=3.4 BRL (1€=4.3 BRL a year earlier). The Chilean peso ended the year at 1€=708 CLP, a 9% appreciation over 2015 year-end.

In 2016 the financial markets were impacted by various shocks from the economic and political sphere

The banking environment in the countries where Banco Santander operates continued to be characterised by regulatory changes and a challenging economic environment

» Banking sector environment

In mature economies, banks continued to bolster their balance sheets and capital adequacy. Specifically, the tier one capital adequacy ratio (CET1) of European banks was 14.1% in the third quarter, according to the European Banking Authority (EBA), more than one percentage point above that recorded a year earlier. Except for some isolated exceptions, the banking system notably improved its capacity to absorb adverse shocks, something that was underscored in the EBA's stress tests.

Even so, banks continued to face significant challenges to drive profitability. Interest rates and business volumes remained low; and there was a sharp rise in competitive pressure in most markets, among banks and in financing via markets, and as a result of the entry of new players in the sector. Shadow banking continued to gain importance and non-banking financial entities, which are focusing their business on niches such as payments, advice and loans, continued to grow.

In emerging countries, with interest rates and margins above those in developed countries, banks' profits remain higher.

The great majority of banks are implementing changes in culture, in order to recover trust, and, in general, all seek to adapt to the digital revolution, which is going to define the way in which banks relate to their customers, the level of services provided and the efficiency of processes.

Moreover, international banks are facing differing sociodemographic trends, with a clear process of ageing in mature economies and a big rise in the middle classes in developing economies, which will require differentiated strategies depending on the features of each market.

» Supervisory and regulatory environment

REGULATORY HIGHLIGHTS IN 2016

The regulatory agenda in 2016 was marked:

- At the international level, by progress in completing the Basel III agreement.
- At the European level, by the European Commission's proposed reforms to the capital requirements and resolution framework and measures to advance in the single European market.
- And in Spain, by measures related to consumer and investor protection.

In 2016 the regulatory environment remained demanding with relevant novelties among which the most important are the revision of Basel III and the proposal of the European Commission for resolution of entities.

Basel III review

The objective of authorities in the Basel III review is to simplify the ratios and make them more comparable and sensitive to risk, without significantly increasing banks' overall capital requirements.

Also under discussion is whether to set limits on capital deductions for entities that use internal models to calculate their capital requirements.

Although there is still much uncertainty, the new framework is expected to be approved in the first months of 2017 and come into force in 2021.

Prudential regulation review in Europe

The European Commission published in November a new proposal of reforms on capital and resolution rules. These include:

- The introduction of new Basel international standards in the capital framework.
- Changes to the resolution framework. The *Single Resolution Board* (SRB) has been fully operational since 1 January 2016. It will set during 2017 a level indicative of the loss absorbing capacity for each institution (MREL and TLAC for the G-SIBs).

Santander is structured around subsidiaries that are autonomous in terms of capital and liquidity. As a result, it has a multiple point of entry approach, which means that the resolution of a particular subsidiary would not affect the other Group entities. Accordingly, the TLAC requirement is expected to be applied to each group's subsidiary, that must fulfil not only the local rules but also the European ones. This will require additional debt issues.

The Commission's proposal is the first step in a long legislative process. It is expected to come into force between 2019 and 2021.

Meanwhile, the European Banking Authority (EBA) and the European Central Bank (ECB) are reviewing the internal models used by the banks in Europe.

European Banking Union

Milestones in the construction of the European Banking Union

November 2014
The European Central Bank takes on the single supervision of banks in the eurozone

January 2015
The European directive on banking supervision came into force

Third quarter of 2015
The ECB establishes the minimum capital requirements for 2016 as conclusion of the *Supervisory Review Evaluation Process* (SREP)

November 2015
The European Commission presented its single deposit insurance scheme proposal (EDIS)

January 2016
The European resolution authority fully assumes its functions and the bail-in comes into force as the SREP's resolution tool

May 2016
European Commission's final proposal for minimum own funds and eligible liabilities (MREL)

November 2016
The European Commission's proposal on reviewing capital requirements (CRR/CRDIV), the bank recovery and resolution directive (BRRD) and the single resolution mechanism (SRM) regulation

July 2017
The European Commission's senior debt subordination proposal in Europe

Fourth quarter of 2017
Setting an indicative MREL level for systemic entities

January 2019
Final total loss absorbing capacity (TLAC) implementation proposal in Europe

Interaction between accounting and prudential rules

The regulatory bodies are working on bringing into force in 2018 the new international financial reporting standard (IFRS 9), which will change the calculation regarding the recognition of losses incurred in the banking system. The new accounting framework adapted to IFRS 9, which must also reconcile with the capital framework, will be defined in 2017.

There is still an intense political debate on the creation of a single European deposit insurance scheme (EDIS). The differences centre on how to carry out the gradual allocation of the fund envisaged for 2024 and to mitigate and share the risks among countries. The date for reaching an agreement is still not known.

Banking supervision via the Single Supervisory Mechanism (SSM)

The number of banks supervised by the European Central Bank stood at 126 at the end of 2016.

Of note among the SSM's activities was the *Supervisory Review and Evaluation Process* (SREP). The supervisory team assigned to Santander had more than 100 meetings with the Bank in 2016.

At the end of 2016, the ECB sent to each bank the minimum capital requirements for the following year. In 2017, at consolidated level, Santander Group must maintain a minimum phase-in CET1 capital ratio of 7.75%, 9.25% for the phase-in T1 and a total phase-in ratio of 11.25%.

SINGLE EUROPEAN MARKET

The European Commission continues to work on measures to strengthen and advance in the single European market.

- Action plan of the single capital market.
- Action plan of the Green Book on retail financial services.
- Digital agenda and initiatives to benefit the single digital market such as digital economy and data economy.
- Harmonisation of consumer protection regulations.

Member states face an important schedule for implementing rules that will come into force in 2018, such as data protection regulations, the cybersecurity directive, the directive on payment services and the Markets in Financial Instruments Directive (MiFID II), which will play a key role in developing retail and digital banking.

SRB (Single Resolution Board): single European mechanism for the resolution of failing banks.
TLAC (Total Loss Absorbing Capacity): loss absorbing capacity of globally systemically important banks. It enables the bail-in to be carried out: the investors, rather than the taxpayers, assume the liabilities.
MREL: Minimum Requirement for own funds and Eligible Liabilities. Similar to the TLAC for globally systemically important banks, the MREL is applied to European banks.
G-SIB: Globally Systemically Important Banks.
SREP: the Supervisory Review and Evaluation Process of banks performed by the European Central Bank.
CRDIV: the EU's Capital Requirements Directive.
BRRD: the EU's Bank Recovery and Resolution Directive.
SRMR: the Single Resolution Mechanism Resolution in the EU.
MiFID (Markets in Financial Instruments Directive): European rules on investor protection in relation to financial products.

Santander Group key data

Balance sheet (million euros)	2016	2015	%2016/2015	2014
Total assets	1,339,125	1,340,260	(0.1)	1,266,296
Net customer loans	790,470	790,848	0.0	734,711
Customer deposits	691,112	683,142	1.2	647,706
Managed and marketed customer funds	1,102,488	1,075,563	2.5	1,023,189
Shareholders' equity	102,699	98,753	4.0	89,714
Total managed and marketed funds	1,521,633	1,506,520	1.0	1,428,083

Income statement* (million euros)	2016	2015	%2016/2015	2014
Net interest income	31,089	32,189	(3.4)	29,548
Gross income	43,853	45,272	(3.1)	42,612
Net operating income	22,766	23,702	(3.9)	22,574
Underlying profit before taxes	11,288	10,939	3.2	9,720
Underlying profit attributable to the Group	6,621	6,566	0.8	5,816
Attributable profit to the Group	6,204	5,966	4.0	5,816

EPS, profitability and efficiency (%)	2016	2015	%2016/2015	2014
EPS (euros)	0.41	0.40	1.0	0.48
RoE	6.99	6.57		7.05
Underlying RoTE**	11.08	10.99		10.95
RoTE	10.38	9.99		10.95
RoA	0.56	0.54		0.58
Underlying RoRWA**	1.36	1.30		1.27
RoRWA	1.29	1.20		1.27
Efficiency ratio (with amortisations)	48.1	47.6		47.0

Solvency and NPL ratios (%)	2016	2015	%2016/2015	2014
CET1 Fully loaded	10.55	10.05		9.65
CET1 Phase-in	12.53	12.55		12.23
NPL ratio	3.93	4.36		5.19
Coverage ratio	73.8	73.1		67.2

Market capitalisation and shares	2016	2015	%2016/2015	2014
Number of shares (million)	14,582	14,434	1.0	12,584
Share price (euros)	4.959	4.558	8.8	6.996
Market capitalisation (million euros)	72,314	65,792	9.9	88,041
Tangible Book value (euros)	4.22	4.07		4.01
Price/ tangible book value (X)	1.17	1.12		1.75
P/E ratio (X)	12.18	11.30		14.59

Other data	2016	2015	%2016/2015	2014
Number of shareholders	3,928,950	3,573,277	10.0	3,240,395
Number of employees	188,492	193,863	(2.8)	185,405
Number of branches	12,235	13,030	(6.1)	12,951

(*) Variations w/o exchange rate: Net interest income: +2.3%, Gross income: +2.5%; Net operating income: +1.6%; Underlying attributable profit: +10.5%; Attributable profit: +15.1%

(**) Excluding non-recurring capital gains and provisions

Note: RoE, RoTE y CET1, proforma data including the January 2015 capital increase.

For more information about the results of the Group and its main units see pages 96 to 157 of Banco Santander's 2016 Annual Report.

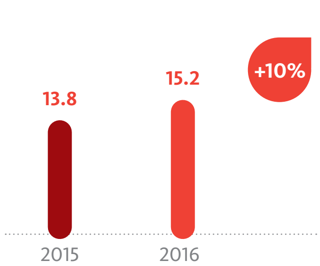
Results

The commercial transformation is driving growth in loyal and digital customers

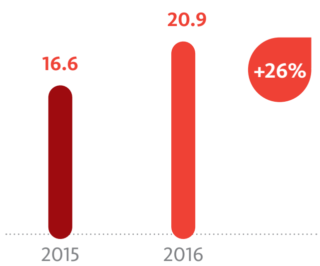
During 2016, Santander advanced in its customer loyalty strategy in all its markets with the launch of various strategies and high value-added products. The Bank strengthened its multichannel offering with new apps for mobile banking, development of biometric identification and the launch of new means of payment facilities in several of its markets.

These measures increased the number of loyal customers by 1.4 million (individuals: +9% and companies: +29%) and digital customers by 4.3 million (notable growth of 53% in mobile banking customers).

Loyal customers
Million



Digital customers
Million



Recurrent growth in commercial revenues. Emphasis on cost control and lower provisions

The loyalty strategy enabled commercial revenues to rise in eight of the Group's 10 core units. Of note was the increase in fee income.

Thanks to the efficiency plan, the investments in the commercial transformation and the higher regulatory costs were absorbed. As a result, operating expenses fell on a like-for-like basis and discounting inflation. Santander remains one of the world's most efficient banks. It is among the Top 3 for customer satisfaction in eight of its nine core countries.

Provisions continue to decline.

+3%[1] Gross income

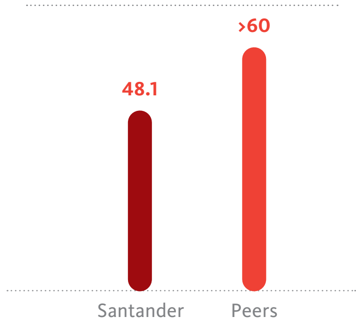
+2% Net interest income

+8% Fee income

-2%[2] Costs

-2%[1] Provisions

Cost-to-income ratio
%



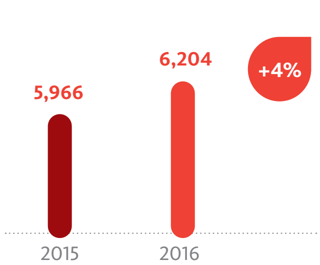
1. Constant euros; 2. Excluding perimeter and inflation.

Solid growth in pre-tax profit and value creation for our shareholders

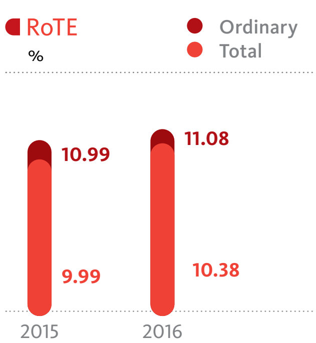
Underlying profit before taxes rose 12% (in constant euros) and increased in nine of the Group's 10 core units. Attributable profit was up 4% to €6,204 million.

The positive trend in the income statement enabled Santander to meet its financial objectives and consolidate itself as one of the European banks with the best shareholder return.

Attributable profit
Million euros



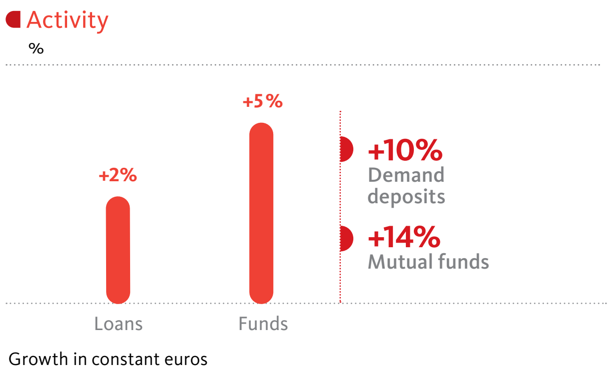
RoTE
%



Balance sheet

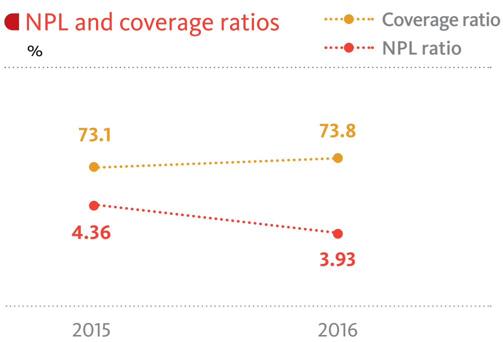
Greater activity in a challenging environment

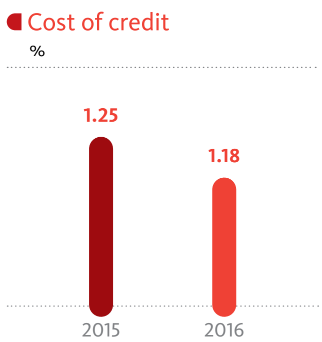
In an environment of low interest rates and economic recovery, Santander maintained constant growth in its commercial activity, both loans and customer funds in almost all its markets, supporting its corporate clients in their expansion plans and helping individual customers to satisfy their financial needs.



Enhanced credit quality ratios

Santander maintained its traditional prudence in risks and continued to reduce the NPL ratio and increase the coverage ratio. The cost of credit continued to fall and was in line with the objectives announced to the market.

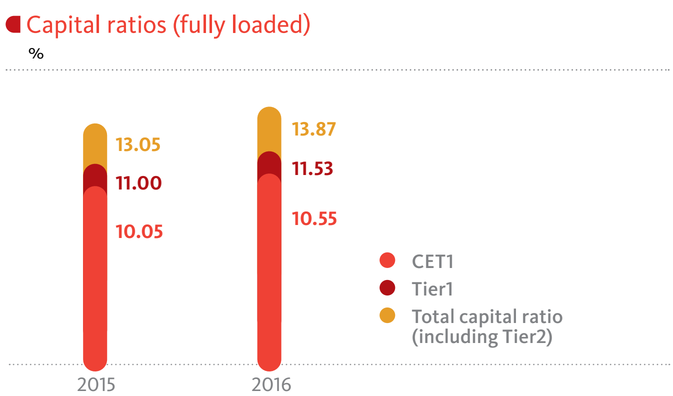




Capital strength underpinned by organic generation

Santander maintained solid capital ratios appropriate for its business model, balance sheet structure and risk profile. The organic generation of capital (€3,363 million in 2016) enabled capital to increase, business growth to be financed and an increased cash dividend to be paid.

In the stress tests conducted by the European Banking Authority, Santander is the bank that destroys least capital among its competitors in the adverse scenario.



Results by countries and businesses

Spain

Santander Spain is maintaining its 1|2|3 strategy to boost loyalty in the medium and long term and improve the quality of service.

+32% loyal customers

+13% digital customers

New model of Santander branch in Spain.

STRATEGIC PRIORITIES

- Profitable growth
- Bank of choice for corporates
- Improve efficiency and customer experience
- Best bank to work for

2016 HIGHLIGHTS

- As part of the **1|2|3 World** programme, a new means of payment strategy that focuses on improving **customer loyalty** was implemented.
- There were increases in loyal customers (+27%), commercial productivity (50% of production comes from 1|2|3 customers) and investment in profitable products (market share increased by 230 b.p. in new consumer lending production).
- **New lending** to individuals rose 16%. By products, consumer credit (+91%) and mortgages (+18%) fuelled growth.
- Santander continued to support SMEs (+48% in loyal SMEs).
- The **NPL ratio** dropped to 5.41% (-112 b.p.).
- An **efficiency plan** was implemented which saw optimisation of small branches and the creation of a new and larger branch model which enables better advice and service to be given to customers, as well as the integration with digital channels. Santander remained among the Top 3 in customer satisfaction among Spanish banks.
- Santander Spain continued to be the leader in the wholesale banking segment, as well as in private banking and Select customers.
- Santander has brought ***ApplePay*** to Spain on an exclusive basis. This mobile payment service demonstrates the Bank's commitment to digital innovation. In addition, other payments services, such as the Wallet app and the contactless payment bracelet, have been launched.
- ***LaLiga Santander*** came into being. This strategic sponsorship agreement gives the Bank projection and visibility, further enhances its brand image and brings it close to customers.

Key data

EMPLOYEES
23,017

CUSTOMERS (million)
12.8

LOANS [1,2]
150,960 (-4%)

ATTRIBUTABLE PROFIT [1]
1,022 (+ 5%)

CONTRIBUTION TO GROUP PROFIT
12%

1. Million euros.
2. Change without repos.

Santander Consumer Finance

SCF is Europe's market leader in consumer finance and specialises in auto finance and in loans for the purchase of durable goods, personal finance and credit cards.

It has a presence in Germany, Austria, Belgium, Denmark, Spain, Finland, France, Netherlands, Italy, Norway, Poland, Portugal, United Kingdom, Sweden and Switzerland.

Santander Consumer Finance branch in Germany.

STRATEGIC PRIORITIES

- Maintain profitability and gain market share
- Manage agreements with vehicle manufacturers proactively
- Speed up the digitalisation of the business

2016 HIGHLIGHTS

- **SCF is among the Top 3 in the markets in which it operates.** It generates recurring profits throughout the economic cycle and offers a unique value proposition among its competitors.
- **It has an extensive network of agreements with more than 130,000 associated points of sale** (car dealers and retailers).
- It offers financing solutions via innovative platforms.
- **It has substantial capacities in risk management and recoveries** that make it possible to maintain high credit quality.
- **The evolution of results (+18%) reflects higher growth in gross income than costs, a fall in provisions with a cost of credit of 0.47%** and an efficiency ratio (44.7%) better than that of its competitors.
- Of note among the units was the good performance of profits in Spain, the Nordic countries and Italy.
- The **agreements signed** in the last few years have consolidated SCF's leadership position in its markets:
  - The agreement with Banque PSA Finance (BPF) to create joint ventures in 11 countries was completed.
  - GE Money was integrated in the Nordic countries.
- All countries registered growth in new lending (+17%).

Key data

EMPLOYEES
14,928

CUSTOMERS (millions)
17.9

LOANS[1,2]
87,742 (+14%)

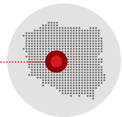
ATTRIBUTABLE PROFIT[1]
1,093 (+18%)

CONTRIBUTION TO GROUP PROFIT
13%

1. Million euros. Change in constant euros. 2. Change without repos.

Poland

Bank Zachodni WBK



One of the Poland's main banks, the leader in mobile and online banking and second in the card market.

Bank Zachodni WBK branch in Poland.

+4% loyal customers

+5% digital customers

1. Million euros, change in local currency.
2. Change without repos.

2016 HIGHLIGHTS

- **In order to increase loyalty and the number of digital customers,** Bank Zachodni WBK continued to develop its electronic channels: **BZWBK24 received several awards** as one of the best mobile banking apps in Poland as well as internationally.
- ***Firmowe Ewolucje (Business Evolutions)* was launched,** an online platform to help SMEs do business in the virtual world and expand into foreign markets.
- **Loans increased 8% year on year, well above the market pace,** with the focus on SMEs and mortgages.
- **Growth in commercial revenue** and improvement in credit quality. The 2016 profit was affected by the new tax on assets, excluding this effect profit grew 14%.
- *Euromoney* magazine recognised **Bank Zachodni WBK** as the **Best Bank in Poland in 2016.**

Key data

EMPLOYEES
12,001

CUSTOMERS (millions)
4.4

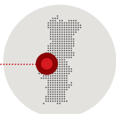
LOANS[1,2]
20,697 (+8%)

ATTRIBUTABLE PROFIT[1]
272 (-6%)

CONTRIBUTION TO GROUP PROFIT
3%

Portugal

Santander Totta



Portugal's most profitable bank, with market shares of around 14% in loans and deposits.

Santander Totta branch in Portugal.

+21% loyal customers

+32% digital customers

1. Million euros. 2. Change without repos.

2016 HIGHLIGHTS

- Following the acquisition of most of Banif's assets and liabilities in December 2015, Santander Totta became Portugal's **second largest private sector bank.** The technological and operational integration was completed in less than a year.
- The bank continued to focus on structural improvements to its commercial model to boost efficiency and the quality of customer service, via the CRM platform, a multichannel offering and streamlined processes. This was reflected in **gains in market share in loans to companies.**
- **The 1|2|3 World programme evolved well,** with significant increases in the number of accounts, credit cards and protection insurance.
- Among the awards Santander Totta received in 2016 was **Best Bank in Portugal,** from both ***Euromoney*** and ***Global Finance.***

Key data

EMPLOYEES
6,306

CUSTOMERS (millions)
4.0

LOANS[1,2]
29,030 (-5%)

ATTRIBUTABLE PROFIT[1]
399 (+33%)

CONTRIBUTION TO GROUP PROFIT
5%

United Kingdom

Santander UK aims to deepen customer loyalty, and improve customer experience through digitalisation and product simplification.

+3% loyal customers

+25% digital customers

Santander UK branch in the United Kingdom.

STRATEGIC PRIORITIES

- Grow customer loyalty and market share
- Deliver operational and digital excellence
- Growing profitability and a strong balance sheet

2016 HIGHLIGHTS

- The UK's decision to leave the EU has led to economic uncertainty and financial market volatility. **Santander's commitment to British businesses, customers and our people remains as strong as ever.**
- **Strong performance for 2016 with solid business growth,** increased cost discipline and good credit quality – all supported by robust UK economic growth.
- **1I2I3 World now has 5.1 million customers** (up 483,000 in 2016). Current account balances continued to grow (£11,600 million in 2016) and resulted in fee income growth.
- **Digital customers reached 4.6 million,** delivering continual improvement in customer experience. Investment made in new technology such as voice banking capabilities and a digital end-to-end mortgage application process, which can be completed in under an hour.
- **Santander UK continued to support the housing market.** Gross mortgage lending stood at £25,800 million, including loans to 25,300 first-time buyers.
- **Santander UK continued to support UK companies,** despite a competitive environment, economic uncertainty and the slowdown in SMEs activity. Lending was up 3%.
- **Operational efficiency is underpinned by digitalisation and product simplification.** The efficiency ratio improved to 51%, reflecting increased cost discipline.
- **Pre-tax profit increased by 8%.** Attributable profit was affected by the new bank corporation tax surcharge.
- **Santander UK maintained a strong balance sheet.** CET1 capital ratio was 11.6%. The NPL ratio also improved to 1.41%.

Key data

EMPLOYEES
25,688

CUSTOMERS (millions)
25.3

LOANS[1,2]
242,510 (+2%)

ATTRIBUTABLE PROFIT[1]
1,681 (-4%)

CONTRIBUTION TO GROUP PROFIT
20%

1. Million euros, change in local currency. 2. Change without repos.

Brazil

In a challenging economic enviroment, Santander Brazil showed the strength of its banking model, registering a sharp growth in profit and accelerating its commercial transformation to focus on the customer.

+16% loyal customers

+45% digital customers

Santander's headquarters in São Paulo, Brazil.

STRATEGIC PRIORITIES

- Focus on revenue growth
- Gain market share in acquiring, consumer credit, SMEs, etc.
- Digital transformation
- Risk management and recoveries

2016 HIGHLIGHTS

Santander Brazil posted growing profit in 2016 thanks to its approach to commercial activity, risk (NPL ratio below the average of private sector banks), **and costs,** which are well-balanced (via initiatives such as the 'Fit to grow' programme).

Solutions to improve the customer experience: Acquisition of 100% of the digital prepaid platform *Conta Super;* streamlining of processes with solutions such as Clique Único, for digitalisation of administrative work previously done on paper and reduce customer reponse time. The mobile banking app has become a benchmark in the market and has been valued highly in Apple Store and Google Play, while e-commerce sales have tripled.

The bank has 6.4 million customers that regularly use digital services. Transactions made through digital channels represented 73% of total transactions and 6.3 million customers use biometric identification systems.

Strengthening of businesses: *Santander Financiamentos* created joint ventures with Hyundai and Banco PSA Finance and launched a new digital model to improve the sales process. In wholesale banking, Santander participated in the country's largest mergers and acquisitions reaching the leading position on the rankings.

Innovation in retail banking: in the pay roll business, creation of *Olé Consignado* with Banco Bonsucesso; innovative initiatives in payments instruments (*Santander Way, Getnet*, arrangement with American Airlines). In the SME segment, in addition to its financial services, the bank has *Avançar,* a programme that helps businesses with staff training and international expansion.

Santander is among the **best companies to work** for in Brazil, according to *Great Place to Work.*

Santander Brazil included social and environmental aspects in the credit analysis of more than 1,000 companies in the corporate customer segment.

Key data

EMPLOYEES
46,728

CUSTOMERS (millions)
34.3

LOANS[1,2]
80,306 (+0.4%)

ATTRIBUTABLE PROFIT[1]
1,786 (+15%)

CONTRIBUTION TO GROUP PROFIT
21%

1. Million euros, change in local currency. 2. Change without repos.

Mexico

Santander Mexico is the country's third largest bank per loan portfolio with a 14% market share. Its main strength is innovation in customer service.

+16% loyal customers

+46% digital customers

Santander's headquarters in Mexico.

STRATEGIC PRIORITIES

- Be the 2nd or 3rd main operator in most segments
- Improve the retail banking franchise
- Improve infrastructure and digitalisation
- Increase the RoTE to close to 17%

2016 HIGHLIGHTS

- **Focus on customer loyalty with the launch of programmes such as Santander Plus,** the most innovative available from banks in Mexico, which pays cashback to customers on the basis of their transactions. This programme attained 1.1 million customers in its first year.

- **Total annual lending growth of 8%.** Companies, SMEs and consumer credit stand out.

- **Santander-Aeroméxico travel card,** the best offer of its kind in Mexico, has 430,000 cards have been issued since the launch, and will be managed exclusively by Santander for the next 10 years.

- **A better, simpler and more innovative mortgage offering:** the range was reduced from four products to two, and included the launch of Hipoteca Personal, the only one in Mexico that offers a tailored interest rate based on the customer's profile.

- **The number of digital customers rose 46% to 1.3 million.** The Digital Suite, the digital banking offer that integrates different services, includes products such as the *Súper Cuenta Go,* which enables accounts to be opened and managed completely digitally. The customer can also check prices for insurance, with the Segurómetro, make investments online and control spending via an app.

- **Santander Mexico will allocate MXN 15,000 million** over the next three years to strategic investments and initiatives, notably to modernise channels, systems and infrastructure.

- *International Finance Magazine* (IFM) recognised Santander as the **Most Socially Responsible Bank in Mexico.** It also achieved first place in the banking sector and second in the total ranking of the Mexican stock market's IPC Sustentable index.

Key data

EMPLOYEES
17,608

CUSTOMERS (millions)
13.4

LOANS[1,2]
28,017 (+8%)

ATTRIBUTABLE PROFIT[1]
629 (+18%)

CONTRIBUTION TO GROUP PROFIT
8%

1. Million euros, change in local currency. 2. Change without repos.

Chile

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

Work café in Chile.

+8% loyal customers

+4% digital customers

1. Million euros, change in local currency. 2. Change without repos.

2016 HIGHLIGHTS

- In 2016 Santander Chile registered a **substancial improvement in the indicators of customer satisfaction** thanks to the simplification of processes and a greater focus on the customer and this closing the gap with the main competitors in terms of quality of service.
- **Innovative model of work/café branches,** a new way of doing banking that adapts to society's changes. These branches have coffee shops along with an ample working area open to anyone, with free Wi-Fi.
- **Increase in the market shares** of loans and deposits in 2016. Total lending increased 7%. Of note was the market share gain of 22 bp. Customer deposits rose 7%.
- Santander was voted the Best Bank in Chile by *Euromoney* and Bank of the Year by *LatinFinance* magazine.

Key data

EMPLOYEES
11,999

CUSTOMERS (millions)
3.6

LOANS[1,2]
38,800 (+7%)

ATTRIBUTABLE PROFIT[1]
513 (+16%)

CONTRIBUTION TO GROUP PROFIT
6%

Argentina

Santander Río

Santander Río consolidated itself as the country's leading private sector bank following its acquisition of Citi's retail business.

Santander Select branch in Argentina.

+6% loyal customers

+20% digital customers

1. Million euros, change in local currency. 2. Change without repos.

* Operation subject to authorization by the relevant authorities.

2016 HIGHLIGHTS

- **Santander Río will incorporate 500,000 individual customers and a 70-branch network** by acquiring the retail business of Citibank Argentina*. This operation includes an agreement with American Airlines and its AAdvantage® frequent traveller programme.
- 17 new branches were opened and 246 branches transformed. **Santander Río pioneered in innovation by opening the country's first digital branch.**
- Improved internal processes: **the +CHE CRM system was implemented** in the branch network in order to offer the most appropriate services at the best moment and via the most suitable channel.
- Credit and deposits market share increase.
- **Santander Río** was top of the ***Great Place to Work* ranking,** was named Best Digital Bank in Argentina by *Global Finance* magazine and **Best Bank 2016 by *Euromoney* and the *Banker*.**

Key data

EMPLOYEES
7,940

CUSTOMERS (millions)
2.9

LOANS[1,2]
7,142 (+37%)

ATTRIBUTABLE PROFIT[1]
359 (+52%)

CONTRIBUTION TO GROUP PROFIT
4%

United States

Santander US made significant progress toward its goals: improving digital capabilities, enhancing product offerings and meeting regulatory obligations to build a strong business and better serve customers.

+5% loyal customers

+26% digital customers

Santander branch in the United States.

STRATEGIC PRIORITIES

- Enhance customer experience
- Meet regulatory requirements
- Improve profitability
- Maintain leadership in auto finance

2016 HIGHLIGHTS

Santander's business in the US focuses on retail and corporate banking via **Santander Bank** and auto finance via **Santander Consumer USA**. It also has an investment banking business, wealth management capabilities for non-US residents, and retail and commercial banking in Puerto Rico.

In 2016, Santander US completed the creation of an intermediate holding company, Santander Holdings USA (SHUSA), which brings together the country's units under a single management and governance structure in order to manage risk and capital more effectively.

Santander US continued making significant progress toward meeting its regulatory obligations in 2016. The team made critical investments to improve its technological, financial control and risk management capabilities. This justifies in part the fall in profit in 2016.

Santander Bank, which has a significant presence in the Northeastern U.S., focused in 2016 on strengthening customer relationships, enhancing the product offerings and improving its digital capabilities.

The number of digital banking customers increased 26%, spurred by the launch of a new mobile application that enables customers to access their account information more easily through fingerprint technology. This, coupled with increased marketing, drove core deposit growth of 4%

Santander Bank achieved this growth while lowering its deposit costs in a rising interest environment.

Corporate and Commercial Banking grew its loan book by 16%. In wholesale banking, the continued focus was on offering products tailored to customers' needs and **leveraging global connections within the Group.**

Santander Consumer USA is one of the country's leading auto finance companies, with an efficient, scalable infrastructure that enables it to achieve its profitability goals. Its strategy focuses on optimizing its customer mix; leveraging its Chrysler Capital platform for growth; maintaining its leadership position in the ABS market; and strengthening its programs in operational risk, compliance, and consumer practices.

Key data

EMPLOYEES
17,509

CUSTOMERS (millions)
5.2

LOANS[1,2]
89,638 (-2%)

ATTRIBUTABLE PROFIT[1]
395 (-42%)

CONTRIBUTION TO GROUP PROFIT
5%

1. Million euros, change in local currency. 2. Change without repos.

Santander Global Corporate Banking
(SGCB)

SGCB is the global business division focused on corporate customers and institutions that, due to their size or sophistication, require a tailored service or value-added wholesale products.

STRATEGIC PRIORITIES

- Consolidate position as experts on Latin America
- Develop high value-added products with low capital consumption
- Increase the offer of products for commercial banking customers

2016 HIGHLIGHTS

- **SGCB attained leading positions** in Cash Management, Export Finance, syndicated corporate loans, capital markets and structured finance in Europe and Latin America.
- **Cash Management** performed well, particularly in Latin America, due to high interest rates.
- **Export Finance** maintained its growth trend, and consolidated its position as a reference in the industry.
- **Trade & Working Capital Solutions.** SGCB strengthened its capabilities and product offering in the Receivables business in order to be the leading bank in this segment.
- SGCB remains the leading bank in Europe and Latin America with top level participations in significant **syndicated corporate lending** transactions.
- **In structured financing, it maintained a clear leadership position,** both in Latin America and core geographies in Europe.
- **In market activity, positive trend in revenues from the customers business,** particularly in the corporate segment with strong growth in Latin America.
- **In capital markets,** SGCB continued to participate in the main transactions in Europe and Latin America.
- **The efficiency exercises conducted by SGCB** in various countries enabled costs to be held down, particularly in Spain and the United States.
- **The trend of the results (+30% in constant euros)** is based on the strength and diversification of customer revenues.

Key data

LOANS[1,2]
96,796 (+0.2%)

ATTRIBUTABLE PROFIT[1,3]
2,089 (+30%)

CONTRIBUTION TO GROUP PROFIT
25%[3]

1. Million euros, change in constant currency. 2. Change without repos.
3. This global unit's result is included in countries' profit figures.

An **effective system of corporate governance** will guarantee the Group's long-term competitiveness and sustainability as we embrace our strategic objectives with adequate controls and risk management process in place

3 Corporate governance report

Balanced and committed board.

- Of 15 directors, 11 are non-executive and 4 are executive.

Equality of shareholder rights.

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

Maximum transparency, particularly as regards remuneration.

A corporate governance model recognised by socially responsible investment indices.

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

Our aim is to make things **Simple, Personal and Fair**. These three words are our guiding philosophy and this year **we have progressed far**. Our people, our customers, our shareholders and communities expect this much of us

Ms Ana Botín, executive chairman of Banco Santander
General shareholders' meeting
18 March 2016

Executive summary

Changes in the composition of the board and its committees

- On 27 September 2016, the board of directors agreed to appoint Ms Homaira Akbari as independent director on the proposal of the appointments committee and after having obtained the necessary regulatory clearance. Ms Akbari will occupy the vacancy left by Mr Ángel Jado Becerro de Bengoa following his resignation on that same date. The board also appointed Ms Akbari to the innovation and technology committee, again on the proposal of the appointments committee.

  Ms Akbari holds a PhD in Particle Physics from Tufts University and an MBA from Carnegie Mellon Tepper School of Business. She has had a solid business career in both the US and France and has served on the boards of several companies working with new technologies. She is the President and CEO of AKnowledge Partners, a global advisory firm specialised in the *Internet of Things*, Big Data and data analytics.

  Ms Akbari's appointment will be put forward for approval at the next general shareholders' meeting.

- In addition, on 26 April 2016 the Bank's board of directors agreed to appoint Ms Belén Romana García as chairman of the audit committee on the proposal of the appointments committee. Ms Romana García will replace Mr Juan Miguel Villar Mir, who will retain his seat on the committee.

  It was subsequently agreed at a board meeting held on 28 October 2016 to appoint Ms Romana García to the risk supervision, regulation and compliance committee, again on the proposal of the appointments committee.

- Following the changes just discussed, the board of directors and its committees are now more diverse in terms of nationality, knowledge, professional experience and gender.

Activities of the board

- The board held 13 meetings during 2016. In addition to the report made by the Group executive chairman at each annual meeting, the chief executive officer submitted management reports on the Group and the vice chairman, Mr Matías Rodríguez Inciarte, reported on the Group's risks. As in previous years, the board held one meeting on the Group's global strategy in 2016.

- The Group's external auditors and heads of internal audit took part in all the meetings held by the audit committee in 2016 and reported to the board on two occasions.

Dividend policy

- In 2015, the Bank restructured its dividend policy with the aim of once again making shareholder remuneration largely a cash event, with the change to become effective from the first dividend paid out against earnings for that year. The Bank also announced its intent that the cash payout represent between 30% and 40% of its recurring profit in the coming years, instead of the previous 20%, and that payments to shareholders reflect the growth in its profit.

- A proposal was raised at the general shareholders' meeting held on 18 March 2016 to make a 5% increase in the total dividend charged to earnings for 2016 in respect of the 0.20 euros relating to 2015, as just discussed. To date, a total of 0.155 euros per share has been paid out against 2016 earnings through the scrip dividend scheme –at a value of 0.045 euros, gross, per free allotment right– and two cash payments –of 0.055 euros each–. A final cash payment of 0.055 euros per share is also to be paid this coming May, subject to the approved of the general meeting. Once paid, this will effectively constitute the aforementioned 5% increase on the total dividend charged to 2016 earnings.

Bylaw-stipulated emoluments

- Bylaw-stipulated emoluments earned by the board amounted to 4.6 million euros in 2016, which is 23.9% lower than the maximum amount approved by shareholders at the general meeting held on 18 March 2016.

Remuneration of executive directors

- At the general shareholders' meeting of 18 March 2016, shareholders also approved the maximum ratio of 200% between variable and fixed pay items for 2016 for a maximum of 1,700 members of the *identified staff*, including executive directors.

  The binding decision was also reached at the same meeting to approve the director remuneration policy of Banco Santander, S. A. for 2016, 2017 and 2018 and the annual report on director remuneration underwent a consultative vote by shareholders.

- Investors and analysts held a positive view of the changes made to the director remuneration policy, such as 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 the multiyear performance measures, thus making the ratio of long and short-term objectives more effective and efficient.

Appointments at subsidiaries

- On 16 May 2016, the supervisory board of Bank Zachodni WBK appointed Mr Michal Gajewski as chief executive officer taking over from Mr Mateusz Morawiecki, who left the bank in November 2015 to join the new Polish Government as Vice President and Minister of Development. The appointment was approved by the Polish Financial Supervision Authority on 29 November 2016.

- Likewise, on 25 December 2016, the general shareholders' meeting of Santander Brasil, acting on a favourable report from the appointments committee of Banco Santander, S.A., proceeded to appoint Mr Álvaro Antonio Cardoso de Souza as independent chairman of Santander Brasil, taking over from Mr Jesús María Zabalza Lotina.

Financial information periodically published by the Bank

- The board has approved or drawn up the quarterly and half-yearly financial information, financial statements and management report for 2016, 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.

Internal governance framework at the Group

- In 2016, the Group continued to develop and update its governance framework, which comprises a governance model regulating parent-subsidiary relations and a set of corporate frameworks that effectively implement this model for all the different functions and decision-making processes. A series of new corporate frameworks were approved in 2016 (for managing special situations and one for strategic purposes) while others were updated where needed.

- Also in 2016 the Group appointed a new global director of internal governance, who is presently implementing a plan to build a suitable internal governance structure that meets the expectations of supervisors. This process will consist of overseeing the effective application of the parent-subsidiary model of governance; ensuring the internal consistency of the system and of its different component elements (model, corporate frameworks, procedure, policies, etc.); identifying areas where new rules need to be implemented; managing the policy relating to regulatory documents and administering the repository where those documents are kept; defining rules on the functioning and on documenting the decisions of committees and other bodies; and supervising the process of applying the governance system across the entire Group.

1. Introduction

Against this complicated economic landscape, with a huge number of players and scenarios involved, we are aware that corporate governance constitutes a key factor driving the creation of value. At Santander, we are continuously coming up with improvements, in line with the highest international standards, and we implement these through specific actions. In doing so, we are building the confidence and trust of our shareholders and other stakeholders, as well as society in general.

We are therefore continuing to strengthen our corporate governance, focusing especially on the effective functioning of the board of directors. For Santander, robust governance is a key element in ensuring a sustainable long-term business model.

We now have a board of directors that possesses the expertise, experience, knowledge, dedication and diversity needed to attain the objective of making Santander the best commercial and retail bank.

In line with the Bank's vision and mission (described in chapter one of this annual report) and within the framework of its general supervisory function, the board of directors takes decisions that relate to the Group's main policies and strategies, its corporate culture, the definition of its structure and the promotion of suitable corporate social responsibility policies. In addition, and especially in exercising its responsibility in managing all risks, the board must approve and monitor the risk framework and appetite, ensure it is in line with the Bank's business plans, capital and liquidity, verify that risks are correctly reported by all units and oversee the operation of the three lines of defence, guaranteeing the independence of the heads of risk, compliance and internal audit and their direct access to the board.

Last year, following the arrival of Ms Homaira Akbari, the board of directors of Banco Santander is now more diverse in terms of nationality, knowledge and professional experience and gender.

2. Ownership structure

» Number of shares and significant interests

Number of shares

In 2016, the Bank effected a rights issue under the Santander Scrip Dividend scheme, a process effectively completed on 4 November. A total of 147,848,122 new shares were issued, equivalent to 1.02% of the Bank's share capital at year-end 2015.

On 31 December 2016, the Bank's share capital was represented by 14,582,340,701 shares. At that date, stock market capitalisation according to the listing price on the Electronic Spanish Stock Market Interconnection System was 72,313.8 million euros.

All shares carry the same voting and dividend rights.

Significant interests

At 31 December 2016, the only shareholders appearing on the Bank's register of shareholders with a stake of over 3%[1] were State Street Bank and Trust Company, holding 12.10%; The Bank of New York Mellon Corporation, holding 8.86%; Chase Nominees Limited, holding 5.98%; EC Nominees Limited, holding 4.39%; and Clearstream Banking S.A., holding 3.38%.

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[2].

Bearing in mind the current number of members of the board of directors (15), the percentage of capital needed to exercise the right to appoint a director, in accordance with article 243 of the Spanish Corporate Enterprises Act (Ley de Sociedades de Capital) on proportional representation, is 6.67%.

» 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 significant event and is described in the public records thereof.

On 3 August and 19 November 2012, Banco Santander notified the CNMV, through a significant event, 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 significant event, 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 significant event, 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). This information was subsequently supplemented through a further significant event notification on 6 February 2015.

On 6 February and 29 May 2015, Banco Santander notified the CNMV, through respective significant events, 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 significant event, 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.

1. The threshold stipulated in Royal Decree 1362 of 19 October 2007, which implemented the Spanish Securities Market Act of 28 July 1988, 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 27 October 2016, in which it notifies an indirect holding in the voting rights attributable to Bank shares of 5.028%, plus a further stake of 0.043% 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 2016.

Shares included in the syndication

At 31 December 2016, the syndication included a total of 73,428,193 shares of the Bank (0.5035% of its share capital), broken down as follows:

Signatories to the shareholders' agreement	Number of shares
Ms Ana Botín-Sanz de Sautuola y O'Shea	612,696
Mr Emilio Botín-Sanz de Sautuola O'Shea[1]	16,873,709
Mr Francisco Javier Botín-Sanz de Sautuola O'Shea[2]	16,291,842
Ms Paloma Botín-Sanz de Sautuola O'Shea[3]	7,835,293
Ms Carmen Botín-Sanz de Sautuola O'Shea	8,636,792
PUENTEPUMAR, S.L.	-
LATIMER INVERSIONES, S.L.	-
CRONJE, S.L., Unipersonal[4]	17,602,582
NUEVA AZIL, S.L.[5]	5,575,279
TOTAL	**73,428,193**

1. 7,800,332 shares held indirectly through Puente San Miguel, S.L.U.
2. 11,447,138 shares held indirectly through Agropecuaria El Castaño, S.L.U.
3. 6,628,291 shares held indirectly through Bright Sky 2012, S.L.
4. Controlled by Ms Ana Patricia Botín-Sanz de Sautuola O'Shea.
5. Controlled by Ms Carolina Botín-Sanz de Sautuola O'Shea.

In all other respects the aforementioned syndication agreement remains unchanged.

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

» 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 resolution of the board of directors on 23 October 2014, approved the current treasury share policy[3] taking into account the recommendations of 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 2016, the Bank and its subsidiaries and investees held a total of 1,476,897 treasury shares in the Bank, representing 0.010% of its share capital at that date (at year-end 2015, there were 40,291,209 treasury shares, representing 0.279% of the Bank's share capital at such date).

The following table sets out the monthly average percentages of treasury shares in 2016 and 2015.

Monthly average percentages of treasury shares[1]
% of the Bank's social capital[2]

	2016	2015
January	0.006%	0.200%
February	0.029%	0.218%
March	0.021%	0.233%
April	0.044%	0.246%
May	0.050%	0.181%
June	0.051%	0.169%
July	0.015%	0.132%
August	0.060%	0.187%
September	0.179%	0.244%
October	0.064%	0.336%
November	0.026%	0.336%
December	0.017%	0.335%

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

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

Transactions with treasury shares performed in the Group's interest by its consolidated companies in 2016 entailed the acquisition of 319,416,152 shares, equivalent to a par value of 159.7 million euros (cash amount of 1,380.5 million euros) and the sale of 358,230,464 shares, with a par value of 179.1 million euros (cash amount of 1,604.8 million euros).

The average purchase price of the Bank's shares in 2016 was 4.32 euros per share, and the average sale price of the Bank's shares was 4.48 euros per share.

The net gain for the Bank in 2015, net of tax, on transactions involving shares issued by the Bank amounted to 14,889,813 euros and was recognised in the Group's equity under *Shareholders' Equity-Reserves*.

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 shareholders at the annual general meeting held on 27 March 2015, under item eight on the agenda, amounted to 3,515,146,471.50 euros. The Bank's directors have until 27 March 2018 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 Corporate Enterprises Act, although this power is limited to capital increases carried out under this authorisation up to 1,406,058,588.50 euros.

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

In addition, the decision was reached at the same general meeting of 27 March 2015 to authorise 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. 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.

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

Moreover, the annual general meeting held on 18 March 2016 passed the following resolutions:

1. To effect a rights issue charged to reserves for the maximum amount of 750 million euros at market value under 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 2016 is typically paid, shares under a scrip issue for an amount equal to that dividend payment.

   This capital increase was carried out on 4 November 2016 through the issuance of 147,848,122 new shares, each of a par value of 0.50 euros each (equal to 73,924,061 euros), representing a total of 1.02% of the Bank's share capital at year-end 2015.

2. To vest powers in the board of directors, pursuant to the terms of article 319 of the Regulations of the Companies 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 18 March 2021, whereupon any part thereof not exercised will be cancelled.

   As of the date of this document, a total of 11,834 million 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 Companies Act, 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 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

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: sits on the board of directors of The Coca-Cola Company and on the advisory board of the Massachusetts Institute of Technology (MIT's CEO Advisory Board). She is 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).

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

Mr José Antonio Álvarez Álvarez

CHIEF EXECUTIVE OFFICER
Executive director

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: board member of Banco Santander (Brasil), S.A. and of 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 was also board member of Bolsas y Mercados Españoles.

Membership of board committees
Executive, international and innovation and technology.

Mr Bruce Carnegie-Brown

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

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: currently the non-executive chairman of Moneysupermarket.com Group Plc and non-executive director of Santander UK Plc and of Jardine Lloyd Thompson Group plc. He was formerly the non-executive chairman of Aon UK Ltd (2012-2015), founder and managing partner of the quoted private equity division of 3i Group Plc., and chairman 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

Born in 1946 in Madrid, Spain.

Joined the board in 1988.

Graduate in Law and Government Attorney.

Other positions of note: former Group 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, international and innovation and technology.

Mr Matías Rodríguez Inciarte

VICE CHAIRMAN
Executive director

Born in 1948 in Oviedo, Spain.

Joined the board in 1988.

Graduate in Economics and Government Economist. He also studied Business Administration at the Massachusetts Institute of Technology (MIT).

Other positions of note: Minister of the Presidency between 1981 and 1982, as well as technical general secretary of the Ministry of Economy, general secretary of the Ministry for European Community Relations and deputy secretary of state to the President. He is currently chairman of Unión de Crédito Inmobiliario, S.A., of the Princess of Asturias Foundation and of the social council of Universidad Carlos III in Madrid. He is also a non-executive director of Sanitas, S.A. de Seguros, Financiera Ponferrada, S.A., SICAV and Financiera El Corte Inglés E.F.C.

Membership of board committees
Executive and innovation and technology.

Mr Guillermo de la Dehesa Romero

VICE CHAIRMAN
Non-executive director

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).

He is an international advisor to Goldman Sachs International.

Other positions of note: former secretary of state for Economy, Secretary General for Trade and chief executive officer of Banco Pastor, S.A. He is currently a non-executive vice chairman of Amadeus IT Holding, S.A., honorary chairman of the Centre for Economic Policy Research (CEPR) based in 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 Corporación and of Aviva Vida y Pensiones, S.A. de Seguros y Reaseguros.

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

Ms Homaira Akbari

Non-executive director (independent)

Born in 1961 in Tehran, Iran.

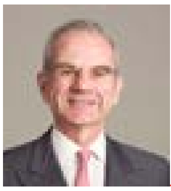
Joined the board in 2016.

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

Chief Executive Officer of AKnowledge Partner, 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 chief executive 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
Innovation and technology.



Mr Ignacio Benjumea Cabeza de Vaca

Non-executive director

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 and of the Governing Body of the Madrid Stock Exchange.

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

Mr Javier Botín-Sanz de Sautuola y O'Shea

Non-executive director (proprietary)

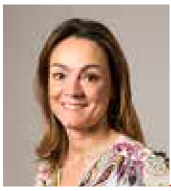
Born in 1973 in Santander, Spain.

Joined the board in 2004.

Degree in Law.

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

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



Ms Sol Daurella Comadrán

Non-executive director (independent)

Born in 1966 in Barcelona, Spain.

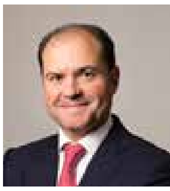
Joined the board in 2015.

Degree in Business and MBA in Business Administration.

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

Other positions of note: she has served as a member of the governing board of the Círculo de Economía and also as an independent non-executive director of Banco Sabadell, S.A., Ebro Foods, S.A. and Acciona, S.A. She is also honorary counsel general of Iceland in Catalonia.

Membership of board committees
Appointments and remuneration.



Mr Carlos Fernández González

Non-executive director (independent)

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 risk supervision, regulation and compliance.

Ms Esther Giménez-Salinas i Colomer

Non-executive director (independent)

Born in 1949 in Barcelona, Spain.

Joined the board in 2012.

PhD in Law and psicologist.

Professor Emeritus at Ramon Llull University, board member of Unibasq and Aqu (quality assurance agencies for the Basque and Catalan university systems) and of Gawa Capital Partners, S.L. She also sits on the advisory board of Endesa-Catalunya.

Other positions of note: she has been chancellor of Ramon Llull University, member of the General Council of the Judiciary, member of the standing committee of the Conference of Chancellors of Spanish Universities and executive vice president of the Centre for Legal Studies attached to the Department of Justice of the Government of Catalonia (Generalitat de Catalunya).

Membership of board committees
International and innovation and technology.

The board is now more diverse in terms of nationality, knowledge, professional experience and gender following the arrival of Ms Homaira Akbari 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.

Ms Belén Romana García

Non-executive director (independent)

Born in 1965 in Madrid, Spain.

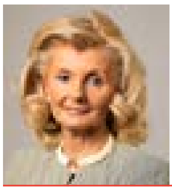
Joined the board in 2015.

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

Non-executive director of Aviva Plc.

Other positions of note: 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. 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) and risk supervision, regulation and compliance.



Ms Isabel Tocino Biscarolasaga

Non-executive director (independent)

Born in 1949 in Santander, Spain.

Joined the board in 2007.

PhD in Law. She has undertaken graduate studies in business administration at IESE and the Harvard Business School.

She is a professor at Universidad Complutense de Madrid.

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

Membership of board committees
Executive, audit, remuneration and risk supervision, regulation and compliance.

Mr Juan Miguel Villar Mir

Non-executive director (independent)

Born in 1931 in Madrid, Spain.

Joined the board in 2013.

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

Chairman of the 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.

Membership of board committees
Audit and risk supervision, regulation and compliance.

Mr Jaime Pérez Renovales

General secretary and secretary of the board

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 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 the 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 Grupo Santander, deputy secretary of the Presidency of the Government and chairman of the committee for the reform of public administration.

Formerly chairman of the Agency of the Official State Gazette and director of Patrimonio Nacional, 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, international and innovation and technology.

» Re-election of directors at the 2017 annual general shareholders' meeting

Pursuant to article 55 of the Bylaws and article 22 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 2017 annual general shareholders' meeting, scheduled for 6 or 7 April 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: Ms Ana Botín-Sanz de Sautuola y O'Shea, Mr José Antonio Álvarez Álvarez, Mr Rodrigo Echenique Gordillo, Ms Esther Jiménez-Salinas i Colomer and Ms Belén Romana García, the first three as executive directors and the latter two as independent directors.

Ms Homaira Akbari's appointment as independent director will also be put before the general meeting for its approval.

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 to be laid before the general shareholders' meeting of 2017.

Each of the re-elections and ratifications 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.

» Powers and duties

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

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. International committee	7. Innovation and technology committee
Group executive chairman	Ms Ana Botín-Sanz de Sautuola y O'Shea	■		C					C	C
Chief Executive Officer	Mr José Antonio Álvarez Álvarez	■		■					■	■
Vice chairmen	Mr Bruce Carnegie-Brown		I	■		C	C	C		■
	Mr Rodrigo Echenique Gordillo	■		■					■	■
	Mr Matías Rodríguez Inciarte	■		■						■
	Mr Guillermo de la Dehesa Romero		N	■		■	■	■	■	■
Members	Ms Homaira Akbari[6]		I							■
	Mr Ignacio Benjumea Cabeza de Vaca		N	■		■	■	■	■	■
	Mr Javier Botín-Sanz de Sautuola y O'Shea		P							
	Ms Sol Daurella Comadrán		I			■	■			
	Mr Carlos Fernández González		I		■	■		■		
	Ms Esther Giménez-Salinas i Colomer		I						■	■
	Ms Belén Romana García		I		C			■		
	Ms Isabel Tocino Biscarolasaga		I	■	■		■	■		
	Mr Juan Miguel Villar Mir		I		■			■		
	Total									
General secretary and secretary of the board	Mr Jaime Pérez Renovales			■	■	■	■	■	■	■

1. Figures at 31 December 2016.

2. 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.

3. Syndicated shares. See page 64.

4. Effective 13 January 2015.

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 the following in particular: strategic or business plans; management objectives and the annual budget; fiscal strategy and capital and liquidity strategy; investment, financing, dividend, treasury share, risk management and control (including fiscal), corporate governance, corporate social responsibility and regulatory compliance policies; policies regarding the internal governance of the Bank and its Group; 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) 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 those 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.

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 standing committees 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 15 members, 11 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. Three 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.

Shareholding								
Direct	Indirect	Shares represented	**Total**	**% of share capital**	Date of first appointment	Date of last appointment	End date[2]	Date of last proposal of the appointments committee
612,696	17,602,582	-	**18,215,278[3]**	**0.125%**	04.02.1989	28.03.2014	First six months of 2017	17.02.2014
697,913	1,348	-	**699,261**	**0.005%**	25.11.2014[4]	27.03.2015	First six months of 2018	20.02.2015
20,099	-	-	**20,099**	**0.000%**	25.11.2014[5]	18.03.2016	First six months of 2019	11.02.2016
822,927	14,184	-	**837,111**	**0.006%**	07.10.1988	28.03.2014	First six months of 2017	13.02.2014
1,475,161	308,163		**1,783,324**	**0.012%**	07.10.1988	27.03.2015	First six months of 2018	20.02.2015
148	-	-	**148**	**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	27.09.2016	First six months of 2019	26.09.2016
3,067,201	-	-	**3,067,201**	**0.021%**	30.06.2015[7]	18.03.2016	First six months of 2019	11.02.2016
4,793,481	11,498,361	116,250,993	**132,542,835**	**0.909%**	25.07.2004	18.03.2016	First six months of 2019	11.02.2016
128,263	412,521	-	**540,784**	**0.004%**	25.11.2014[8]	18.03.2016	First six months of 2019	11.02.2016
16,840,455	-	-	**16,840,455**	**0.115%**	25.11.2014[5]	27.03.2015	First six months of 2018	20.02.2015
5,405	-	-	**5,405**	**0.000%**	30.03.2012	28.03.2014	First six months of 2017	17.02.2014
150	-	-	**150**	**0.000%**	22.12.2015	18.03.2016	First six months of 2019	11.02.2016
270,585	-	-	**270,585**	**0.002%**	26.03.2007	18.03.2016	First six months of 2019	11.02.2016
1,199	-	-	**1,199**	**0.000%**	07.05.2013	27.03.2015	First six months of 2018	20.02.2015
28,757,683	29,837,159	116,250,993	174,845,835	1.198%				

5. Effective 12 February 2015.

6. Their appointment will be submitted for ratification at the general shareholders' meeting scheduled for 6 or 7 April 2017, on first or second call.

7. Effective 21 September 2015.

8. Effective 18 February 2015.

C Chairman of the committee
P Proprietary
I Independent
N Non-executive (neither proprietary nor independent

Commitment of the board[1]

Number of shares of the Board
174,845,835
1.2% of share capital

Stock market value
868
million euros

Share price
4.959
euros

1. Figures at 31 December 2016.

» Size and composition of the board

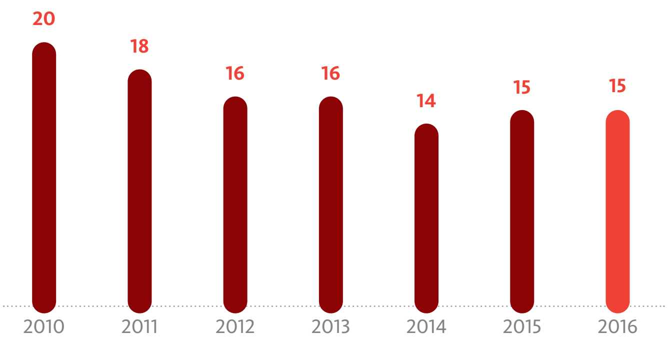
Since the end of 2010, the size of the board has been downsized by 25%, from 20 to 15 members.

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.

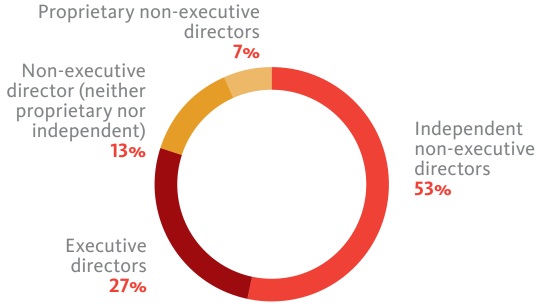
Pursuant to article 6.3 of the Rules and Regulations of the Board, the appointments committee has duly verified the status of each director. Its proposal was submitted to the board, which approved it at the meeting held on 21 February 2017.

Of the 15 members currently sitting on the board, four 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.

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, Mr Rodrigo Echenique Gordillo and Mr Matías Rodríguez Inciarte.

Proprietary non-executive directors

According to article 6.2.b) of the Rules and Regulations of the Board, proprietary directors are non-executive directors who hold or represent shareholdings equal to or greater than that which qualifies as significant under the law, or who have been designated as such on account of their status as shareholders despite their shareholdings not reaching the threshold to be considered significant, as well as anyone representing such shareholders.

Since 2002, the appointments committee and the board of directors have stipulated that having or representing at least 1% of the Bank's share capital is a necessary condition, though not the only condition, to be appointed a non-executive proprietary director. This percentage was established by the Bank in accordance with its self-regulatory powers and is less than that deemed significant by law, although the Bank believes it is sufficiently important so as to enable the board to classify directors that hold or represent a shareholding equal to or greater than such percentage as proprietary directors.

The board, taking into account the prevailing circumstances of each case, and following a report by the appointments committee, appointed Mr Javier Botín-Sanz de Sautuola y O'Shea as an external proprietary director representing the following shareholders: Fundación Botín, Cronje, S.L., Puente de San Miguel, S.L.U., Nueva Azil, S.L., Agropecuaria El Castaño, S.L.U., Bright Sky 2012, S.L., Ms Ana Botín-Sanz de Sautuola y O'Shea, Mr Emilio Botín-Sanz de Sautuola y O'Shea, Ms Carmen Botín-Sanz de Sautuola y O'Shea, Ms Paloma Botín-Sanz de Sautuola y O'Shea, Mr Jorge Botín-Sanz de Sautuola Ríos, Mr Francisco Javier Botín-Sanz de Sautuola Ríos, Ms Marta Botín-Sanz de Sautuola Ríos and his own shareholding.

The voting rights of the aforementioned shareholders corresponded to 1.034% of the Bank's share capital at year-end 2016.

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 Companies Act. 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, Ms Belén Romana García, Ms Isabel Tocino Biscarolasaga and Mr Juan Miguel Villar Mir.

Given the current number of directors (15), independent non-executive directors account for 53% 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-executives 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.

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

» Diversity on the board

As established in article 17.4 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.

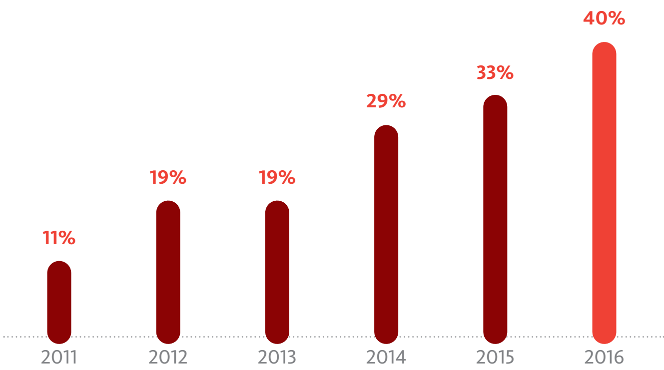
As regards gender diversity, both the appointments committee and the board of directors are aware of the importance of fostering equal opportunities between men and women and of the appropriateness of appointing to the board women who fulfil the requirements of ability, suitability and effective dedication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

The appointments committee, at the meeting held on 26 March 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 40% of seats.

At present, there are six women on the board of directors, one of whom is its Group 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, Ms Belén Romana García and Ms Isabel Tocino Biscarolasaga.

The share of women on Banco Santander's board (40%) 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

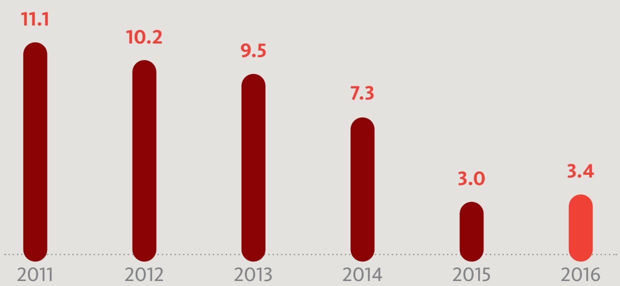


The table below shows the number and percentage of women on the board and on each of its committees.

	Number of members	Number of female directors	% of female directors
Board	15	6	40.0%
Executive committee	8	2	25.0%
Audit committee	4	2	50.0%
Appointments committee	5	1	20.0%
Remuneration committee	5	2	40.0%
Risk supervision, regulation and compliance committee	7	2	30.0%
International committee	6	2	33.3%
Innovation and technology committee	9	3	33.3%

Years of service of independent directors

At the date of this document, the average length of service for independent non-executive directors serving as board member is just over three years.



» Balanced structure of corporate governance

There is a clear separation of duties between those of the Group 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 Group executive chairman and the chief executive officer.
- The lead 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.
- The audit committee is chaired by an independent director acting in her capacity as financial expert.
- The powers delegated to the Group executive chairman and the chief executive officer exclude those that are exclusively reserved for the board itself.
- The Group executive chairman may not simultaneously hold the position of chief executive officer of the Bank.
- The corporate Risk, Compliance and Internal Audit functions report to a committee or a member of the board of directors and have direct access thereto.

» 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 24 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 9 bis 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 chairman of the board of directors, stating that in these cases the chairman will be substituted by a vice chairman to be selected in order of length of service on the board, except where the lead director is one of the vice chairmen, in which case he or she will be the first choice. If there are no vice chairmen, the remaining directors will replace the Group 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.

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 48.1 of the Bylaws and article 8.1 of the Rules and Regulations of the Board). In accordance with her position as such, the Group 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 Group executive chairman all its powers, except those that cannot be delegated by law, the Bylaws or the Rules and Regulations of the Board.
- The Group strategic and corporate functions report to the Group executive chairman.

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 10.1 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.
- 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.

» 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 12 bis 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, replacing Mr Fernando de Asúa Álvarez.

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	Spanish average	US average	UK average
Board	13	11.3	8.4	7.7
Executive committee	52	9.4	-	-
Audit committee	10	7.7	8.6	5.1
Appointments committee	10	6.0	4.8	3.7
Remuneration committee	9	6.0	6.1	5.1
Risk supervision, regulation and compliance committee	12	16.0	-	5.5

* Source: Stuart Spencer Board Indices 2016 (Spain, United States and United Kingdom).

» Secretary of the board

The Bylaws (article 45.2) and the Rules and Regulations of the Board (article 11) include among the duties of the secretary those of ensuring the formal and substantive legality of all action undertaken 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 17.4.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 13 meetings during 2016.

The board holds its meetings in accordance with an annual calendar and agenda of business to discuss, without prejudice to any further 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.

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 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 12 bis 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.

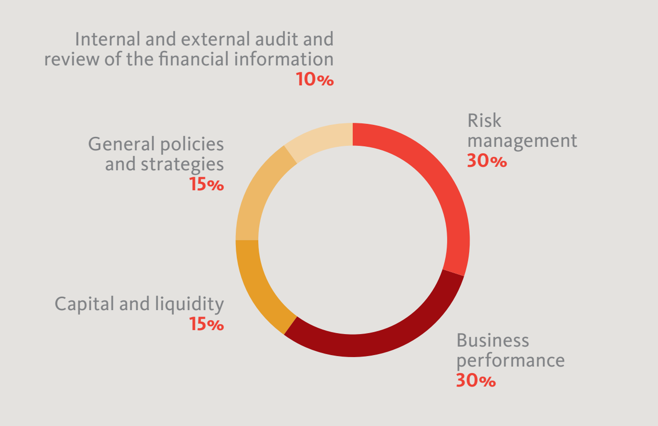
The board may meet in various rooms at the same time, provided that interactivity and communication among them in real time is ensured by audiovisual means or by telephone and the concurrent holding of the meeting is thereby ensured.

Board meetings shall be validly convened when more than half of board 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 2016 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. During the year, the board has also 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. Thus, Bank directors will not be allowed to occupy, at the same time, more than: (a) one executive position and two non-executive positions, or (b) four non-executive positions. For such purposes, positions held within the same group 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. 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

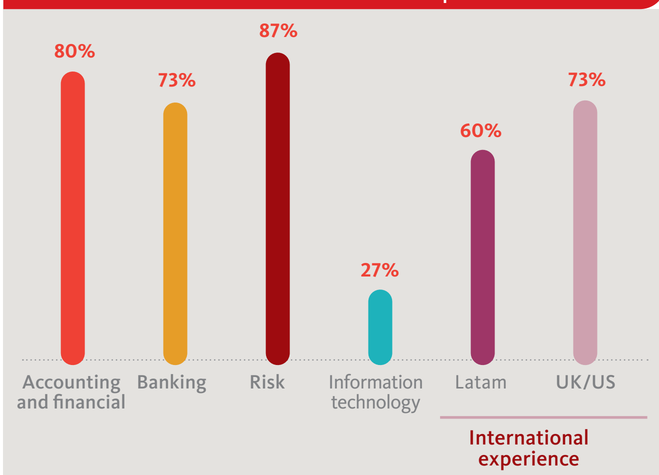
As a result of the Board's self-assessment process of 2005, an ongoing training programme for directors was implemented.

Within the framework of the Bank's ongoing director training programme, ten sessions were held in 2016 with an average attendance of eight directors, who devoted approximately two hours to each session. Various issues were covered in depth at such meetings, including: multi-channel and digital transformation; corporate defence; non-financial risks: model risk and reputational risk; regulatory developments relating to capital; risk appetite in relation to compliance and conduct risk, and approval systems for the marketing and sale of products.

Likewise, the Rules and Regulations of the Board (article 21.7) 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, Ms Homaira Akbari (appointed to the board in 2016) attended a specific training programme for new board members, at which the following matters were addressed:

- General presentation of the Group and the regulatory context in which it operates.
- Compliance.
- Capital.
- Liquidity and balance sheet management.
- Budget and financial statements.
- The Group's main regions and businesses.
- Main support areas (Technology and Operations, Risks, Audit, Human Resources, Organisation and Costs).
- Innovation.
- Corporate governance and internal governance.
- Sustainability, communication and the Santander brand.

% Of board members with relevant experience



DECISION-MAKING PROCESS

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

Self-assessment by the board

Pursuant to article 19.7 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, the last one having been completed in 2015.

Specific measures or practices adopted as a product of the board's assessment in 2015 included the following:

- Meetings to be held yearly to analyse matters of strategic interest to the Group.
- Information to be sent to board members on all opinions and reports issued by financial analysts and institutional investors in relation to the Bank.
- Board composition to be adjusted by incorporating new independent directors with a more international profile, while strengthening diversity and increasing board expertise in digital strategy.
- More preparatory meetings to be held in the lead-up to actual board members so as to improve relations between board members and encourage interaction between board members and company executives.
- Board to become involved in managing talent by setting up talent committees tasked with assessment processes and succession plans and reporting to the appointments committee and the board.

In accordance with article 17.4.(j) of the Rules and Regulations of the Board, the appointments committee, at the meeting held on 18 November 2016, agreed to initiate the board assessment process in 2016, which was conducted internally.

The assessment is based on the information collected from board members via a questionnaire, as part of a confidential and anonymous process that also included personal interviews between the directors and the chairman of the appointments committee.

All non-executive directors were involved in the process of assessing the lead director. In turn, the lead director oversaw the process of assessing the chairman.

The assessment process focused on the following aspects:

- In relation to the board as a whole: structure; organisation and functioning; internal culture and arrangements (planning of meetings, director support and training); knowledge and diversity; and performance of the supervisory function. The process also addressed a number of other issues relating to strategy, such as where their priorities should lie and what their challenges should be for 2017, plus other matters of interest.
- In relation to commissions: composition; functioning; board support and reporting; committee content; and their main challenges and priorities for 2017.
- In relation to the lead director: performance of his or her functions; leadership; relations with institutional investors; dedication; and performance of the role.

The results of the assessment process for the board and its committees revealed the following: high levels of commitment and dedication from all board and committee 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.

It also confirmed a clear and proper segmentation of responsibilities and functions between the chairman and chief executive officer, and a steady increase in the work of the lead director in supporting non-executive directors by scheduling periodic meetings with them to assess the activities and functioning of the board.

The report containing the conclusions and results of the assessment process for the board and its committees in 2016 was presented at the board meeting held on 24 January 2017. In view of these findings and the results of the business reports of the various committees in 2016, the board approved an action plan that envisages improvements in the following areas, among others:

Increase the time dedicated to digital transformation and technology, human resources, succession and talent, strategic, cyber-security, competitor landscape and innovation.

Strengthen coordination among committees of the Group entities, especially regarding the audit, appointments and risk supervision, regulation and compliance committees.

Monitoring and updating verified and robust succession plans for the board of directors, its committees and the senior management.

» 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, following the relevant selection process, be preceded by the corresponding report and proposal of the appointments committee.

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

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

Skills matrix of the members of the board and diversity analysis*

In accordance with the director selection process just discussed, as set out in articles 6.1 of the Rules and Regulations of the Board and 42.4 of the Bylaws, the committee proceeded to review the director selection and succession policy on 23 January 2017, as well as the conclusions of the annual board self-assessment process completed in 2016. Following this self-assessment, and on a proposal from the appointments committee, the board of directors reviewed its composition and drew up the following skills matrix at a meeting held on 21 February 2017. The findings of the analysis identified the need to strengthen skills with profiles that specialise in new technologies and banking.

				Vice chairmen				Members								
		Group executive chairman	Chief Executive Officer	Vice chairman 1	Vice chairman 2	Vice chairman 3	Vice chairman 4	Member 1	Member 2	Member 3	Member 4	Member 5	Member 6	Member 7	Member 8	Member 9
	Senior management	🔴🔵	🔴🔵	🔴🔵	🔴🔵	🔴🔵	🔴🔵	🔴🔵	🔴	🔴🔵	🔴🔵	🔵	🔴🔵	🔴🔵	🔴🔵	🔴🔵
Experience in the financial sector	General	🔴🔵	🔴🔵	🔴🔵	🔴🔵	🔴🔵	🔴🔵	🔴🔵			🔴🔵	🔵	🔵		🔴🔵	🔴🔵
	Banking	🔴🔵	🔴🔵	🔴🔵	🔴🔵	🔴🔵	🔴🔵	🔵			🔵	🔵			🔴🔵	🔵
	International diversity			🟣						🟣	🟣					
International experience	Spain	🔴🔵	🔴🔵	🔵	🔴🔵	🔴🔵	🔴🔵	🔴	🔴🔵		🔴🔵	🔴🔵	🔴🔵	🔴🔵	🔴🔵	🔴🔵
	Latam	🔴🔵	🔴🔵		🔴🔵	🔵	🔵	🔴	🔵		🔴🔵			🔵		
	UK/US	🔴🔵	🔴🔵	🔴🔵	🔴🔵	🔵	🔵	🔴	🔵	🔴🔵	🔴🔵					🔵
	Others	🔴	🔴🔵	🔴🔵	🔴🔵	🔵	🔵	🔴	🔵	🔴🔵	🔴🔵	🔵	🔵	🔵		🔵
	Accounting and financial background	🔴🔵	🔴	🔴🔵	🔴🔵	🔴🔵	🔴🔵			🔴🔵		🔵	🔵	🔴🔵	🔴🔵	🔴🔵
	Other commercial	🔴🔵			🔵	🔵	🔵			🔴🔵	🔴🔵	🔴🔵		🔴🔵		🔴🔵
	Risks	🔴🔵	🔴	🔴🔵	🔴🔵	🔴🔵	🔵	🔴		🔴🔵	🔵		🔵	🔵	🔴🔵	🔴🔵
	Government/ Academic/ Research	🔵		🔵	🔴🔵	🔴🔵	🔵		🔴🔵	🔵	🔵	🔵	🔴🔵	🔴🔵	🔴🔵	🔴🔵
	IT/Digital	🔴🔵	🔴							🔴🔵				🔵		
	Strategy	🔴🔵	🔴	🔴🔵	🔴🔵	🔴🔵	🔴🔵	🔴🔵		🔴🔵	🔴🔵	🔴		🔴🔵		🔴
	Regulation/ Regulatory relations	🔴🔵	🔴	🔴🔵	🔵	🔴🔵	🔴🔵	🔴		🔴	🔴				🔴🔵	🔴🔵
	Experience in corporate governance	🔴🔵	🔴🔵	🔴🔵	🔵	🔴🔵	🔴🔵	🔴		🔴🔵	🔴🔵		🔵	🔴🔵	🔴🔵	🔴🔵
	Gender diversity	🟣							🟣	🟣		🟣	🟣			🟣

🔴 Skills as executive 🔵 Skills as non-executive 🟣 Nature *Data in February 2017

Total number of independent directors	**8**
Total board members	**15**

» 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%.

With relation to the foregoing, the shareholders acting at the general shareholders' meeting of 18 March 2016 approved a maximum ratio between fixed and variable components of executive directors' remuneration of 200% for 2016.

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 Companies Act 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. Accordingly, the board of directors, at the proposal of the remuneration committee, is 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 Circular 2/2016 of 2 February, of Banco of Spain, on credit institutions, supervision and capital adequacy.

Remuneration of the board in 2016

Bylaw-stipulated allotments earned by the board amounted to 4.6 million euros in 2016, which is 23.9% lower than the maximum amount of 6 million euros approved by shareholders at the general shareholders' meeting.

Full details regarding director remuneration and the policy for 2016 can be found in the report of the remuneration committee, which forms part of the corporate documentation of Banco Santander.

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

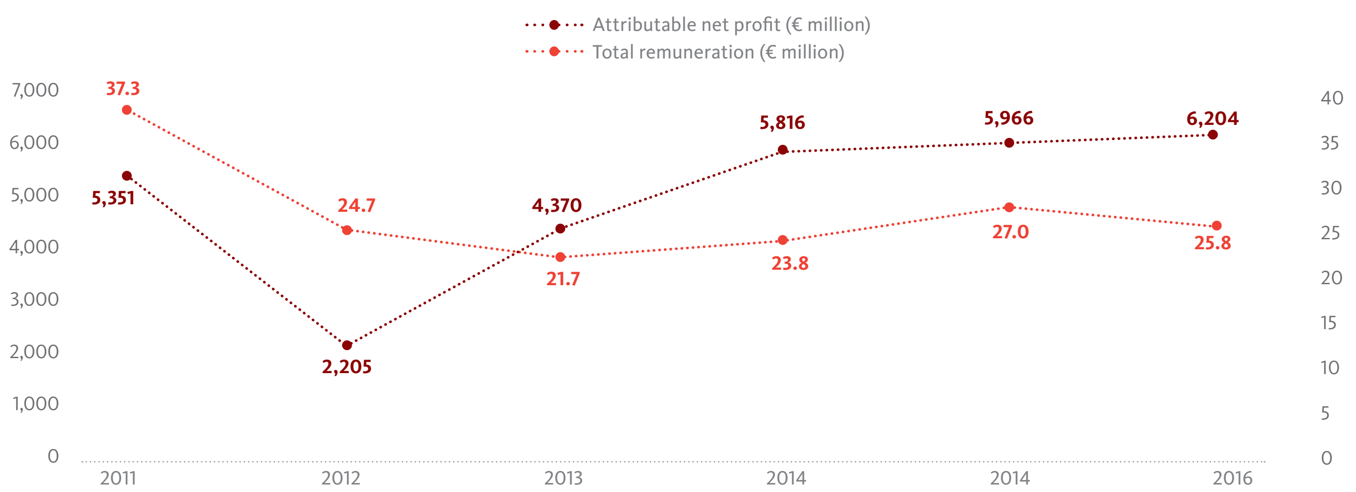
Anticipation of and adjustment to the regulatory framework

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 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 Companies Act and in the Bylaws (article 59.bis.1), the board of directors annually 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 the remuneration for all items of directors with executives duties against attributable net profit*



* Remuneration data of executive directors and attributable net profit in millions of euros.

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 2016, the report corresponding to 2015 was submitted to the shareholders at the general shareholders' meeting held on 18 March, as a separate item on the agenda and as a consultative matter, with 91.507% of the votes being in favour of the report accounts.

The director remuneration policy for 2016, 2017 and 2018 was also submitted for approval, on a binding basis, by shareholders at the annual general shareholders' meeting held on 18 March 2016, in accordance with article 529 novodecies of the Spanish Companies Act. The policies were approved with 91.467% of the votes in favour.

Lastly, the 2016 annual report on director remuneration will be laid before the annual general shareholders' meeting to be held on 6 or 7 April 2017 (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 2017, 2018 and 2019 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 accounts.

» 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 for 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.

Some measures taken by the board

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

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

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

The shareholders 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 shareholders 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: changes in the remuneration policies

A number of changes were proposed at the 2016 general shareholders' meeting with regard to the remuneration policies for executive directors and senior managers, 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.

2016: changes to the remuneration policy of executive directors

A number of changes to the remuneration policy of executive directors will be laid before shareholders for their approval at the general meeting to be held on 6 or 7 April, on first or second call, respectively. These changes are intended to:

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

Related-party transactions

In accordance with that stipulated by law, article 53 of the Bylaws and articles 3, 16 and 33 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.

In accordance with applicable legislation and the Rules and Regulations of the Board, authorisation will not be necessary in the case of transactions subject to standard terms and conditions, normal market prices and where the amount does not exceed 1% of the company's annual income.

These transactions will require board authorisation, based on a favourable report from the audit committee, except for those cases where by law approval 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 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 30), 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 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 2016, there were 95 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 95 cases is as follows: on 28 occasions the abstention was due to proposals to appoint, re-elect or withdraw directors, and to appoint members of board committees or other committees at Group or related companies; on 51 occasions the matter under consideration related to remuneration or granting loans or credits; on nine occasions the matter concerned the discussion of financing or investment proposals or other risk transactions in favour of companies related to any director; on five occasions the abstention concerned the annual verification of the status of directors carried out by the appointments committee, pursuant to article 6.3 of the Rules and Regulations of the Board; and on two occasions the abstention concerned the approval of a related-party transaction.

» 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, international, and innovation and technology committees).

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.

At the annual general shareholders' meeting of 18 March 2016, a proposal was put forward to amend articles 53, 54, 54.bis and 54.ter of the Bylaws in order to increase the maximum number of members of the audit, the appointments, the remuneration and the risk supervision, regulation and compliance committees from the current seven directors to a maximum of nine directors for the purpose of giving the board of directors more flexibility in establishing the adequate composition for these committees at any given time.

Executive committee

The executive committee is key to ensuring the proper functioning of the Bank's corporate governance, and that of 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 2016 it held 52 meetings.

There are currently eight directors sitting on the committee, four 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 14).

Audit committee

The audit committee, among other functions, 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 typically meets on a monthly basis and met 10 times in 2016.

As provided in the Bylaws (article 53) and the Rules and Regulations of the Board (article 16), the committee must comprise 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 within the meaning of 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.

Lastly, and so as to ensure that the audit committee exercises its decision-making powers properly when commissioning the external auditor to provide non-audit services, it was agreed at the audit committee meeting held on 20 April 2016 to approve the policy for approving non-audit services provided by the external auditor. In line with the latest national and international practices, this policy contains the proper procedure for approving non-audit services provided by the Group's financial auditor, as well as the system governing the maximum fees payables. The committee must endorse any decision to arrange non-audit services insofar as not prohibited by applicable regulations, having first properly assessed any threats to the auditor's independence and the safeguard measures applied in accordance with said regulations.

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 10 occasions in 2016.

The Bylaws (article 54) and the Rules and Regulations of the Board (article 17) 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, five 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. It also proposes the remuneration of other members of senior management and draws up their remuneration policy.

The committee met on nine occasions in 2016.

The Bylaws (article 54 bis) and the Rules and Regulations of the Board (arti-cle 17 bis) 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 its relationship with authorities and regulators in the various countries in which the Group has a presence, assists the board with its capital and liquidity strategy, and monitors compliance with the General Code of Conduct and, in general, with the Bank's governance rules and compliance and criminal risk prevention programmes. Matters such as sustainability, communication and relations with the Bank's stakeholders, as well as matters regarding corporate governance and regulation, are also discussed at committee meetings.

The committee met on 12 occasions in 2016.

As provided in the Bylaws (article 54 ter) and the Rules and Regulations of the Board (article 17 ter), the committee must be made up of non-executive directors, the majority of whom must be independent, including the chairman.

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

International committee

The international committee has the following functions (article 17 of the Rules and Regulations of the Board): (i) monitoring the development of the Group's strategy and of the activities, markets and countries in which the Group desires to have a presence through direct investments or specific transactions, while remaining duly informed of the commercial initiatives and strategies of the various units within the Group and of the new projects presented thereto; and (ii) reviewing the performance of financial investments and businesses, as well as the international economic situation, and making proposals to adjust risk-country limits, its structure and return and its assignment by businesses and/or units.

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

Innovation and technology committee

Given the importance assigned to innovation and technology as a strategic priority for the Group, the regulations of the innovation and technology committee have been amended in order to expand the committee's functions by redrafting article 17 quinquies of the Rules and Regulations of the Board upon a board resolution dated 26 January 2016.

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 technological and security risks and to supervise all matters relating to cyber-security.

The committee met on three occasions in 2016.

This committee comprises nine directors, of whom four are executive and five are non-executive. Three of these five non-executive directors are independent.

***

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

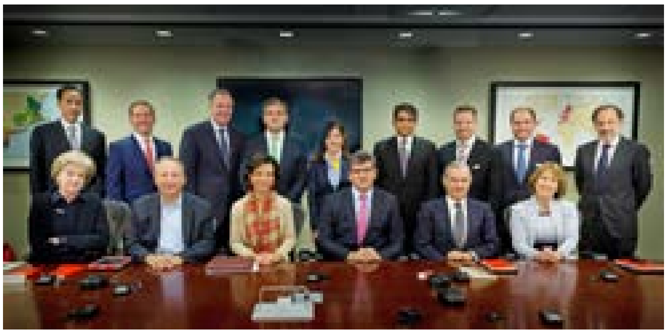
Additionally, all board members who are not also members of the executive committee may attend its meetings, whatever the chairman's reason is for calling such meeting. In 2016, directors with no seat on the executive committee attended an average of 10.9 meetings of that committee.

The audit, appointments, remuneration and risk supervision, regulation and compliance committees have prepared reports on their activities in 2016. 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 2016.

» International advisory board

Banco Santander's new international advisory board, comprising at-large experts in strategy, IT and innovation, held its first meeting on 26 April 2016 in Boston (US).

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 board is expected to meet two times per year.



First meeting of the international advisory board held on 26 April 2016 in Boston (US).

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 Francisco 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 Charles Phillips
CEO of Infor and former President of Oracle

Mr Mike Rhodin
Senior Vice President of IBM Watson

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

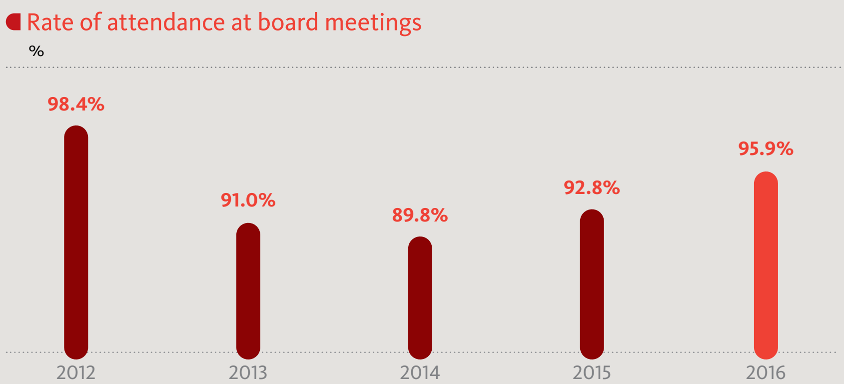
Composition of the committees of the board

Number of meetings and estimated average hours devoted by each director

Committees	No. of meetings	Hours
Executive committee	52	260
Audit committee	10	100
Appointments committee	10	40
Remuneration committee	9	36
Risk supervision, regulation and compliance committee	12	120
International committee	-	-
Innovation and technology committee	3	12

Attendance at meetings of the board of directors and its committees in 2016

Pursuant to the Rules and Regulations of the Board (article 20.1), absences from meetings must be limited to unavoidable cases. The average attendance rate at board meetings in 2016 was 95.92%.



Committees

		Decision-making	Advisory				Reporting	
Directors	**Board**	**Executive**	**Audit**	**Appointments**	**Remuneration**	**Risk supervision, regulation and compliance**	**Innovation and technology**	**International[a]**
Average attendance	**95.92%**	**94.71%**	**91.49%**	**93.10%**	**100.00%**	**89.16%**	**100.00%**	**–**
Individual attendance								
Ms Ana Botín-Sanz de Sautuola y O´Shea	13/13	50/52					3/3	
Mr José Antonio Álvarez Álvarez	13/13	51/52					3/3	
Mr Bruce Carnegie-Brown	13/13	39/52		10/10	9/9	12/12	3/3	
Mr Rodrigo Echenique Gordillo	13/13	50/52					3/3	
Mr Matías Rodríguez Inciarte	13/13	52/52					3/3	
Mr Guillermo de la Dehesa Romero	13/13	50/52		10/10	9/9	12/12	3/3	
Ms Homaira Akbari[1]	4/4						0/0	
Mr Ignacio Benjumea Cabeza de Vaca	13/13	52/52		10/10	9/9	12/12	3/3	
Mr Javier Botín-Sanz de Sautuola y O´Shea	11/13							
Ms Sol Daurella Comadrán	11/13			10/10	9/9			
Mr Carlos Fernández González	12/13		8/10	6/10		7/12		
Ms Esther Giménez-Salinas i Colomer	13/13						3/3	
Ms Belén Romana García	13/13		10/10			2/2		
Ms Isabel Tocino Biscarolasaga	13/13	50/52	10/10		9/9	11/12		
Mr Juan Miguel Villar Mir	10/13		8/10			9/12		
Mr Ángel Jado Becerro de Bengoa[2]	10/10		7/7	8/8	7/7	9/9		

a. No meetings held in 2016.
1. Director since 27 September 2016.
2. Withdrawal from position of director effective 27 September 2016.

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.

Improvements were made to the functioning of the board and its committees. These include the use of devices and technological tools in order to make the documents relating to each item on the agenda available to board members, thereby enhancing their knowledge and awareness of the matters to be addressed, the ensuing discussions, and their ability to challenge any proposals or motions made by the directors.

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:

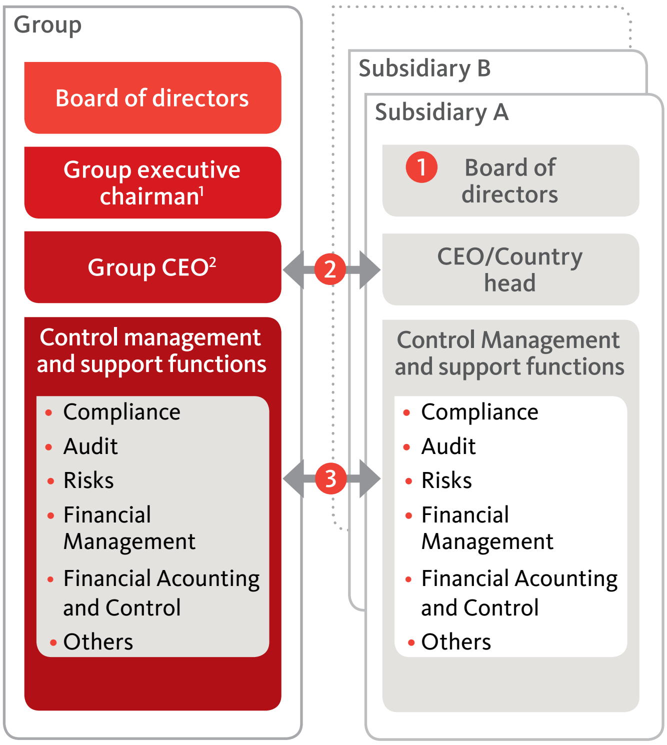
- Making the Group's governance more robust, through policies, models and control frameworks that allow the Group to implement corporate criteria and ensure effective supervision over the Group.
- Making the Group's units more efficient by unlocking cost management synergies, economies of scale and achieving 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.
- Between the CEOs (Chief Executive Officers) and country heads and the Group and between the officers and teams deemed fit to exercise control functions within the Group and at the subsidiaries: CRO (Chief Risk Officer), CCO (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 CEOs, country heads 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.



1. Senior executive.
2. Second-ranking executive.

Santander also has thematic frameworks (corporate frameworks), developed as common operating 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 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 comprise the internal governance framework 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.

» 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 control function, the compliance function and the internal audit function, and also between them and other functions which control or supervise them.

- The risks control function, the compliance function and the internal audit function are headed by the following group chief executives, each of whom has independent and direct access to the directors and committees for the purpose of reporting on their verification and inspection work.

  - Risks 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).

- Furthermore, and given the Group's structure, a further two functions are considered relevant at Group level, entrusted with financial control functions. Reporting directly to the Group's chief executive officer, they are themselves headed by a group chief executive: 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

- In 2015, the board of directors approved a new risk governance model 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.
  - To simplify the committee structure.
- There are currently two internal risk committees not specifically envisaged in the Bylaws: the executive risks committee, tasked with global risk management functions and comprising three executive members; and the risk control committee, 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 set up in June 2014 with general powers to support and advise the board of directors on risk supervision and control, on determining the Group's risk policies, on relations with supervisory authorities, on regulation and compliance, corporate social responsibility and corporate governance. This committee held 12 meetings in 2016, the estimated time devoted by each member of the committee to preparing and taking part in those meetings was approximately 10 hours per meeting.
- The executive committee held 52 meetings in 2016 and devoted a very significant amount of its time to discussions on the Group's risks.
- The audit committee met 10 times in 2016, the estimated time devoted by each member of the committee to preparing and taking part in those meetings was approximately 10 hours per meeting, it received the report of the head of internal audit and discussed matters relating to conduct risk and the financial reporting process.

Number of meetings of the executive, the audit, and the risk supervision, regulation and compliance committees

	2012	2013	2014	2015	2016
Executive*	59	58	65	59	52
Audit	11	12	13	13	10
Risk supervision, regulation and compliance	-	-	5	13	12
Total meetings	**70**	**70**	**81**	**85**	**74**

* The executive committee devoted a very significant amount of its time to discussions on 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 (common 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.

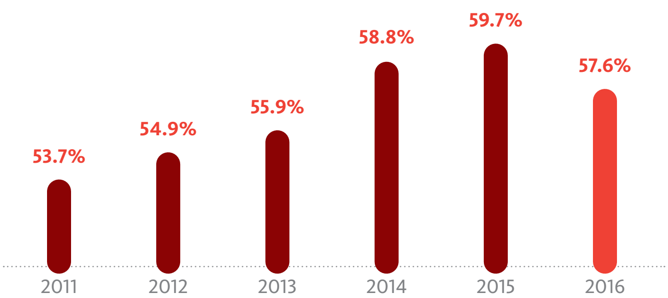
Any individual is eligible for a director position, subject, exclusively, to the limitations established by law.

» Quorum at the annual general shareholders' meeting held in 2016

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

The quorum at the 2016 annual general shareholders' meeting was 57.627%.

Quorum at annual general shareholders' meetings



» Encouraging the informed participation of shareholders at general shareholders' meetings

Since the annual general meeting held in 2011, shareholders have had access to an electronic shareholders' forum, in compliance with the provisions of the Companies Act. 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 at law, as well as offers or requests to act as a voluntary proxy.

Furthermore, 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.

KEY POINTS OF THE 2016 ANNUAL GENERAL SHAREHOLDERS' MEETING

- Shareholders approved the corporate management of the Bank in 2015 with 94% voting in favour.
- The 2015 annual report on director remuneration received a 92% favourable vote.

» Annual general shareholders' meeting held on 18 March 2016

Information on the call notice, establishment of a quorum, attendance, proxy-granting and voting

A total of 541,072 shareholders attended in person or by proxy, with 8,318,158,012 shares. The quorum was thus 57.627% 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 93.491%.

The following data are expressed as percentages of the Bank's share capital at the date of the annual general shareholders' meeting:

Physically present	0.863%[1]
By proxy	43.459%[2]
Absentee votes	13.305%[3]
Total	**57.627%**

1. Of this percentage (0.863%), 0.003% 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 1.064%.
3. Of this percentage (13.305%), 13.039% corresponds to votes cast by post, while the rest is the percentage of electronic votes.

At that meeting, 12 of the board's 15 directors at that date exercised, in accordance with article 186 of the Spanish Corporate Enterprises Act, the right to vote on behalf of a total of 6,194,277,775 shares, equivalent to the same number of votes, the breakdown being as follows:

Ms Ana Botín-Sanz de Sautuola y O'Shea	6,032,110,807
Mr José Antonio Álvarez Álvarez	155,651
Mr Bruce Carnegie-Brown	1,690
Mr Rodrigo Echenique Gordillo	90,323
Mr Matías Rodríguez Inciarte	714,933
Mr Guillermo de la Dehesa Romero	762
Mr Ignacio Benjumea Cabeza de Vaca	742,941
Mr Javier Botín-Sanz de Sautuola y O'Shea	67,993,418
Ms Sol Daurella Comadrán	73,941
Mr Ángel Jado Becerro de Bengoa*	5,180,557
Ms Belén Romana García	33,151
Ms Isabel Tocino Biscarolasaga	154,299

*Stood down from the board on 27 September 2016.

» Resolutions adopted at the 2016 general shareholders' meetings

The full texts of the resolutions adopted at the general shareholders' meetings held in 2016 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 18 March 2016.

» Information provided to shareholders and shareholder communication

In 2016, Banco Santander continued to strengthen communication with, service to and its relationship with shareholders and investors.

Channels for shareholder information and service

Telephone service lines	177,884	Queries received
Shareholder and investor mailbox	9,069	E-mails answered
Personal actions	928	Actions carried out

During 2016, there were 928 meetings with investors, analysts and rating agencies, which entailed contact with 531 investors/analysts. In addition, 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. London was the venue of the Group's Group Strategy Update in September. During the event, the senior management reviewed the 2018 objectives presented at the 2015 Investor Day in relation to both the Group and its main business units. Over 200 delegates took part in the various Group Strategy Update events, including the Group's main analysts and investors.

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 sufficiently in advance.

» Policy for contacting and communicating with shareholders

The Bank's board of directors has approved a policy for contacting and communicating with shareholders, institutional investors and proxy advisors. This policy is published on the Group's corporate website (www.santander.com). The policy 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 the Shareholder section of this annual report.

Communication between the board and shareholders and investors has been stepped up through the Group Strategy Update and the corporate governance road show arranged and held by the lead director

6. Grupo Santander management team[1]

Everything we do stems from a **sense of responsibility and commitment to our people**, to **sustainability** and to the **communities** in which we are present

Ms Ana Botín, executive chairman of Banco Santander
General shareholders' meeting
18 March 2016

Composición

Group executive 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
Executive vice chairman[2]	Mr Matías Rodríguez Inciarte
Businesses	
Argentina	Mr Enrique Cristofani
Brazil	Mr Sérgio Agapito Lires Rial
Chile	Mr Claudio Melandri Hinojosa
United States	Mr Scott Powell
Spain	Mr Rami Aboukhair Hurtado
Consumer Finance	Ms Magda Salarich Fernández de Valderrama
Mexico	Mr Héctor Blas Grisi Checa
Poland	Mr Gerry Byrne Mr Michal Gajewski
Portugal	Mr Antonio Vieira Monteiro
United Kingdom	Mr Nathan Bostock
Business divisions	
Santander Global Corporate Banking	Mr Jacques Ripoll
Business support divisions	
Retail & Commercial Banking	Mr Ángel Rivera Congosto
Support and control functions	
Risks	Mr José María Nus Badía *(Group Chief Risk Officer)* Mr Keiran Foad[3]
Financial	Mr José Antonio García Cantera (*Group Chief Financial Officer*)
Office of the General Secretary and Human Resources	Mr Jaime Pérez Renovales
Compliance	Ms Mónica López-Monís Gallego (*Group Chief Compliance Officer*)
Internal audit	Mr Juan Guitard Marín (*Group Chief Audit Executive*)
Strategic Alliances in Asset Management and Insurance	Mr Juan Manuel San Román López
Communication, Corporate Marketing and Research	Mr Juan Manuel Cendoya Méndez de Vigo Ms Jennifer Scardino[3]
Corporate Development	Mr José Luis de Mora Gil-Gallardo
Innovation	Mr J. Peter Jackson
Financial Accounting and Control	Mr José Francisco Doncel Razola *(Group Chief Accounting Officer)*
Executive Chairman's Office and Strategy	Mr Víctor Matarranz Sanz de Madrid
Costs	Mr Javier Maldonado Trinchant
Technology and Operations	Mr Andreu Plaza López
Universities	Mr Javier Roglá Puig

1. Information on 31 December 2016. Subsequent to that date it was announced: the integration of the Retail & Commercial Banking and Innovation divisions into a new division called Santander Digital whose will be temporarily occupied by Mr Víctor Matarranz Sanz de Madrid as global head until the appointment of a new person in charge; the departure of the Group of Mr J. Peter Jackson; the appointment of Mr Ángel Rivera Congosto as executive vice president of Banco Comercial de Santander México; and the departure of the Group of Mr Jacques Ripoll and the appointment of Mr José María Linares Perou as executive vice president of Santander Global Corporate Banking. Those appointments are subject, where appropiate, to clearance of supervisor.
2. To whom the Group Chief Risk Officer reports.
3. This appointment is subject authorisation and other formalities.

» Remuneration

Information on the remuneration of senior executive vice presidents is provided in note 5 to the Group's annual accounts.

» 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 2016 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

Santander has been included in the DJSI and FTSE4Good indices since 2000 and 2002, respectively, and its corporate governance model is recognised by socially responsible investment indices.

» Financial information and other relevant information

Financial information

Pursuant to the provisions of its Rules and Regulations (article 34.2), the board has taken the necessary actions to ensure that the quarterly and 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 shall be disseminated in a true, clear, complete and equitable fashion and on a timely basis and, whenever practicable, such information shall be quantified.

In 2016, the Bank published 57 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 auditor

Independence of the auditor

In line with good corporate governance recommendations regarding the rotation of the external auditor, the annual general shareholders' meeting held on 18 March 2016 agreed to designate PricewaterhouseCoopers Auditores, S.L. (PwC) as external auditor of both the Bank and its wider consolidated Group for the years 2016, 2017 and 2018, obtaining the favourable vote of 94.663% of all capital present and represented by proxy

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 2016 is contained in note 48 to the Group's annual accounts.

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 issue a report in this regard. The financial statements of the Bank and of the consolidated Group for 2016 are submitted without qualifications.

At its meeting of 15 February 2017, 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.

The Bylaws, the Rules and Regulations for the General Shareholders' Meeting and the Rules and Regulations of the Board were amended in 2016 to bring them in line with both legislative changes and best practices in corporate governance.

» Intra-group transactions

There were no intra-group transactions in 2016 that were not eliminated in the consolidation process and that are not part of the ordinary course of business of the Bank or of the Group companies as regards their purpose and conditions.

» 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 Corporate Enterprises Act; Order ECC/461/2013, of 20 March; CNMV Circular 3/2015, of 23 June; and Banco 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 145,000 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 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 2017 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).

» Good governance code of listed companies

Banco Santander follows the recommendations for good corporate governance contained in the good governance code of listed companies.

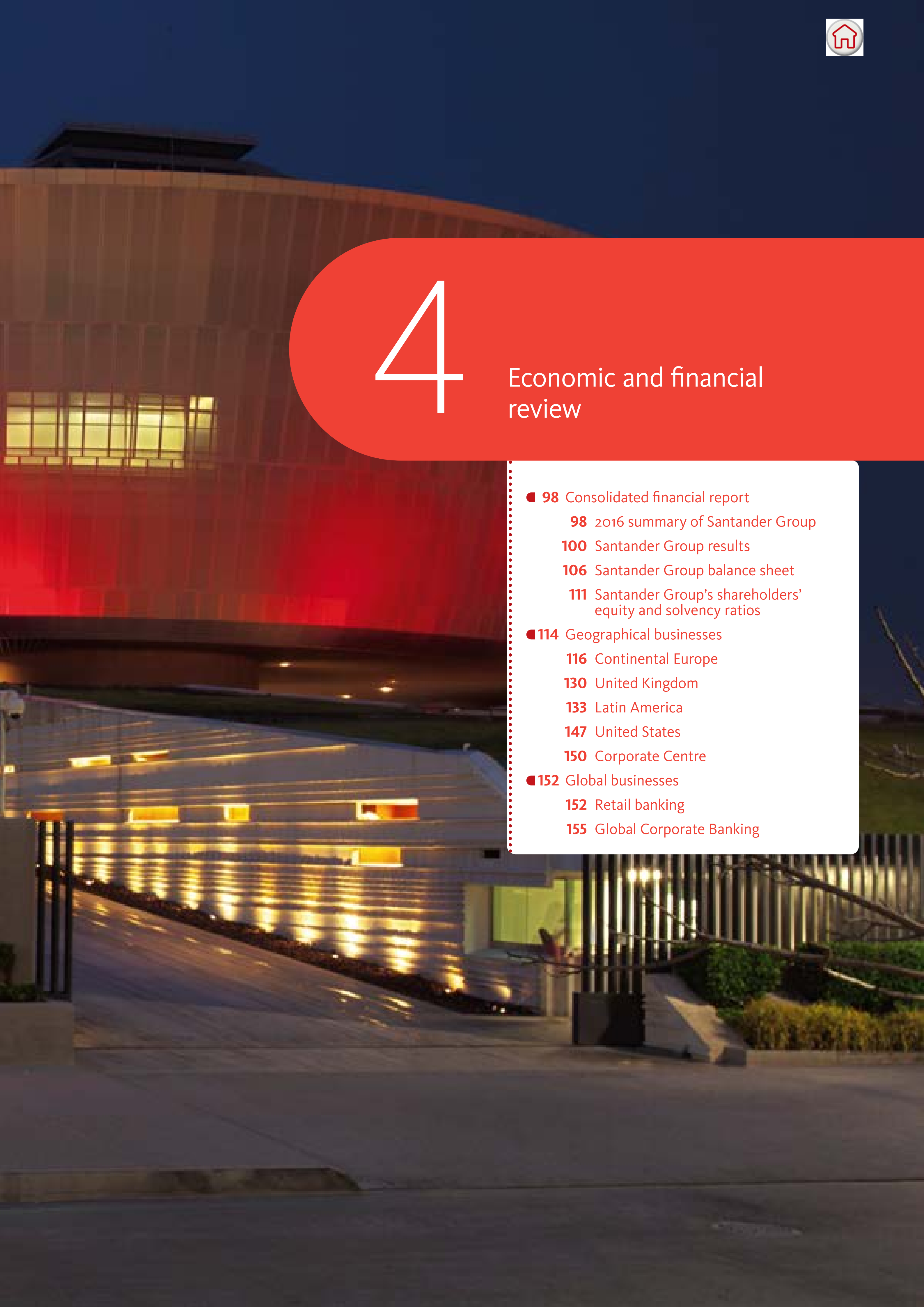
Banco Santander follows the good governance recommendations and best practices for credit institutions, such as the corporate governance principles for banks of the Basel Committee and the recommendations of the Organisation for Economic Co-operation and Development, and also takes into account the good governance codes of the stock markets on which its shares are listed.

8. Goals for 2017

The board's goals for 2017 with regard to corporate governance are as follows:

- Disseminating the culture and corporate values of Simple, Personal and Fair across the entire organisation.
- Consolidating the governance model so as to further strengthen the relations between the parent bank and its subsidiaries, especially with regard to corporate governance, ensuring gradual implementation of the model at all of the Group's main units. The purpose here is to ensure the consistency and soundness of decision-making processes, control systems, information flows and control mechanisms on a Group scale.
- Consolidating interaction between board members, especially between non-executive directors and the management team.
- Arranging and encouraging joint meetings between the risk supervision, regulation and compliance committee and the audit committee, and also between the former and the remuneration committee, so as to ensure an effective and efficient exchange of information and proper coverage of all risks.
- Incorporate into the functioning of the board the improvements resulting from the self-assessment process by counteracting the growing number of matters the board must address -especially regulatory affairs- with an agile and effective system for making well-informed decisions.


Santander



4 Economic and financial review

Consolidated Financial Report

» Grupo Santander 2016 summary

Our **strategy** and **business model** continued to generate value for our customers and shareholders. Our geographic diversification, with critical mass in our ten core markets, and leadership in efficiency give us a clear competitive advantage that enables us to withstand a difficult economic environment, particularly for banks, bouts of high volatility and greater tax pressure in some countries.

In this context, we ended 2016 with solid financial results, generating sustainable and predicable returns, and meeting our financial and commercial commitments.

Profit and dividends increased, we grew in volumes in constant euro terms, the balance sheet maintained a balanced structure, with liquidity ratios well above those required, and we significantly improved our capital position and our credit quality. All of this while advancing in our process of commercial transformation, renewing the relation with our customers and improving their experience with the bank.

The highlights in 2016 were:

Strong results. Santander's business model has demonstrated its strength in the last few years, which has enabled us to generate very predictable results and put us among the leaders in efficiency and profitability.

Underlying profit before tax was 3% higher at **€11,288 million.** In constant euros, the increase was 12%, with rises in nine out of the 10 core markets.

The main lines of the income statement reflect the strategy followed in 2016:

- **Good evolution of revenues,** driven by net interest income and fee income, which together generated 94% of gross income.
- **Strict control of costs** for the third year running. They were 2% lower in real terms and on a like-for-like basis.
- **Further fall in loan-loss provisions** and improvement in the cost of credit thanks to the strengthening of the corporate risk culture.

Higher tax charge, with new taxes in some units, as well as the recording of some non-recurring positive and negative results, which overall represented a charge net of taxes of €417 million (€600 million negative in 2015).

As a result, Grupo Santander posted an **attributable profit of €6,204 million**, 4% more than in 2015 and 15% higher in constant euros.

Commercial transformation process. We continued to make progress in 2016 in transforming our commercial model into one focusing more on customer loyalty, digitalisation and customer satisfaction.

Progress in all units to improve customer loyalty, developing new products and services, both for individuals as well as companies, which provide innovative solutions and global proposals. The *examples include: the 1|2|3 World, Santander Select, Santander Private Banking, Santander pymes, Santander Trade Network, Global Treasury Solutions, Santander Flame* and new digital apps in all countries.

In order to improve customer loyalty, we need to ensure operational excellence which for us means the best customer experience and efficiency. Exploiting new technologies is key to achieve this. We continued to work on different levels of digital transformation.

Our customers require greater availability and proximity from us and via digital channels, but at the same time strengthening the attention and tailored treatment that have always been Santander's hallmarks. We worked hard to also improve branches with the *Smart Red* project and contact centres. Equally noteworthy was the significant progress made in *Santander NEO CRM*, our commercial intelligence tool which integrates the information of all channels (branches, contact centres, digital means, etc) and incorporates new transactional capacities, enabling us to know our customers better and offer them value proposals, on the basis of their experience and needs, and help to achieve cost savings.

As a result of this transformation process, we reached **15.2 million loyal customers** (+10%) and **20.9 million digital customers** (+26%). These increases improved our revenue base, mainly fee income, where growth doubled that in 2015.

As regards customer satisfaction, we also achieved improved results. We now have **eight units,** three more than in 2015, **among the three best local banks in customer experience.**

Growth in activity. The greater customer loyalty and commercial strategy is reflected in higher business volumes, particularly in emerging markets, while maintaining our medium-low risk profile and a well-diversified portfolio.

Lending increased more in Latin America, Santander Consumer Finance and Poland and more moderately in the United Kingdom. Of note was Brazil (+0.4%), after improving its trend in the second half of the year. Spain and Portugal are still in a process of deleveraging and the United States was partially affected by the sale of portfolios of lower quality.

In customer funds, all main units grew, particularly in demand deposits and mutual funds, as part of our strategy to improve the cost of funding.

Strengthened solvency. In capital, we again demonstrated our capacity to combine a solid generation of sustainable capital with payment of dividends. Our **fully loaded CET1** capital ratio was **10.55%** at the end of 2016, surpassing the target and progressing toward our goal of 11% in 2018.

The total fully loaded ratio and the leverage ratio also improved, and we ended the year with a CET1 of 12.53%, well above the European Central Bank's minimum requirement.

Enhanced credit quality. Santander maintains a medium-low risk profile and high asset quality. All the quality indicators improved. The Group's NPL ratio was 43 b.p. lower at 3.93%, coverage rose one percentage point to 74% and the cost of credit fell by 7 b.p. to 1.18%.

Almost all countries improved; this was directly related to the strengthening of our risk culture throughout the Group, known as risk pro.

Creation of shareholder value. This was again one of our main priorities.

We increased earnings per share by 1%, the cash dividend by 8% and we continued to offer one of the best returns among banks in terms of RoTE.

In addition, our fully loaded capital rose by more than €3,000 million and the tangible book value per share increased for the third straight year to €4.22 per share.

The Santander share rose 8.8% in 2016 and the total shareholder return was 14.2% higher. Both these increases were much better than the rise in the DJ Stoxx Banks and DJ Stoxx 50 indexes.

Exchange rates: 1 euro / currency parity

	2016		2015	
	Period-end	Average	Period-end	Average
US$	1.054	1.106	1.089	1.109
Pound sterling	0.856	0.817	0.734	0.725
Brazilian real	3.431	3.831	4.312	3.645
Mexican peso	21.772	20.637	18.915	17.568
Chilean peso	707.612	747.500	773.772	724.014
Argentine peso	16.705	16.316	14.140	10.207
Polish zloty	4.410	4.362	4.264	4.182

GRUPO SANTANDER. INCOME STATEMENT

Attributable profit of €6,204 million, 4% more than 2015 (+15% in constant euros). The main factors were:

- **Solid commercial revenues, underpinned by net interest income and fee income.**
- **Strict control of costs for the third straight year. They declined 2% in real terms and on a like-for-like basis, principally because of savings products and the streamlining measures.**
- **Further reduction in provisions and in the cost of credit (from 1.25% in December 2015 to 1.18%), reflecting the improvement in the quality of portfolios.**

The efficiency ratio was 48.1%, one of the best among our competitors.

Underlying RoTE of 11.1%, a reference in the banking sector.

Earnings per share of €0.41 (+1%).

Income statement

€ Million

	2016	2015	Variation amount	%	%w/o FX	2014
Net interest income	**31,089**	**32,189**	**(1,101)**	**(3.4)**	**2.3**	**29,548**
Net fee income	10,180	10,033	147	1.5	8.1	9,696
Gains (losses) on financial transactions	1,723	2,386	(663)	(27.8)	(24.0)	2,850
Other operating income	862	665	197	29.7	26.1	519
Dividends	413	455	(41)	(9.1)	(7.7)	435
Income from equity-accounted method	444	375	69	18.3	26.0	243
Other operating income/expenses	5	(165)	170	—	—	(159)
Gross income	**43,853**	**45,272**	**(1,419)**	**(3.1)**	**2.5**	**42,612**
Operating expenses	(21,088)	(21,571)	483	(2.2)	3.5	(20,038)
General administrative expenses	(18,723)	(19,152)	429	(2.2)	3.7	(17,781)
Personnel	*(10,997)*	*(11,107)*	*110*	*(1.0)*	*4.5*	*(10,213)*
Other general administrative expenses	*(7,727)*	*(8,045)*	*318*	*(4.0)*	*2.6*	*(7,568)*
Depreciation and amortisation	(2,364)	(2,419)	54	(2.3)	2.2	(2,257)
Net operating income	**22,766**	**23,702**	**(936)**	**(3.9)**	**1.6**	**22,574**
Net loan-loss provisions	(9,518)	(10,108)	590	(5.8)	(2.1)	(10,562)
Impairment losses on other assets	(247)	(462)	215	(46.5)	(45.6)	(375)
Other income	(1,712)	(2,192)	480	(21.9)	(19.0)	(1,917)
Underlying profit before taxes	**11,288**	**10,939**	**349**	**3.2**	**11.7**	**9,720**
Tax on profit	(3,396)	(3,120)	(276)	8.9	16.4	(2,696)
Underlying profit from continuing operations	**7,892**	**7,819**	**73**	**0.9**	**9.8**	**7,024**
Net profit from discontinued operations	0	—	0	—	—	(26)
Underlying consolidated profit	**7,893**	**7,819**	**73**	**0.9**	**9.8**	**6,998**
Minority interests	1,272	1,253	18	1.5	6.2	1,182
Underlying attributable profit to the Group	**6,621**	**6,566**	**55**	**0.8**	**10.5**	**5,816**
Net capital gains and provisions	(417)	(600)	183	(30.5)	(30.5)	—
Attributable profit to the Group	**6,204**	**5,966**	**238**	**4.0**	**15.1**	**5,816**
Underlying EPS (euros)	**0.44**	**0.45**	**(0.01)**	**(2.1)**		**0.48**
Underlying diluted EPS (euros)	**0.43**	**0.44**	**(0.01)**	**(2.3)**		**0.48**
EPS (euros)	**0.41**	**0.40**	**0.00**	**1.0**		**0.48**
Diluted EPS (euros)	**0.41**	**0.40**	**0.00**	**0.9**		**0.48**
Pro memoria:						
Average total assets	1,337,661	1,345,657	(7,996)	(0.6)		1,203,260
Average stockholders' equity*	88,744	90,798	(2,054)	(2.3)		82,545

(*).- In 2014, pro-forma taking into account the January 2015 capital increase

Grupo Santander posted attributable profit of €6,204 million, 4% higher than the €5,966 registered in 2015 (+15% in constant euros).

The profit includes non-recurring negative results of €417 million (-€600 million in 2015), as follows:

- In 2016: €227 million of capital gains from the sale of VISA Europe; -€475 million of restructuring costs; a €137 million provision for eventual claims related to payment protection insurance (PPI) in the UK and -€32 million following the re-statement of Santander Consumer USA's figures.
- In 2015: the net result of the reversal of tax liabilities in Brazil (€835 million), €283 million of badwill of Banif in Portugal, a €600 million provision for eventual claims related to PPI in the UK, -€683 million for impairment of intangible assets and -€435 million for other provisions (goodwill and others).

The underlying pre-tax profit, before these non-recurring results and taxes, was 3% higher at €11,288 million (+12% in constant euros), due to the good performance of commercial revenues, strict control of costs, lower provisions and a reduced cost of credit.

Nine of the ten core units generated higher profits and six of them registered double-digit growth.

This performance is even more striking if we bear in mind the environment in which banks have been operating since the beginning of the financial crisis:

- Mature markets continue to have low interest rates, tough regulatory requirements, high levels of unproductive assets, sluggish demand for loans, new entrants, the technological challenge and a level of profitability still below the cost of capital.

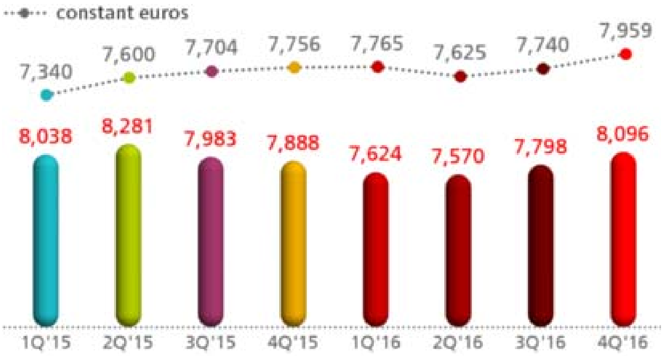
Quarterly income statement

€ Million

	2015				2016			
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
Net interest income	**8,038**	**8,281**	**7,983**	**7,888**	**7,624**	**7,570**	**7,798**	**8,096**
Net fee income	2,524	2,586	2,474	2,448	2,397	2,549	2,597	2,637
Gains (losses) on financial transactions	695	372	634	684	504	366	440	412
Other operating income	186	379	225	(126)	204	445	245	(32)
Dividends	33	239	75	107	44	209	37	124
Income from equity-accounted method	99	101	93	82	83	112	119	130
Other operating income/expenses	53	39	57	(315)	78	124	90	(286)
Gross income	**11,444**	**11,618**	**11,316**	**10,894**	**10,730**	**10,929**	**11,080**	**11,113**
Operating expenses	(5,377)	(5,429)	(5,342)	(5,422)	(5,158)	(5,227)	(5,250)	(5,453)
General administrative expenses	(4,785)	(4,826)	(4,731)	(4,810)	(4,572)	(4,632)	(4,692)	(4,828)
Personnel	*(2,755)*	*(2,836)*	*(2,717)*	*(2,799)*	*(2,683)*	*(2,712)*	*(2,726)*	*(2,876)*
Other general administrative expenses	*(2,030)*	*(1,989)*	*(2,015)*	*(2,011)*	*(1,889)*	*(1,920)*	*(1,966)*	*(1,952)*
Depreciation and amortisation	(592)	(603)	(611)	(612)	(586)	(595)	(558)	(626)
Net operating income	**6,067**	**6,189**	**5,974**	**5,472**	**5,572**	**5,703**	**5,831**	**5,660**
Net loan-loss provisions	(2,563)	(2,508)	(2,479)	(2,558)	(2,408)	(2,205)	(2,499)	(2,406)
Impairment losses on other assets	(60)	(78)	(110)	(215)	(44)	(29)	(16)	(159)
Other income	(454)	(605)	(606)	(526)	(389)	(515)	(376)	(432)
Underlying profit before taxes	**2,990**	**2,998**	**2,778**	**2,173**	**2,732**	**2,954**	**2,940**	**2,663**
Tax on profit	(922)	(939)	(787)	(471)	(810)	(970)	(904)	(712)
Underlying profit from continuing operations	**2,067**	**2,059**	**1,991**	**1,702**	**1,922**	**1,984**	**2,036**	**1,951**
Net profit from discontinued operations	0	0	(0)	—	—	0	(0)	0
Underlying consolidated profit	**2,067**	**2,059**	**1,991**	**1,702**	**1,922**	**1,984**	**2,036**	**1,951**
Minority interests	350	350	311	242	288	338	341	305
Underlying attributable profit to the Group	**1,717**	**1,709**	**1,680**	**1,460**	**1,633**	**1,646**	**1,695**	**1,646**
Net capital gains and provisions*	—	835	—	(1,435)	—	(368)	—	(49)
Attributable profit to the Group	**1,717**	**2,544**	**1,680**	**25**	**1,633**	**1,278**	**1,695**	**1,598**
Underlying EPS (euros)	**0.12**	**0.12**	**0.11**	**0.10**	**0.11**	**0.11**	**0.11**	**0.11**
Underlying diluted EPS (euros)	**0.12**	**0.12**	**0.11**	**0.10**	**0.11**	**0.11**	**0.11**	**0.11**
EPS (euros)	**0.12**	**0.18**	**0.11**	**(0.01)**	**0.11**	**0.08**	**0.11**	**0.10**
Diluted EPS (euros)	**0.12**	**0.17**	**0.11**	**(0.01)**	**0.11**	**0.08**	**0.11**	**0.10**

Net interest income

€ Million



Net fee income

€ Million

- Developing markets, meanwhile, recorded faster growth in business volumes, higher interest rates and substantial potential for banking services.

Lastly, there are two factors to take into account in the year-on-year comparisons. The first one is a slightly positive perimeter impact from SCF operations and Banif's acquisition in Portugal and the other is negative from the evolution of exchange rates against the euro of the various currencies in which the Group operates. The forex impact is 6 p.p. for the whole Group in revenue and cost comparisons and 11 p.p. in the attributable profit.

The main lines of the income statement were as follows:

Gross income

Gross income was 3% lower at €43,853 million because of the impact of exchange rates. Excluding this impact, growth was 3% and the quality of the results was better as they were underpinned by customer revenues.

Our revenue structure, where net interest income and fee income account for 94% of gross income, much higher than that of our competitors, continues to enable us to grow revenues consistently and recurrently. Gross income grew in six of the last seven quarters.

- **Net interest income** in 2016 amounted to €31,089 million (71% of gross income) and was 3% lower in constant euros. On a like-for-like basis, growth was 2%, due to higher lending and deposits combined with good management of the cost of funds.

  By units and in constant euros, growth of 28% in Argentina, 14% in Mexico, 11% in Santander Consumer Finance and Poland, 7% in Chile, 2% in Brazil and 0.4% in the UK.

  The only declines were in Spain because of lower volumes and interest rate pressure on loans and the US, affected by the fall in Santander Consumer USA's auto finance balances and the change of mix toward a lower risk profile.

- **Fee income** increased 1% to €10,180 million (+8% in constant euros, double the growth in 2015), reflecting the greater activity and customer loyalty. By businesses, fee income rose from both Retail Banking (86% of the total) and Global Corporate Banking.

  All countries generated more fee income, 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 4% of gross income, fell 24% in constant euros as they were very high in 2015 due to management of interest rate and exchange rate hedging portfolios.

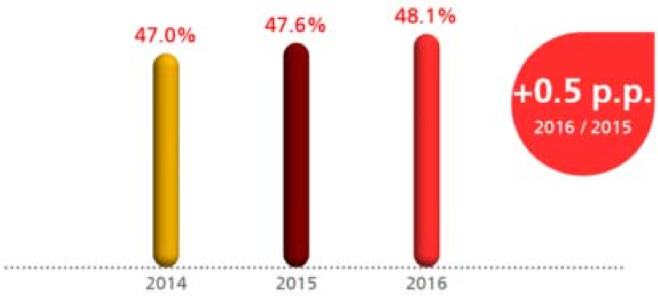
Net fee income

€ Million

	2016	2015	Variation amount	%	2014
Fees from services	6,261	6,040	220	3.6	5,827
Mutual & pension funds	757	862	(105)	(12.2)	913
Securities and custody	913	905	9	1.0	763
Insurance	2,249	2,225	23	1.0	2,193
Net fee income	**10,180**	**10,033**	**147**	**1.5**	**9,696**

Operating expenses
€ Million

Efficiency ratio
%



- Lastly, **other revenues** represented less than 2% of gross income, They include dividends, which were €41 million lower, equity accounted method results (up by €69 million) and other operating income, which rose by €170 million, partly due to higher revenues from leasing activity in the US.

Operating expenses

Operating expenses fell 2% to €21,088 million (+4% in constant euros). In real terms and on a like-for-like basis, they were 2% lower. This was the third consecutive year with flat growth or lower in real terms.

The measures adopted to simplify structures are enabling us to keep on investing in the commercial transformation (commercial tools, streamlined processes, new branch models) and improve customer satisfaction while forging a more efficient corporation.

We continued to manage the units very actively throughout the year, adapting the cost base to the business reality in each market. This enabled us to reduce costs in seven of the 10 core units in real terms and on a like-for-like basis, and also in the Corporate Centre. The two units whose costs rose the most were Mexico, because of the business expansion plans that entail investments in technology, and the US due to adapting to regulatory requirements and developing the franchise.

The evolution of revenues in an environment of high pressure on them and the control of costs are reflected in the stable efficiency ratio (48.1% vs. 47.6% in 2015), a level that compares very well with that of our main European and US competitors.

Loan-loss provisions

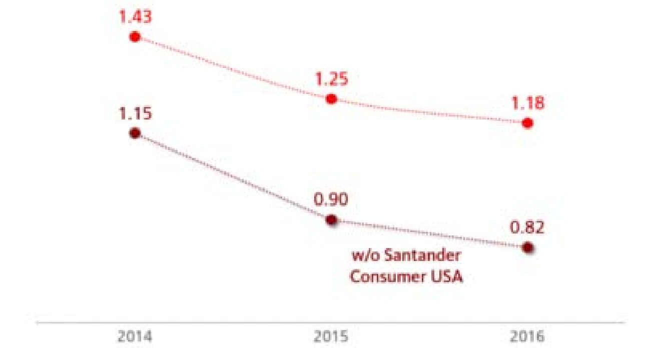
Loan-loss provisions fell 6% to €9,518 million. In constant euros, the reduction was 2%.

Operating expenses
€ Million

	2016	2015	Variation amount	%	2014
Personnel expenses	10,997	11,107	(110)	(1.0)	10,213
General expenses	7,727	8,045	(318)	(4.0)	7,568
Information technology	1,094	1,039	55	5.3	936
Communications	499	587	(88)	(15.0)	489
Advertising	691	705	(14)	(2.0)	654
Buildings and premises	1,708	1,786	(78)	(4.4)	1,775
Printed and office material	146	157	(11)	(6.8)	155
Taxes (other than profit tax)	484	529	(45)	(8.5)	460
Other expenses	3,105	3,243	(138)	(4.3)	3,098
Personnel and general expenses	**18,723**	**19,152**	**(429)**	**(2.2)**	**17,781**
Depreciation and amortisation	2,364	2,419	(54)	(2.3)	2,257
Total operating expenses	**21,088**	**21,571**	**(483)**	**(2.2)**	**20,038**

Net loan-loss provisions
€ Million

Cost of credit
%



Net loan-loss provisions
€ Million

	2016	2015	Variation amount	%	2014
Non-performing loans	11,097	11,484	(387)	(3.4)	11,922
Country-risk	3	(0)	3	—	(24)
Recovery of written-off assets	(1,582)	(1,375)	(207)	15.1	(1,336)
Total	**9,518**	**10,108**	**(590)**	**(5.8)**	**10,562**

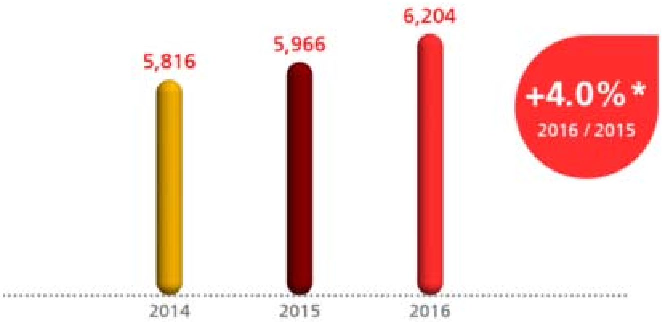
In constant euros, all European units recorded significant falls in provisions: Spain (-41%), United Kingdom (-39%), SCF (-27%), Portugal (-25%) and Poland (-10%). Increases in Latin American countries in line with the growth in lending, except for Chile where they were lower.

The cost of credit continued to improve quarter after quarter, reflecting the strategy of selective growth and an appropriate risk management policy. It fell from 1.25% in 2015 to 1.18%. Almost all the Group's units improved, notably Spain, Portugal, Argentina and SCF but also Mexico, Chile and Poland. Brazil's cost of credit was virtually stable and ended the year at below the 5% set as the maximum objective.

Other income and provisions

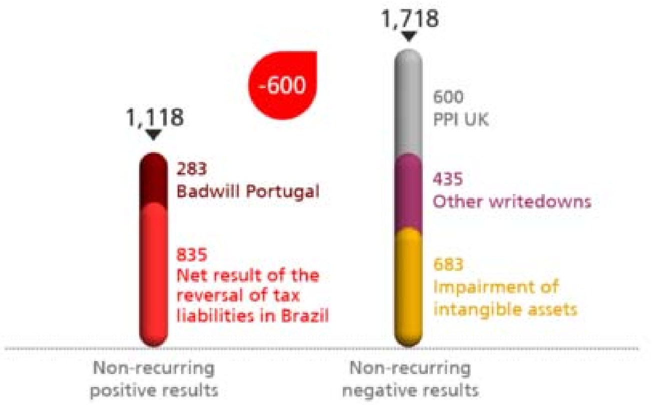
Other income and provisions was €1,959 million negative compared to €2,654 million also negative in 2015. This item covers various kinds of provisions, as well as capital gains and losses and impairment of financial assets. The decline over 2015 was very diluted by concepts, countries and businesses.

Attributable profit to the Group
%

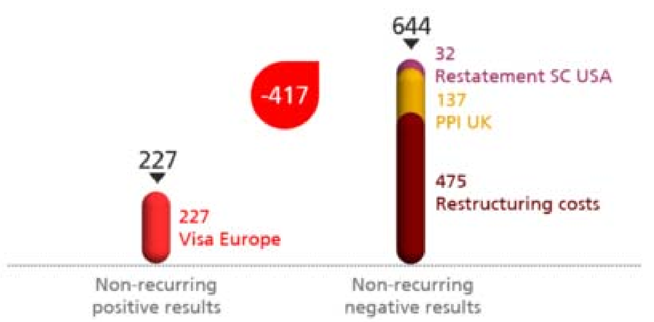


(*) In constant euros: +15.1%

Non-recurring results net of tax. 2015
€ Million



Non-recurring results net of tax. 2016
€ Million



Underlying profit before taxes

The underlying profit before taxes was 3% higher at €11,288 million (+12% in constant euros), underscoring the good evolution of gross income, control of costs and the good evolution of provisions and the cost of credit.

Despite the difficult environment in some markets, all units increased their underlying profit before taxes except for the US, and six of them did so by more than 15%.

Taxes increased in most countries, increasing the tax pressure in some units, mainly in Chile, UK and Poland (the latter two because of the introduction of new taxes on the sector). The tax rate for the Group as a whole was 30%.

Group attributable profit

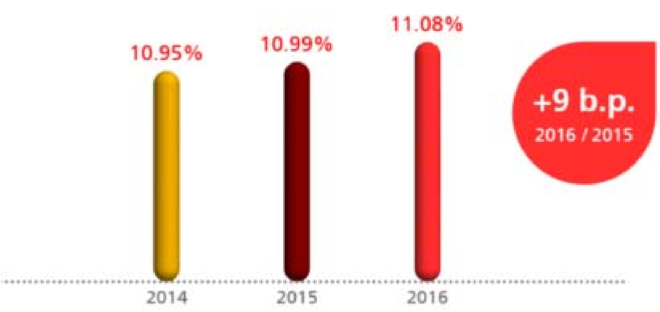
As already indicated, attributable profit was affected by non-recurring positive and negative results. Excluding them, underlying attributable profit was 1% higher at €6,621 million (+10% in constant euros).

We ended 2016 with solid results, profit growth and an underlying RoTE of 11.081%, which continued to be among the highest in the financial sector. The underlying RoRWA also improved (from 1.30% to 1.36%).

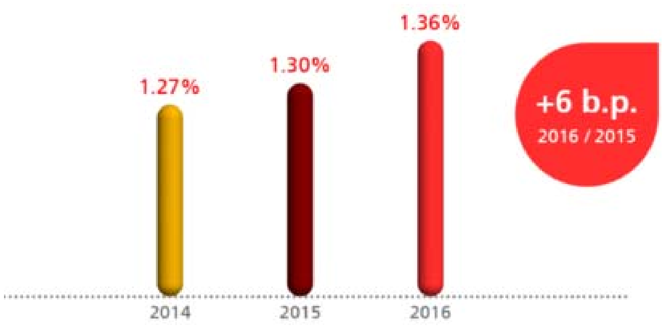
The Group's attributable profit was €6,204 million, 4% more than in 2015 (+15% in constant euros).

Earnings per share increased 1% to €0.41 (€0.40 in 2015). The total RoTE was 10.38% (9.99% in 2015) and the total RoRWA 1.29% (1.20%).

Underlying RoTE
%



Underlying RoRWA
%



Balance sheet

€ Million

Assets	2016	2015	Variation amount	%	2014
Cash, cash balances at central banks and other demand deposits	76,454	77,751	(1,297)	(1.7)	69,853
Financial assets held for trading	148,187	146,346	1,841	1.3	148,094
Debt securities	*48,922*	*43,964*	*4,958*	*11.3*	*54,374*
Equity instruments	*14,497*	*18,225*	*(3,728)*	*(20.5)*	*12,920*
Loans and advances to customers	*9,504*	*6,081*	*3,423*	*56.3*	*2,921*
Loans and advances to central banks and credit institutions	*3,221*	*1,352*	*1,869*	*138.2*	*1,020*
Derivatives	*72,043*	*76,724*	*(4,681)*	*(6.1)*	*76,858*
Financial assets designated at fair value	31,609	45,043	(13,434)	(29.8)	42,673
Loans and advances to customers	*17,596*	*14,293*	*3,303*	*23.1*	*8,971*
Loans and advances to central banks and credit institutions	*10,069*	*26,403*	*(16,334)*	*(61.9)*	*28,592*
Other (debt securities an equity instruments)	*3,944*	*4,347*	*(403)*	*(9.3)*	*5,111*
Available-for-sale financial assets	116,774	122,036	(5,262)	(4.3)	115,251
Debt securities	*111,287*	*117,187*	*(5,900)*	*(5.0)*	*110,249*
Equity instruments	*5,487*	*4,849*	*638*	*13.2*	*5,001*
Loans and receivables	840,004	836,156	3,848	0.5	782,005
Debt securities	*13,237*	*10,907*	*2,330*	*21.4*	*7,510*
Loans and advances to customers	*763,370*	*770,474*	*(7,104)*	*(0.9)*	*722,819*
Loans and advances to central banks and credit institutions	*63,397*	*54,775*	*8,622*	*15.7*	*51,676*
Held-to-maturity investments	14,468	4,355	10,113	232.2	—
Investments in subsidaries, joint ventures and associates	4,836	3,251	1,585	48.8	3,471
Tangible assets	23,286	25,320	(2,034)	(8.0)	23,256
Intangible assets	29,421	29,430	(9)	(0.0)	30,401
o/w: goodwill	*26,724*	*26,960*	*(236)*	*(0.9)*	*27,548*
Other assets	54,086	50,572	3,514	6.9	51,293
Total assets	**1,339,125**	**1,340,260**	**(1,135)**	**(0.1)**	**1,266,296**

Liabilities and shareholders' equity	2016	2015	Variation amount	%	2014
Financial liabilities held for trading	108,765	105,218	3,547	3.4	109,792
Customer deposits	*9,996*	*9,187*	*809*	*8.8*	*5,544*
Debt securities issued	—	—	—	—	—
Deposits by central banks and credit institutions	*1,395*	*2,255*	*(860)*	*(38.1)*	*7,572*
Derivatives	*74,369*	*76,414*	*(2,045)*	*(2.7)*	*79,048*
Other	*23,005*	*17,362*	*5,643*	*32.5*	*17,628*
Financial liabilities designated at fair value	40,263	54,768	(14,505)	(26.5)	62,318
Customer deposits	*23,345*	*26,357*	*(3,012)*	*(11.4)*	*33,127*
Debt securities issued	*2,791*	*3,373*	*(582)*	*(17.3)*	*3,830*
Deposits by central banks and credit institutions	*14,127*	*25,037*	*(10,910)*	*(43.6)*	*25,360*
Other	—	*1*	*(1)*	*(100.0)*	—
Financial liabilities measured at amortized cost	1,044,240	1,039,343	4,897	0.5	961,053
Customer deposits	*657,770*	*647,598*	*10,172*	*1.6*	*609,034*
Debt securities issued	*226,078*	*222,787*	*3,291*	*1.5*	*209,865*
Deposits by central banks and credit institutions	*133,876*	*148,081*	*(14,205)*	*(9.6)*	*122,685*
Other	*26,516*	*20,877*	*5,639*	*27.0*	*19,468*
Liabilities under insurance contracts	652	627	25	4.0	713
Provisions	14,459	14,494	(35)	(0.2)	15,376
Other liabilities	28,047	27,057	990	3.7	27,331
Total liabilities	**1,236,426**	**1,241,507**	**(5,081)**	**(0.4)**	**1,176,581**
Shareholders' equity	105,977	102,402	3,575	3.5	91,664
Capital stock	*7,291*	*7,217*	*74*	*1.0*	*6,292*
Reserves	*94,149*	*90,765*	*3,384*	*3.7*	*80,026*
Attributable profit to the Group	*6,204*	*5,966*	*238*	*4.0*	*5,816*
Less: dividends	*(1,667)*	*(1,546)*	*(121)*	*7.8*	*(471)*
Accumulated other comprehensive income	(15,039)	(14,362)	(677)	4.7	(10,858)
Minority interests	11,761	10,713	1,048	9.8	8,909
Total equity	**102,699**	**98,753**	**3,946**	**4.0**	**89,714**
Total liabilities and shareholders' equity	**1,339,125**	**1,340,260**	**(1,135)**	**(0.1)**	**1,266,296**

GRUPO SANTANDER. BALANCE SHEET*

- **Loans increased 2%, with advances in the main segments and increases in seven of the Group's 10 core countries.**
- **NPL ratio improved to 3.93%, below 4% for the first time since March 2012.**
- **The cost of credit dropped to 1.18%, meeting the goal set at the Investor Day for the 2016-2018 average.**
- **In funds, growth of 5% due to demand deposits and mutual funds. Growth in all 10 core units.**
- **The Group's net loan-to-deposit ratio was 114% (116% in 2015).**

* Variations in constant euros

Total managed and marketed funds at the end of 2016 amounted to €1,521,633 million, of which €1,339,125 million were on-balance sheet and the rest mutual and pension funds and managed portfolios.

In the Group as a whole, exchange rates had a negative impact on the evolution of loans (-3 p.p.) and customer funds (-2 p.p.). The impact varied by country: Brazil (+26 p.p.); Chile (+10 p.p.); United States (+3 p.p.); Poland (-4 p.p.); Mexico (-14 p.p.); United Kingdom (-15 p.p.) and Argentina (-21 p.p.).

The perimeter impact was irrelevant (less than 1%).

Gross customer lending (excluding repos)

The Group's gross lending (excluding repos) fell 1% (+2% in constant euros). By country:

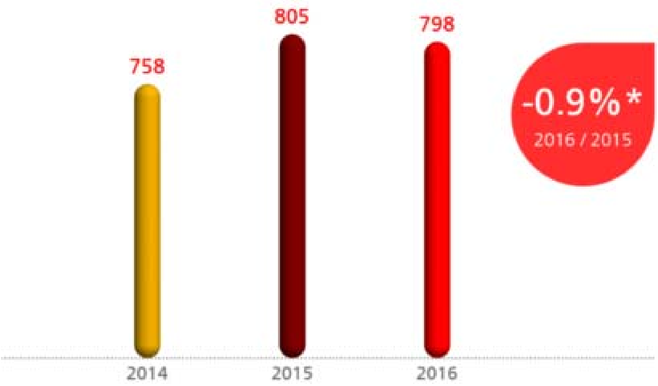
- The main rises were in Argentina (+37%), Santander Consumer Finance (+14%, benefiting from the agreement with PSA Finance), Mexico and Poland (both +8%) and Chile (+7%).
- More moderate rises in the United Kingdom (+2%) and Brazil (+0.4%) after increasing 5% in the fourth quarter, reflecting the change of trend, mainly in mortgage loans, in the second half of 2016.

Customer loans
€ Million

	2016	2015	Variation amount	%	2014
Spanish Public sector	14,127	13,993	133	1.0	17,465
Other residents	147,246	153,863	(6,617)	(4.3)	154,905
Commercial bills	9,567	9,037	531	5.9	7,293
Secured loans	87,509	92,478	(4,969)	(5.4)	96,426
Other loans	50,170	52,348	(2,178)	(4.2)	51,187
Non-resident sector	653,490	649,509	3,981	0.6	589,557
Secured loans	387,546	409,136	(21,590)	(5.3)	369,266
Other loans	265,944	240,373	25,571	10.6	220,291
Gross customer loans	**814,863**	**817,366**	**(2,503)**	**(0.3)**	**761,928**
Loan-loss allowances	24,393	26,517	(2,125)	(8.0)	27,217
Net customer loans	**790,470**	**790,848**	**(378)**	**(0.0)**	**734,711**
Pro memoria: Doubtful loans	32,573	36,133	(3,560)	(9.9)	40,424
Public sector	101	145	(44)	(30.3)	167
Other residents	12,666	16,301	(3,635)	(22.3)	19,951
Non-resident sector	19,806	19,686	120	0.6	20,306

Gross customer loans (w/o repos)

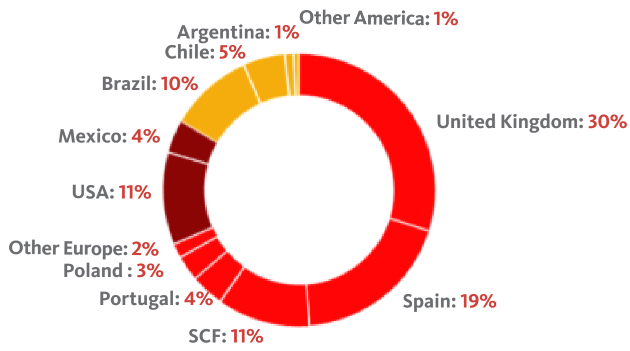
€ Billion



(*) In constant euros +1.9%

Gross customer loans (w/o repos)

% / operating areas. December 2016



- Falls of 2% in the United States, partly affected by the sale of portfolios, 4% in Spain, mainly due to balances in institutions, mortgages and the reduction in doubtful balances, and 5% in Portugal. The latter two occurred in markets that are deleveraging, where growth in new lending is still not sufficient to increase the stock.

- By segments, growth in loans to individual customers as well as SMEs and companies, spurred by the *1|2|3 and SMEs* strategies. The effort made in marketing of products and services for SMEs was recognised by the magazine Euromoney and awarded Santander as the Best Bank in the World for SMEs.

- As for real estate activity in Spain, net lending was down 29%, as a result of continuing the deleveraging strategy of the last few years.

Credit risk

Net NPL entries in 2016 amounted to €7,362 million (-4% over 2015) after eliminating the perimeter and exchange-rate effects.

Bad and doubtful loans ended the year at €33,643 million, 9% lower (-11% in constant euros). This lowered the Group's NPL ratio to 3.93%, 43 b.p. lower than in 2015. It fell every quarter of the year and, for the first time since March 2012, was below 4%.

Loan-loss provisions amounted to €24,835 million, which provided coverage of 74% (73% in 2015). In order to properly view this figure, one has to take into account that the UK and Spain ratios are affected by the weight of mortgage balances, which require fewer provisions as these loans have guarantees.

Credit risk management*

€ Million

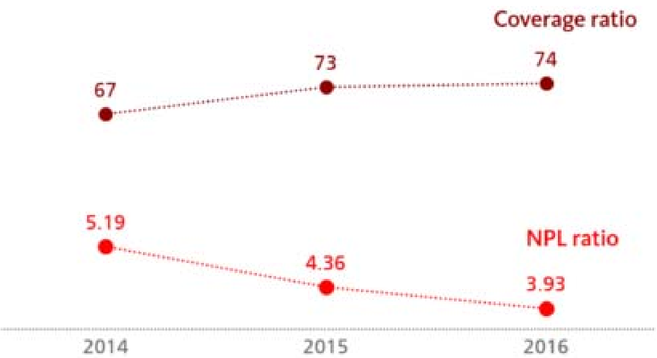
	2016	2015	Variation amount	%	2014
Non-performing loans	33,643	37,094	(3,450)	(9.3)	41,709
NPL ratio (%)	3.93	4.36	(0.43)		5.19
Loan-loss allowances	24,835	27,121	(2,286)	(8.4)	28,046
For impaired assets	*15,466*	*17,707*	*(2,241)*	*(12.7)*	*21,784*
For other assets	*9,369*	*9,414*	*(45)*	*(0.5)*	*6,262*
Coverage ratio (%)	73.8	73.1	0.7		67.2
Cost of credit (%) **	1.18	1.25	(0.07)		1.43

(*) Excluding country-risk
(**) 12 months net loan-loss provisions / average lending

Note: NPL ratio: Non-performing loans / computable assets

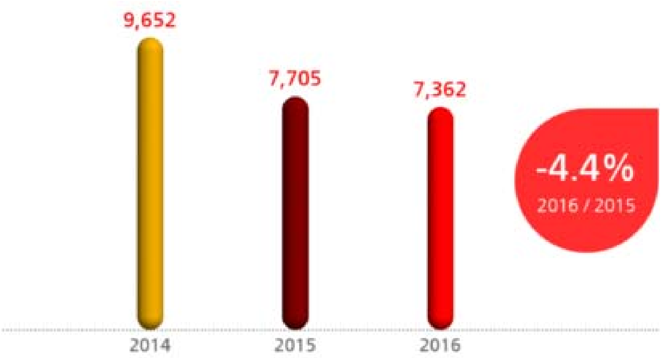
NPL and coverage ratios

%



Net NPL entries

€ Million



The improved credit quality is reflected in the 6% reduction in loan-loss provisions (-2% in constant euros) and in the consequent reduction in the cost of credit, which dropped from 1.25% at the end of 2015 to 1.18%. Excluding Santander Consumer USA, which because of the nature of its business has a high level of provisions and recoveries, the cost of credit was 0.82% (0.90% at the end of 2015).

Credit quality ratios improved in almost all the Group's countries.

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.

Customer funds under management and marketed

Total managed funds (deposits excluding repos and mutual funds) rose 3%. In constant euros growth was 5%.

All the main countries increased their funds, in constant euros as follows:

- Double-digit growth in Argentina (+49%), Mexico (+12%) and Poland (+10%).
- More moderate rises in the United States and SCF (+7%) and in the United Kingdom and Chile (+6%).

Managed and marketed customer funds

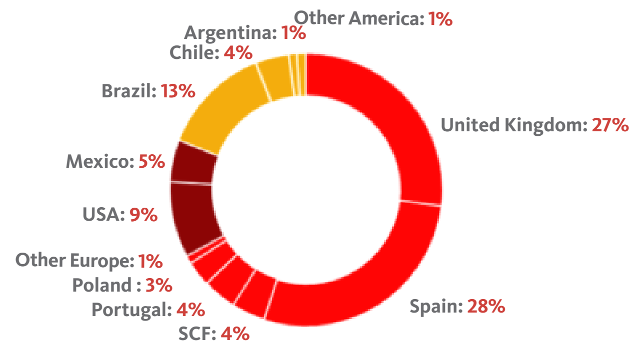
€ Million

	2016	2015	Variation amount	%	2014
Resident public sector	8,699	11,737	(3,038)	(25.9)	9,349
Other residents	160,026	157,611	2,415	1.5	163,340
Demand deposits	119,425	108,410	11,016	10.2	88,312
Time deposits	39,506	47,297	(7,791)	(16.5)	67,495
Other	1,094	1,904	(809)	(42.5)	7,532
Non-resident sector	522,387	513,795	8,592	1.7	475,017
Demand deposits	328,736	313,175	15,561	5.0	273,889
Time deposits	134,528	146,317	(11,789)	(8.1)	151,113
Other	59,123	54,303	4,820	8.9	50,015
Customer deposits	**691,112**	**683,142**	**7,970**	**1.2**	**647,706**
Debt securities issued	228,869	226,160	2,709	1.2	213,696
On-balance-sheet customer funds	**919,981**	**909,302**	**10,679**	**1.2**	**861,402**
o/w: subordinated debt	*19,897*	*21,151*	*(1,254)*	*(5.9)*	*16,884*
Mutual funds	147,416	129,077	18,340	14.2	124,708
Pension funds	11,298	11,376	(78)	(0.7)	11,481
Managed portfolios	23,793	25,808	(2,015)	(7.8)	25,599
Other managed and marketed customer funds	**182,508**	**166,260**	**16,247**	**9.8**	**161,788**
Managed and marketed customer funds	**1,102,488**	**1,075,563**	**26,926**	**2.5**	**1,023,189**

Customer funds
(deposits w/o repos + mutual funds)
€ Billion

(*) In constant euros +4.7%

Customer funds
(deposits w/o repos + mutual funds)
% / operating areas. December 2016



- Lastly, rises of 3% in Brazil and Spain and 2% in Portugal, in the latter two due to the strategy of reducing time deposits. The balances of demand deposits increased €10,000 million and €4,000 million respectively.

In accordance with the strategy to reduce the cost of funds, demand deposits increased 10% and mutual funds 7% (growing in all countries). Time deposits, on the other hand, fell 9%.

As well 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 2016, various Group units carried out:

- Medium and long-term senior debt issues amounting to €24,309 million, covered bonds of €4,720 million and subordinated debt issues of €2,239 million.

- Securitizations placed in the market (€13,144 million).

- Maturities of medium and long-term debt of €35,597 million

The net loan-to-deposit ratio was 114% (116% in 2015) and the ratio of deposits plus medium- and long-term funding to the Group's loans was 114%, underscoring the comfortable funding structure.

Other items of the balance sheet

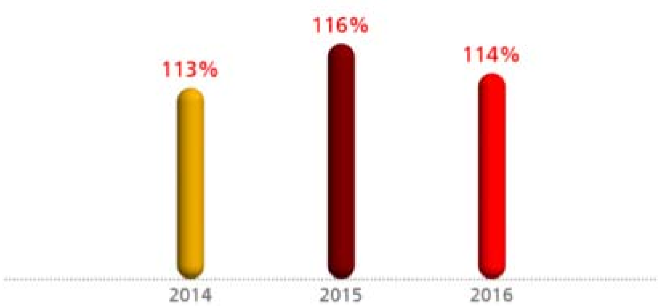
The balance of financial assets available for sale stood at €116,774 million at the end of 2016, €5,262 million less than in 2015 (-4%), due to reduced positions in Spain and the United States.

The balance of the portfolio of investment held to maturity was €14,468 million, higher than in 2015 due to the acquisition of a €7,765 million portfolio of UK sovereign bonds, as part of the management of the ALCO balances.

Total goodwill was €26,724 million, similar to the €26,960 million recorded in 2015.

Tangible assets amounted to €23,286 million, €2,034 million less than in 2015 due to the deconsolidation of assets from the merger of Metrovacesa / Merlín, which amply offset the increase in the United States from assets associated with leasing business.

Total Group. Loan-to-deposit ratio
%



GRUPO SANTANDER. SHAREHOLDERS' EQUITY AND SOLVENCY RATIOS

- **In fully loaded terms, the CET1 capital ratio rose 50 b.p. to 10.55%, surpassing the target after rising in every quarter.**
- **Tangible equity per share rose for the third year running (+4%) to €4.22.**
- **The fully loaded leverage ratio was 5.0% (4.7% in December 2015).**

The eligible CET1 fully-loaded amounted to €62,068 million, €3,300 million more than in 2015 (+6%), mostly due to the profit retained after the payment of dividends.

In fully-loaded terms, the CET1 increased from 10.05% in 2015 to 10.55% in 2016, after increasing every quarter during 2016.

The fully-loaded total capital ratio was 13.87%, after increasing 82 b.p. in the year.

From a qualitative standpoint, the Group's ratios are solid and adequate to its business model, balance sheet structure and risk profile.

Grupo Santander has a business model that generates stable and predictable results. This model allows us to accumulate capital organically in a recurring way while funding the growth in customer lending. And all of this consistent with the increase in cash dividends.

Capital ratios (*fully loaded*)

%

Note: on February 3rd 2016, the ECB authorised the use of the Alternative Standardised Approach to calculate the capital charge for operational risk on a consolidated level for Banco Santander (Brasil) S.A.

Eligible capital (fully loaded)*

€ Million

	2016	2015	Variation amount	%	2014
Capital stock and reserves	101,437	98,193	3,244	3.3	93,748
Attributable profit	6,204	5,966	238	4.0	5,816
Dividends	(2,469)	(2,268)	(201)	8.8	(1,014)
Other retained earnings	(16,116)	(15,448)	(668)	4.3	(11,468)
Minority interests	6,784	6,148	636	10.3	4,131
Goodwill and intangible assets	(28,405)	(28,254)	(151)	0.5	(29,164)
Treasury stock and other deductions	(5,368)	(5,633)	265	(4.7)	(5,767)
Core CET1	**62,068**	**58,705**	**3,363**	**5.7**	**56,282**
Preferred shares and other eligibles T1	5,767	5,504	262	4.8	4,728
Tier 1	**67,834**	**64,209**	**3,625**	**5.6**	**61,010**
Generic funds and eligible T2 instruments	13,749	12,000	1,749	14.6	7,561
Eligible capital	**81,584**	**76,209**	**5,375**	**7.1**	**68,570**
Risk-weighted assets	588,088	583,917	4,171	0.7	583,366
CET1 capital ratio	**10.55**	**10.05**	**0.50**		**9.65**
T1 capital ratio	**11.53**	**11.00**	**0.53**		**10.46**
Total capital ratio	**13.87**	**13.05**	**0.82**		**11.75**

(*),- In 2014, pro-forma data taking into account the January 2015 capital increase

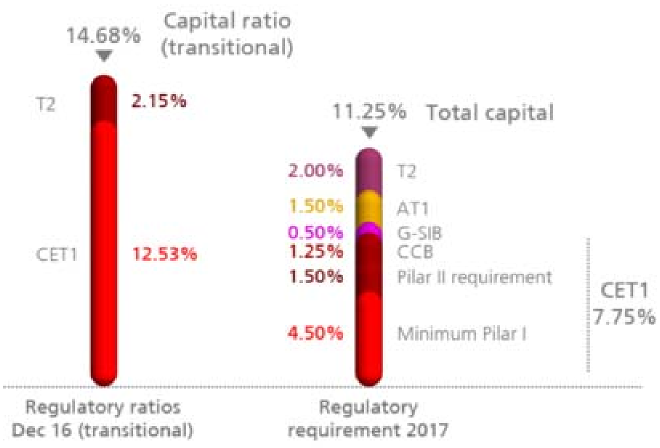
Eligible capital (phase-in)

€ Million

	2016	2015
CET1	73,709	73,478
Basic capital	73,709	73,478
Eligible capital	**86,337**	**84,350**
Risk-weighted assets	588,088	585,633
CET1 capital ratio	**12.53**	**12.55**
T1 capital ratio	**12.53**	**12.55**
Total capital ratio	**14.68**	**14.40**

Capital ratios

%



Santander again obtained excellent results in the stress tests conducted by the European Banking Authority (EBA) in 2016. Under the adverse scenario, Santander showed greater resistance than its peers due to its high generation of revenues and results, thanks to its commercial and retail banking model and unique geographic diversification

This continuous improvement in capital ratios reflects, on the one hand, the Group's strategy of profitable growth, where we aim to increase lending and profit ahead growth in risk-weighted assets. On the other, the various measures adopted by the Group, including the effort made to improve and deepen a more active capital management culture at all levels.

Among the actions taken were:

- More teams for managing capital together with continued improved coordination between the Corporate Centre and local teams.
- Capital will have a greater relevance in the incentives as of 2016.
- Launch of a training programme with global scope.
- All countries and business units developed their individual capital plans, focused on having a business that consumes less capital per unit of return in the future.

Tangible equity per share rose from €4.07 to €4.22 (+4%).

The fully loaded leverage ratio was 5.0%. (4.7% in December 2015).

In regulatory terms, the phase-in eligible capital amounted to €86,337 million, equivalent to a total capital ratio of 14.68%, and the phase-in CET1 to 12.53%.

The minimum ratios required by the European Central Bank for Grupo Santander on a consolidated basis for 2017 are a total capital ratio of 11.25% and a CET1 of 7.75%.

RATING AGENCIES

- The Group's access to the wholesale funding markets, as well as the cost of issues, depends to some extent on the ratings of rating agencies.

- Rating agencies regularly review the Group's ratings. The rating depends on a series of internal (solvency, business model, capacity to generate results) 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.

- During 2016 the agencies DBRS, Fitch, Moody's and Standard & Poors confirmed their ratings, with stable outlook by all of them. In 2017, Standard & Poors affirmed the ratings, improving the outlook from stable to positive.

Rating agencies

	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	Positive
Scope	A+	S-1	Stable

Description of the businesses

Grupo Santander maintained the general criteria applied since the third quarter of 2015 when some changes were made to them and to the composition of some units, in order to make the Group more transparent, facilitate analysis of the business units and enhance the value of the activity developed by the corporation.

The only exception, as in prior years, is the annual adjustment of the perimeter of the Global Customer Relationship Model between Retail Banking and Santander Global Corporate Banking, whose figures from previous periods have been restated to include these adjustments.

The change has no impact on the geographic businesses or on the Group's consolidated figures, which remained unchanged.

The financial statements of each business segment have been drawn up by aggregating the Group's basic operating units. The information relates to both the accounting data of the units 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 Intermediate Holding Company (IHC) and its subsidiaries Santander Bank, Banco Santander Puerto Rico, Santander Consumer USA, Banco Santander International, Santander Investment Securities, and the Santander branch in New York.

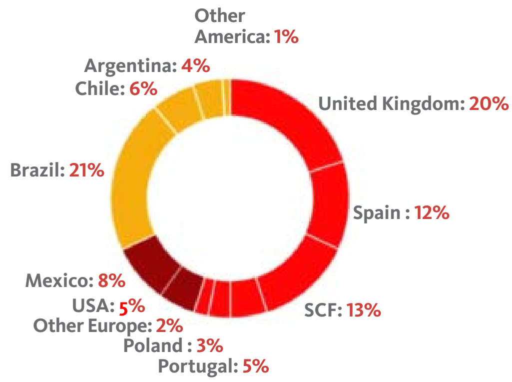
Global businesses. The activity of the operating units is distributed by the type of business: retail banking, Santander Global Corporate Banking and Spain Real Estate unit.

- **Retail Banking**. This covers all customer banking businesses, including consumer finance, except those of corporate banking, which are managed through 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.

In addition to these operating units, which report by geographic area and by businesses, the Group continues to maintain the **Corporate Centre**. This 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 through issues and securitisations.

As the Group's holding entity, the Corporate Centre manages all capital and reserves and allocations of capital and liquidity with the rest of businesses. It also incorporates provisions of a varied nature and amortisation of goodwill. The costs related to the Group's central services (charged to the areas) are not included, except for corporate and institutional expenses related to the Group's functioning.

Distribution of underlying attributable profit by geographical business*. 2016



(*) Over 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	2016	2015	Variation amount	%	% w/o FX
Continental Europe	**6,025**	**6,093**	**(68)**	**(1.1)**	**(0.3)**
o/w: Spain	2,311	2,646	(335)	(12.7)	(12.7)
Santander Consumer Finance	2,357	2,192	166	7.6	8.6
Poland	735	683	53	7.7	12.3
Portugal	620	522	99	18.9	18.9
United Kingdom	**2,850**	**3,025**	**(176)**	**(5.8)**	**6.1**
Latin America	**11,073**	**10,851**	**222**	**2.0**	**11.6**
o/w: Brazil	6,845	6,689	157	2.3	7.6
Mexico	1,928	1,947	(19)	(1.0)	16.3
Chile	1,435	1,332	103	7.7	11.2
USA	**4,334**	**4,774**	**(440)**	**(9.2)**	**(9.4)**
Operating areas	**24,282**	**24,744**	**(462)**	**(1.9)**	**3.6**
Corporate Centre	(1,516)	(1,042)	(474)	45.5	45.5
Total Group	**22,766**	**23,702**	**(936)**	**(3.9)**	**1.6**

Attributable profit to the Group

€ Million	2016	2015	Variation amount	%	% w/o FX
Continental Europe	**2,599**	**2,218**	**381**	**17.2**	**18.5**
o/w: Spain	1,022	977	45	4.6	4.6
Santander Consumer Finance	1,093	938	155	16.5	17.9
Poland	272	300	(29)	(9.5)	(5.6)
Portugal	399	300	99	33.0	33.0
United Kingdom	**1,681**	**1,971**	**(290)**	**(14.7)**	**(4.0)**
Latin America	**3,386**	**3,193**	**193**	**6.1**	**18.6**
o/w: Brazil	1,786	1,631	154	9.5	15.0
Mexico	629	629	0	0.1	17.5
Chile	513	455	58	12.7	16.4
USA	**395**	**678**	**(283)**	**(41.8)**	**(41.9)**
Operating areas	**8,060**	**8,059**	**1**	**0.0**	**7.8**
Corporate Centre*	(1,856)	(2,093)	237	(11.3)	(11.3)
Total Group	**6,204**	**5,966**	**238**	**4.0**	**15.1**

(*).- Including net capital gains and provisions. Without them, 2016: -€1.439 million; 2015: -€1.493 million

Gross customer loans w/o repos

€ Million	2016	2015	Variation amount	%	% w/o FX
Continental Europe	**302,564**	**298,720**	**3,845**	**1.3**	**1.3**
o/w: Spain	150,960	157,162	(6,201)	(3.9)	(3.9)
Santander Consumer Finance	87,742	76,561	11,182	14.6	13.9
Poland	20,697	19,805	892	4.5	8.1
Portugal	29,030	30,564	(1,534)	(5.0)	(5.0)
United Kingdom	**242,510**	**277,718**	**(35,208)**	**(12.7)**	**1.9**
Latin America	**159,134**	**137,331**	**21,804**	**15.9**	**4.5**
o/w: Brazil	80,306	63,636	16,670	26.2	0.4
Mexico	28,017	29,739	(1,722)	(5.8)	8.4
Chile	38,800	33,309	5,491	16.5	6.5
USA	**89,638**	**88,412**	**1,226**	**1.4**	**(1.8)**
Operating areas	**793,847**	**802,181**	**(8,334)**	**(1.0)**	**1.7**
Total Group	**798,312**	**805,395**	**(7,083)**	**(0.9)**	**1.9**

Customer funds (deposits w/o repos + mutual funds)

€ Million	2016	2015	Variation amount	%	% w/o FX
Continental Europe	**322,606**	**312,482**	**10,124**	**3.2**	**3.4**
o/w: Spain	224,798	219,263	5,535	2.5	2.5
Santander Consumer Finance	35,052	32,597	2,455	7.5	7.0
Poland	25,898	24,421	1,477	6.0	9.7
Portugal	31,438	30,684	754	2.5	2.5
United Kingdom	**210,611**	**231,960**	**(21,349)**	**(9.2)**	**5.9**
Latin America	**187,516**	**158,322**	**29,194**	**18.4**	**7.3**
o/w: Brazil	99,771	76,751	23,020	30.0	3.4
Mexico	36,438	37,499	(1,061)	(2.8)	11.8
Chile	34,559	29,680	4,879	16.4	6.5
USA	**74,166**	**66,870**	**7,296**	**10.9**	**7.4**
Operating areas	**794,899**	**769,634**	**25,265**	**3.3**	**5.3**
Total Group	**795,767**	**774,839**	**20,928**	**2.7**	**4.7**

Continental Europe

€ Million

Income statement	2016	2015	Variation amount	%	% w/o FX
Net interest income	**8,161**	**8,006**	**155**	**1.9**	**2.8**
Net fee income	3,497	3,417	80	2.3	3.0
Gains (losses) on financial transactions	818	1,186	(369)	(31.1)	(30.8)
Other operating income*	330	220	110	49.9	49.1
Gross income	**12,806**	**12,830**	**(24)**	**(0.2)**	**0.5**
Operating expenses	(6,781)	(6,736)	(44)	0.7	1.3
General administrative expenses	(6,342)	(6,274)	(68)	1.1	1.7
Personnel	*(3,257)*	*(3,223)*	*(34)*	*1.1*	*1.7*
Other general administrative expenses	*(3,085)*	*(3,051)*	*(34)*	*1.1*	*1.7*
Depreciation and amortisation	(439)	(463)	24	(5.2)	(4.6)
Net operating income	**6,025**	**6,093**	**(68)**	**(1.1)**	**(0.3)**
Net loan-loss provisions	(1,342)	(1,975)	632	(32.0)	(31.6)
Other income	(671)	(753)	82	(10.9)	(10.8)
Profit before taxes	**4,012**	**3,366**	**646**	**19.2**	**20.5**
Tax on profit	(1,083)	(887)	(196)	22.1	23.2
Profit from continuing operations	**2,929**	**2,479**	**450**	**18.2**	**19.6**
Net profit from discontinued operations	—	—	—	—	—
Consolidated profit	**2,929**	**2,479**	**450**	**18.2**	**19.6**
Minority interests	330	261	69	26.5	29.2
Attributable profit to the Group	**2,599**	**2,218**	**381**	**17.2**	**18.5**

Balance sheet	2016	2015	Variation amount	%	% w/o FX
Customer loans **	297,214	287,253	9,961	3.5	3.5
Financial assets held for trading (w/o loans)	53,966	60,151	(6,185)	(10.3)	(10.2)
Financial assets available-for-sale	55,736	60,913	(5,177)	(8.5)	(8.3)
Central banks and credit institutions **	58,085	76,111	(18,026)	(23.7)	(23.9)
Tangible and intangible assets	7,902	11,798	(3,896)	(33.0)	(33.2)
Other assets	47,231	42,420	4,811	11.3	11.4
Total assets/liabilities & shareholders' equity	**520,134**	**538,645**	**(18,511)**	**(3.4)**	**(3.5)**
Customer deposits **	269,934	263,462	6,472	2.5	2.6
Debt securities issued **	53,064	51,104	1,960	3.8	3.5
Liabilities under insurance contracts	652	626	26	4.1	4.1
Central banks and credit institutions **	103,816	132,688	(28,872)	(21.8)	(22.0)
Other liabilities	61,485	58,251	3,234	5.6	5.7
Stockholders' equity ***	31,183	32,515	(1,332)	(4.1)	(4.2)
Other managed and marketed customer funds	**73,624**	**71,389**	**2,236**	**3.1**	**3.2**
Mutual and pension funds	65,308	62,669	2,640	4.2	4.4
Managed portfolios	8,316	8,720	(404)	(4.6)	(4.9)
Managed and marketed customer funds	**396,622**	**385,954**	**10,668**	**2.8**	**2.9**

Ratios (%) and operating means	2016	2015	Variation amount	%	% w/o FX
RoTE	8.07	7.27	0.80		
Efficiency ratio (with amortisations)	52.9	52.5	0.4		
NPL ratio	5.92	7.27	(1.35)		
NPL coverage	60.0	64.2	(4.2)		
Number of employees	57,259	58,049	(790)	(1.4)	
Number of branches	4,805	5,548	(743)	(13.4)	

(*).- Including dividends, income from equity-accounted method and other operating income/expenses
(**).- Including all on-balance sheet balances for this item
(***).- Capital + reserves + profit + other accumulated results

CONTINENTAL EUROPE*

€2,599 M
Attributable Profit

* Changes in constant currency

2016 HIGHLIGHTS

- Growth in Europe was moderate and varied by country.
- Santander accelerated customer loyalty and growth in digital customers.
- Slight growth in volumes, compatible with a strong improvement in credit quality and a better funding structure.
- Profit before tax rose 21%, with the four units increasing.

Economic environment

The euro zone grew by an estimated 1.7%, lower than in 2015 but resistant if one takes into account the year's adverse news.

The deflation risk seems to have gone away, although consumer prices increased at below the 2% target, which led the European Central Bank to cut interest rates to new lows.

Strategy

The dynamics of banking business in Continental Europe continued to be moderate. The strategy in this environment focused on growth in loyal customers, gaining market share, controlling costs and improving credit quality.

Of note was the successful completion of the agreement between Santander Consumer Finance and Banque PSA Finance, as well as integrating Banco Internacional do Funchal (Banif) technologically and operationally in Portugal within the timetable.

Loyal and digital customers continued to grow (individuals: +12%; SMEs and companies: +48%). The effort in multi channels produced an 11% rise in the number of digital customers.

Activity

Lending rose 1% over December 2015 in constant euros. This is the net between the growth in SCF and Poland, and the drop in Spain and Portugal.

Funds increased 3%, with the four units in positive growth rates. The strategy to increase demand deposits (+11%) and mutual funds (+6%) continued, while time deposits fell 12%.

Results

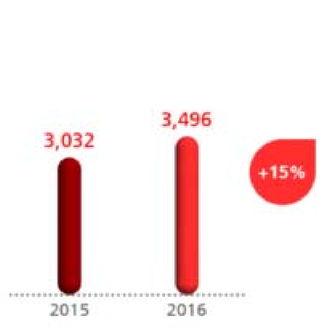
Attributable profit was 18% higher in constant euros at €2,599 million.

This improvement was largely due to the 32% fall in loan-loss provisions, something seen in the main units and which reflects the improvement in NPL ratios and the cost of credit.

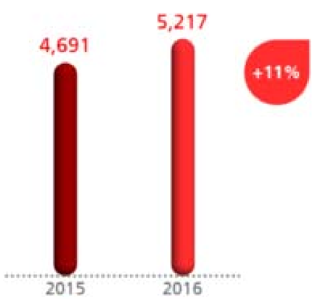
Strict control of costs (+1%, -3% on a like-for-like basis) was another positive factor.

Lastly, low growth in net interest income and fee income in an environment of interest rates at historic lows and tough competition that eroded spreads on loans.

Loyal customers
Thousand



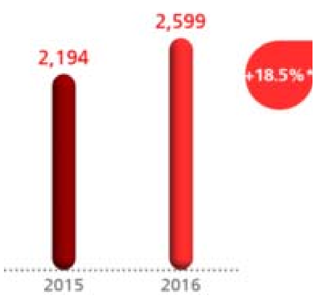
Digital customers
Thousand



Activity performance
% var. 2016 / 2015 (w/o FX)

(*) Customer deposits + mutual funds

Attributable profit
Constant € million



(*) In euros: +17.2%

Spain

€ Million

Income statement	2016	2015	Variation amount	%
Net interest income	**3,077**	**3,430**	**(353)**	**(10.3)**
Net fee income	1,781	1,688	93	5.5
Gains (losses) on financial transactions	595	784	(189)	(24.1)
Other operating income*	155	178	(24)	(13.2)
Gross income	**5,608**	**6,080**	**(472)**	**(7.8)**
Operating expenses	(3,297)	(3,434)	137	(4.0)
General administrative expenses	(3,156)	(3,244)	87	(2.7)
Personnel	*(1,632)*	*(1,670)*	*38*	*(2.3)*
Other general administrative expenses	*(1,524)*	*(1,573)*	*49*	*(3.1)*
Depreciation and amortisation	(140)	(190)	50	(26.1)
Net operating income	**2,311**	**2,646**	**(335)**	**(12.7)**
Net loan-loss provisions	(585)	(992)	406	(41.0)
Other income	(267)	(263)	(4)	1.7
Profit before taxes	**1,459**	**1,392**	**67**	**4.8**
Tax on profit	(416)	(393)	(23)	5.8
Profit from continuing operations	**1,043**	**999**	**44**	**4.4**
Net profit from discontinued operations	—	—	—	—
Consolidated profit	**1,043**	**999**	**44**	**4.4**
Minority interests	21	22	(1)	(5.5)
Attributable profit to the Group	**1,022**	**977**	**45**	**4.6**

Balance sheet	2016	2015	Variation amount	%
Customer loans **	152,850	155,204	(2,354)	(1.5)
Financial assets held for trading (w/o loans)	51,470	57,401	(5,931)	(10.3)
Financial assets available-for-sale	39,267	44,057	(4,790)	(10.9)
Central banks and credit institutions **	42,701	53,582	(10,881)	(20.3)
Tangible and intangible assets	3,147	2,874	273	9.5
Other assets	22,919	13,920	8,999	64.6
Total assets/liabilities & shareholders' equity	**312,354**	**327,039**	**(14,685)**	**(4.5)**
Customer deposits **	176,779	174,828	1,951	1.1
Debt securities issued **	20,863	22,265	(1,402)	(6.3)
Liabilities under insurance contracts	552	536	15	2.9
Central banks and credit institutions **	50,687	68,995	(18,308)	(26.5)
Other liabilities	50,690	47,502	3,188	6.7
Stockholders' equity ***	12,783	12,913	(129)	(1.0)
Other managed and marketed customer funds	**66,649**	**63,931**	**2,718**	**4.3**
Mutual and pension funds	59,716	57,017	2,699	4.7
Managed portfolios	6,932	6,914	19	0.3
Managed and marketed customer funds	**264,291**	**261,024**	**3,267**	**1.3**

Ratios (%) and operating means	2016	2015	Variation amount	%
RoTE	7.74	8.15	(0.41)	
Efficiency ratio (with amortisations)	58.8	56.5	2.3	
NPL ratio	5.41	6.53	(1.12)	
NPL coverage	48.3	48.1	0.2	
Number of employees	23,017	24,216	(1,199)	(5.0)
Number of branches	2,911	3,467	(556)	(16.0)

(*).- Including dividends, income from equity-accounted method and other operating income/expenses
(**).- Including all on-balance sheet balances for this item
(***).- Capital + reserves + profit + other accumulated results

SPAIN

€1,022 M
Attributable Profit

2016 HIGHLIGHTS

- **We maintained the 1|2|3 strategy to foster a deeper and lasting relation with customers.**
- **This strategy enabled us to increase loyalty, boost activity and improve customers' satisfaction and their risk profile.**
- **Loyal customers rose 32%, there was greater activity in consumer credit, payroll, savings products, insurance and cards, while we remain the leader in the wholesale and private banking segments.**
- **Attributable profit rose 5% underpinned by improved credit quality, higher fee income from more transactions and control of costs.**

Economic environment

The economy grew 3.2%, similar to 2015 but significantly higher than the euro zone average. Growth was broadly based and again underpinned by domestic demand. Job creation was strong and the unemployment rate came down to 19%.

The recovery continued to be very balanced as it combined growth with moderate inflation and a current account surplus, the fruit of the improvement over the last few years in competitiveness. The fiscal deficit was also lower. This situation favours sustained growth.

Strategy

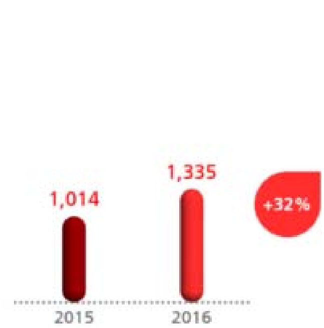
In this environment, Santander Spain made progress in the Bank's commercial transformation and in attaining its objectives. The *1|2|3* strategy is the driving force of this transformation and is enabling us to increase customer loyalty, boost activity and improve customers' satisfaction and their risk profile. This was reflected in:

- 50% of new lending comes from *1|2|3* customers.
- We are gaining market share in new consumer credit loans, payroll and transactional products.
- Improved risk profile, underscored by a 112 b.p. reduction in the NPL ratio.
- Our ranking in customer satisfaction has risen from 5th, before the launch of the *1|2|3* strategy, to the Top 3.
- The number of loyal customers rose 32% (+27% individuals; +48% companies).

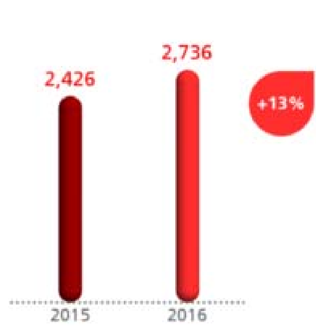
The main 2016 HIGHLIGHTS were:

- We are transforming our commercial network with the creation of a new and larger branch model *(Smart Red)* to enable better advice and services for customers, as well as integration with digital channels.
- Substantial progress was made in the Bank's technological and operational transformation. We have 2.7 million digital customers and more than 950,000 mobile banking customers, and this is growing at 45% thanks to the development of new apps and the push in payments via mobile phones.
- Exclusive launch of *Apple Pay* in Spain, underscoring the Bank's drive for digital leadership and innovation.
- We received the CRC Gold Award for Excellence in Customer Attention, the most prestigious in the contact centre industry.

Loyal customers
Thousand

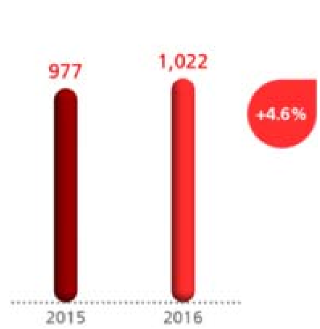


Digital customers
Thousand

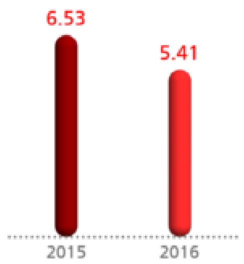


Activity performance
% var. 2016 / 2015

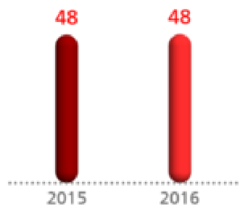
Attributable profit
€ Million



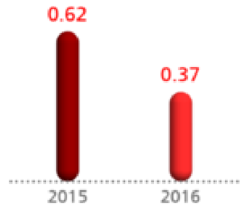
NPL ratio
%



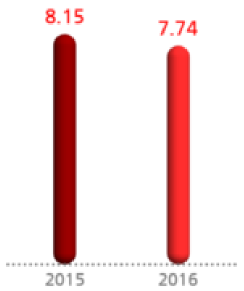
Coverage ratio
%



Cost of credit
%



RoTE
%



- We began to sponsor *LaLiga Santander,* a strategic agreement that will enable us to improve our brand image and become closer to our customers.

Activity

New lending increased, although this is not yet reflected in an increase in the stock. Loans fell 4%, mainly due to amortisation of mortgages, the reduction in credit to institutions and the sharp fall in doubtful loans.

Loans to individuals increased 16% (+91% consumer credit; +18% mortgages).

We continued to lead the wholesale and private banking segments. In corporate global banking we maintained our leadership in the market league tables for structured financing and markets. We participated in most of the listings in the Spanish market. In Private Banking, the lending balance rose 6%.

In funds, we maintained the strategy to reduce the cost of deposits, with 8% growth in demand deposits and 6% in mutual funds, while time deposits declined 14%.

Results

Attributable profit was 5% higher at €1,022 million, due to better credit quality, the efficiency plan and the good performance of fee income.

- Substantial improvement in the cost of credit, which continued to normalise thanks to a more favourable cycle, improved profile of *1|2|3* customers and active risk management focused on anticipation. Loan-loss provisions fell 41% and were the main factor behind the higher profit.

  The NPL ratio was 112 b.p. lower at 5.41%.

- Costs declined 4%, partly due to the efficiency plan.

- Fee income rose 6%, particularly from retail banking, very linked to the greater volume of transactions derived from the customer loyalty strategy.

- Net interest income, on the other hand, was lower, due to low interest rates, the repricing of mortgages and the impact of reduced revenues from ALCO portfolios. Also lower gains on financial transactions (-24%).

STRATEGY IN 2017

- Gain market share in an organic, sustainable, profitable and predictable way.
- Be the reference bank for companies, strengthening our commercial positioning while maintaining leadership in wholesale banking and large companies.
- Continue the digital transformation in order to boost loyalty and improve the customer experience.
- Continue to implement our Simple, Personal and Fair culture and the commitment to be the best bank to work for.

Santander Consumer Finance

€ Million

Income statement	2016	2015	Variation amount	%	% w/o FX
Net interest income	**3,391**	**3,096**	**295**	**9.5**	**10.7**
Net fee income	862	876	(14)	(1.6)	(1.2)
Gains (losses) on financial transactions	(14)	(11)	(3)	25.8	27.2
Other operating income*	23	4	19	508.5	428.2
Gross income	**4,262**	**3,965**	**296**	**7.5**	**8.5**
Operating expenses	(1,904)	(1,774)	(131)	7.4	8.3
General administrative expenses	(1,719)	(1,602)	(118)	7.3	8.4
Personnel	*(810)*	*(746)*	*(63)*	*8.5*	*9.6*
Other general administrative expenses	*(910)*	*(855)*	*(54)*	*6.4*	*7.3*
Depreciation and amortisation	(185)	(172)	(13)	7.6	8.2
Net operating income	**2,357**	**2,192**	**166**	**7.6**	**8.6**
Net loan-loss provisions	(387)	(537)	150	(28.0)	(27.3)
Other income	(168)	(152)	(16)	10.2	10.6
Profit before taxes	**1,803**	**1,502**	**301**	**20.0**	**21.3**
Tax on profit	(521)	(426)	(95)	22.2	23.2
Profit from continuing operations	**1,282**	**1,076**	**206**	**19.2**	**20.5**
Net profit from discontinued operations	—	—	—	—	—
Consolidated profit	**1,282**	**1,076**	**206**	**19.2**	**20.5**
Minority interests	189	137	51	37.3	38.1
Attributable profit to the Group	**1,093**	**938**	**155**	**16.5**	**17.9**

Balance sheet	2016	2015	Variation amount	%	% w/o FX
Customer loans **	85,180	73,709	11,471	15.6	14.8
Financial assets held for trading (w/o loans)	25	94	(69)	(73.2)	(74.1)
Financial assets available-for-sale	3,836	3,654	182	5.0	3.9
Central banks and credit institutions **	2,894	2,297	597	26.0	24.2
Tangible and intangible assets	632	692	(59)	(8.6)	(8.8)
Other assets	7,054	8,087	(1,033)	(12.8)	(13.1)
Total assets/liabilities & shareholders' equity	**99,622**	**88,534**	**11,088**	**12.5**	**11.8**
Customer deposits **	35,050	32,595	2,455	7.5	7.0
Debt securities issued **	27,892	23,347	4,545	19.5	18.5
Liabilities under insurance contracts	—	—	—	—	—
Central banks and credit institutions **	23,399	20,314	3,085	15.2	14.3
Other liabilities	5,470	4,325	1,145	26.5	26.0
Stockholders' equity ***	7,811	7,953	(142)	(1.8)	(2.6)
Other managed and marketed customer funds	**7**	**7**	**0**	**2.5**	**2.5**
Mutual and pension funds	7	7	0	2.5	2.5
Managed portfolios	—	—	—	—	—
Managed and marketed customer funds	**62,950**	**55,950**	**7,000**	**12.5**	**11.8**

Ratios (%) and operating means	2016	2015	Variation amount	%	% w/o FX
RoTE	14.86	12.63	2.23		
Efficiency ratio (with amortisations)	44.7	44.7	(0.0)		
NPL ratio	2.68	3.42	(0.74)		
NPL coverage	109.1	109.1	—		
Number of employees	14,928	14,533	395	2.7	
Number of branches	567	588	(21)	(3.6)	

(*).- Including dividends, income from equity-accounted method and other operating income/expenses
(**).- Including all on-balance sheet balances for this item
(***).- Capital + reserves + profit + other accumulated results

SANTANDER CONSUMER FINANCE*

€1,093 M
Attributable Profit

* Changes in constant currency

2016 HIGHLIGHTS

- The agreement with PSA Finance to increase SCF's activity in 11 European countries was successfully completed.
- Other management priorities: auto and consumer finance and strengthening digital channels.
- As a result, new business increased in all countries. Attributable profit of €1,093 million, 18% more than in 2015. This was the seventh consecutive year of profit growth.
- High profitability, with RoTE around 15% and RoRWA above 2%. Moreover, 2016 ended with an excellent cost of credit.

Economic environment
The main European markets where Santander Consumer Finance (SCF) carries out its activity, registered growth ranging from 0.9% in Italy to 3.2% in Spain. This growth was underpinned by the recovery in consumer indicators, as well as by new car sales (+7%).

Strategy
SCF is Europe's consumer finance leader. It operates in 14 countries, providing finance and services via more than 130,000 associated points-of-sale (auto dealerships and shops). It also has a large number of finance agreements with manufacturers of cars and motorbikes and with retail distribution groups.

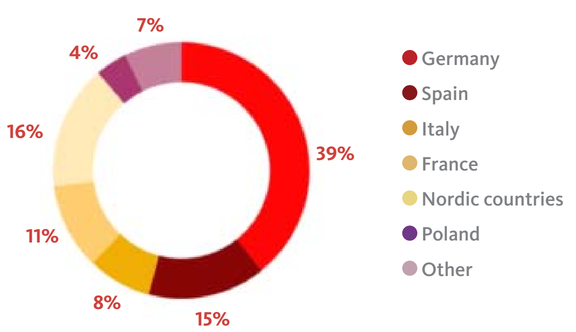
In 2016, SCF continued to gain market share, backed by its solid business model: high geographic diversification with critical mass in key products, better efficiency than our competitors and a common risk control and recoveries system that keeps credit quality high.

Management focused on:

- Completing the agreements with Banque PSA Finance (BPF) in order to create joint-ventues in 11 countries.
- Increase auto and consumer finance by extending the agreements to the main dealers.
- Boost digital channels.

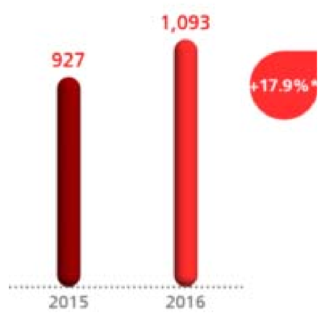
The creation of the joint-ventures was implemented as scheduled. In 2015 we created joint-ventures in Spain, Portugal, UK, France and Switzerland, and in 2016 we incorporated six more countries: Italy and Netherlands (first quarter), Belgium (second quarter), Germany and Austria (third quarter) and Poland (fourth quarter).

Customer loans by geography
2016



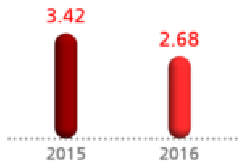
Activity performance
% var. 2016 / 2015 (w/o FX)

Attributable profit
Constant € million

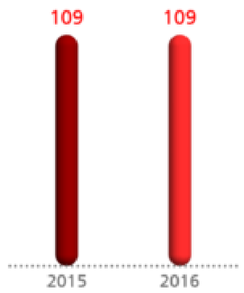


(*) In euros: +16.5%

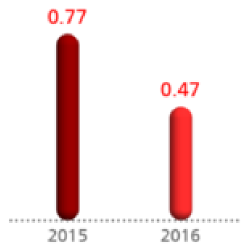
NPL ratio
%



Coverage ratio
%



Cost of credit
%



RoTE
%

Activity

As well as the agreement with BPF, we continued to progress in signing and developing new agreements with retail distributors as well as manufacturers.

Lending rose 14% in the year, with new loans increasing 17% over 2015, spurred by auto finance, which increased 28%. Widespread growth in all units.

Of note on the funding side was the 7% rise in customer deposits, something that distinguishes us from our competitors. Recourse to wholesale funding amounted to €12,484 million, via senior issues and securitizations and other long-term issues.

Deposits plus medium and long-term issues and securitisations covered 72% of net lending.

Results

Attributable profit was €1,093 million, 18% more than in 2015. Growth was due to two factors:

- The low interest rate environment, very positive for consumer business, both in revenues and provisions.
- The impact of the incorporated units, reflected in growth in the main lines of the income statement.

Gross income increased, mainly due to the 11% rise in net interest income, which accounts for 80% of revenues.

Operating expenses rose 8%, in line with business growth and the incorporation of new units. The efficiency ratio remained at around 45%, unchanged from 2015.

Provisions fell 27% and the cost of credit dropped significantly from 0.77% in 2015 to 0.47%, which is very low for consumer business. This was made possible by the good performance of portfolios and a reduction of 74 b.p. in the NPL ratio to 2.68%. Coverage remained at 109%.

Of note by units was Spain's attributable profit (+22%), the Nordic countries (+24%) and Italy (+226%).

In short, solid organic business and a good execution of agreements, giving us a strong potential to keep on growing in 2017, gain market share and maintain our levels of profitability and efficiency.

STRATEGY IN 2017

- Increase and maximize auto finance business through pro-active management of brand agreements and development of digital projects.
- Sustained growth and focused on value creation, while maintaining a good risk-adjusted return.
- Step up consumer finance business by speeding up the digital transformation and increasing our presence in these channels.

Poland

€ Million

Income statement	2016	2015	Variation amount	%	% w/o FX
Net interest income	**834**	**782**	**52**	**6.6**	**11.2**
Net fee income	400	422	(22)	(5.3)	(1.2)
Gains (losses) on financial transactions	83	112	(29)	(25.8)	(22.6)
Other operating income*	(2)	(40)	38	(94.6)	(94.4)
Gross income	**1,314**	**1,276**	**38**	**3.0**	**7.4**
Operating expenses	(579)	(594)	15	(2.5)	1.7
General administrative expenses	(521)	(550)	28	(5.2)	(1.1)
Personnel	*(303)*	*(324)*	*21*	*(6.6)*	*(2.6)*
Other general administrative expenses	*(219)*	*(226)*	*7*	*(3.1)*	*1.1*
Depreciation and amortisation	(58)	(44)	(14)	30.9	36.5
Net operating income	**735**	**683**	**53**	**7.7**	**12.3**
Net loan-loss provisions	(145)	(167)	23	(13.5)	(9.8)
Other income	(83)	(4)	(78)	—	—
Profit before taxes	**508**	**511**	**(3)**	**(0.7)**	**3.6**
Tax on profit	(121)	(101)	(20)	19.6	24.7
Profit from continuing operations	**387**	**410**	**(23)**	**(5.6)**	**(1.6)**
Net profit from discontinued operations	—	—	—	—	—
Consolidated profit	**387**	**410**	**(23)**	**(5.6)**	**(1.6)**
Minority interests	115	110	5	5.0	9.5
Attributable profit to the Group	**272**	**300**	**(29)**	**(9.5)**	**(5.6)**

Balance sheet					
Customer loans **	19,979	18,977	1,002	5.3	8.9
Financial assets held for trading (w/o loans)	634	894	(259)	(29.0)	(26.6)
Financial assets available-for-sale	5,974	5,305	669	12.6	16.5
Central banks and credit institutions **	911	1,153	(242)	(21.0)	(18.3)
Tangible and intangible assets	258	260	(2)	(0.7)	2.7
Other assets	2,023	2,523	(500)	(19.8)	(17.1)
Total assets/liabilities & shareholders' equity	**29,779**	**29,112**	**667**	**2.3**	**5.8**
Customer deposits **	22,780	21,460	1,320	6.2	9.8
Debt securities issued **	504	498	6	1.2	4.6
Liabilities under insurance contracts	—	—	—	—	—
Central banks and credit institutions **	853	1,152	(298)	(25.9)	(23.3)
Other liabilities	3,249	3,515	(267)	(7.6)	(4.4)
Stockholders' equity ***	2,393	2,487	(94)	(3.8)	(0.5)
Other managed and marketed customer funds	**3,202**	**3,209**	**(7)**	**(0.2)**	**3.2**
Mutual and pension funds	3,118	3,106	12	0.4	3.8
Managed portfolios	84	103	(19)	(18.6)	(15.8)
Managed and marketed customer funds	**26,487**	**25,168**	**1,319**	**5.2**	**8.9**

Ratios (%) and operating means					
RoTE	11.64	12.89	(1.25)		
Efficiency ratio (with amortisations)	44.1	46.5	(2.5)		
NPL ratio	5.42	6.30	(0.88)		
NPL coverage	61.0	64.0	(3.0)		
Number of employees	12,001	11,474	527	4.6	
Number of branches	658	723	(65)	(9.0)	

(*).- Including dividends, income from equity-accounted method and other operating income/expenses
(**).- Including all on-balance sheet balances for this item
(***).- Capital + reserves + profit + other accumulated results

POLAND*

€272 M
Attributable Profit

* Changes in local currency

2016 HIGHLIGHTS

- **Santander continued to be the leader in mobile and online banking and second in cards.**
- **Market share gain in loans, with focus on SMEs and mortgages. In deposits, focus on demand deposits.**
- **In results, management of spreads, revenues and costs in a low interest rate environment. Big improvement in the cost of credit.**
- **The regulatory changes stemming from the introduction of the new tax on assets in February 2016 impacted the year's results. Excluding this, attributable profit would have increased 14% over 2015.**

Economic environment

The economy slowed in 2016 (an estimated 2.8% against 3.9% in 2015), due to the poor performance of investments and exports and also lower than expected growth in consumption.

Inflation, after 28 months of deflation (-0.6% on average in 2016) began to turn positive in December (0.8% year-on-year). The low inflation did not harm purchasing decisions and the profile of the GDP slowdown, as a result of which the Bank of Poland held its benchmark rate at 1.5% throughout the year.

The zloty ended the year at PLN 4.41/€, a depreciation of 3%. This weakening was largely due to external factors such as the UK referendum and the US elections.

Strategy

The Bank maintained in 2016 its objective of being the bank of first choice for customers.

We remained the leader in mobile and online banking and the second in the number of active credit cards. We are also the second in debit cards, third in total assets (September 2016 data) and fourth in the number of current accounts in Poland, almost level with the third.

We promoted digital channels and improved our digital bank by:

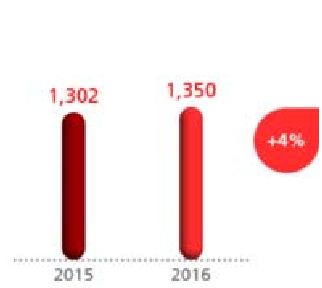
- Introducing the new version of the *BZWBK24* mobile app with new features, such as *BLIK* payments, forex option, *ID Touch*.
- Incorporating the function that allows sales of credit products without going to your branch (new version of *BZWBK24* Internet).
- *TLS 1.2* security protocol in both mobile and online channels.

As a result of these improvements, *BZWBK24* was again recognised in June 2016 as one of Europe's best mobile banking apps. For the second year running, Forrester Research recognised *BZWBK24* as the best app in Poland and the third among the 11 main banks in Europe.

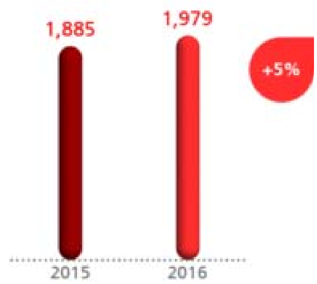
And we are also making improvements to the processes.

- We continued to strengthen mortgage business, focusing on improving processes. As a result, 2016 was a record year for mortgage sales (+30%). Our share of new business was around 15%, putting us in third place.
- The *CRM* tool was installed during the year in order to provide better customer attention and service. It focuses on their needs and expectations. This tool enables the Bank to give a tailored service, based on knowledge of the customer, their performance and risk profile, as well as offering continuous service and communication via the various distribution channels.

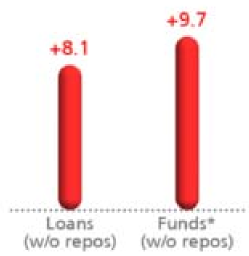
Loyal customers
Thousand



Digital customers
Thousand

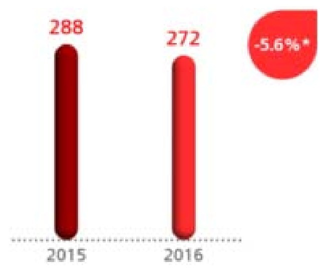


Activity performance
% var. 2016 / 2015 (w/o FX)



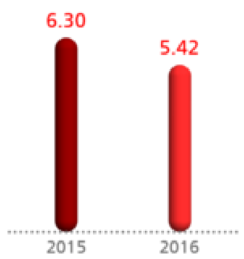
(*) Customer deposits + mutual funds

Attributable profit
Constant € million

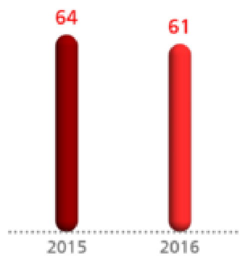


(*) In euros: -9.5%

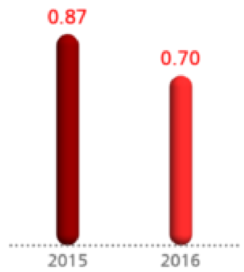
NPL ratio
%



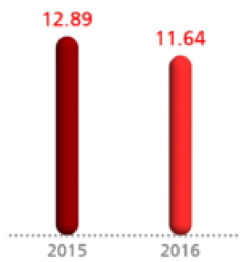
Coverage ratio
%



Cost of credit
%



RoTE
%



These actions produced growth of 4% in loyal customers and 5% in digital customers.

Activity

Business volumes increased more than the sector average. Of note was the 8% rise in loans, both to companies and individuals. Lending to SMEs grew 9%, Business and Corporate 6% and Global Corporate Banking 17%. That to individuals rose 11% (mortgages: +12%, cash loans +8% and credit cards +12%).

Deposits were up 11%, a growth equally shared by individuals and companies.

Our funding structure remained solid (net loan to deposit ratio of 88%).

Results

Attributable profit was 6% lower at €272 million, due to the new tax on assets of 0.44%. Excluding this impact, profit was 14% more than in 2015, as follows:

- Gross income rose 7%, with a good performance of net interest income (+11%, mainly due to larger volumes). Fee income was slightly down due to regulatory issues, but was better than the sector's. Reduced sales of ALCO portfolios in 2016 lowered gains on financial transactions.

- Operating expenses rose 2%, due to the higher amortisations which increased 37%. On the other hand, personnel expenses were 3% lower.

- Loan-loss provisions fell 10% thanks to the significant improvement in credit quality. The NPL ratio dropped to 5.42% from 6.30% in 2015 and the cost of credit fell from 0.87% to 0.70%.

STRATEGY IN 2017

- Top 3 in quality of service, increasing the number of loyal customers.
- Continue end-to-end digital transformation in order to remain the leaders in digital channels in Poland.
- Grow at a faster pace than our competitors in volumes, gaining market share.
- Remain the leader in profitability in an environment of tougher regulatory pressure.

Portugal

€ Million

Income statement	2016	2015	Variation amount	%
Net interest income	**733**	**555**	**178**	**32.0**
Net fee income	314	263	50	19.1
Gains (losses) on financial transactions	112	164	(53)	(31.9)
Other operating income*	51	33	18	54.1
Gross income	**1,209**	**1,016**	**193**	**19.0**
Operating expenses	(589)	(494)	(95)	19.1
General administrative expenses	(551)	(458)	(93)	20.3
Personnel	*(339)*	*(291)*	*(48)*	*16.6*
Other general administrative expenses	*(212)*	*(167)*	*(45)*	*26.6*
Depreciation and amortisation	(38)	(36)	(2)	4.7
Net operating income	**620**	**522**	**99**	**18.9**
Net loan-loss provisions	(54)	(72)	18	(25.4)
Other income	(34)	(31)	(3)	9.1
Profit before taxes	**533**	**419**	**114**	**27.2**
Tax on profit	(131)	(118)	(13)	11.4
Profit from continuing operations	**402**	**301**	**101**	**33.4**
Net profit from discontinued operations	—	—	—	—
Consolidated profit	**402**	**301**	**101**	**33.4**
Minority interests	2	1	2	197.8
Attributable profit to the Group	**399**	**300**	**99**	**33.0**

Balance sheet				
Customer loans **	27,328	28,221	(893)	(3.2)
Financial assets held for trading (w/o loans)	1,553	1,678	(126)	(7.5)
Financial assets available-for-sale	5,769	6,799	(1,030)	(15.2)
Central banks and credit institutions **	1,320	2,104	(784)	(37.3)
Tangible and intangible assets	703	720	(17)	(2.4)
Other assets	8,148	10,046	(1,898)	(18.9)
Total assets/liabilities & shareholders' equity	**44,820**	**49,568**	**(4,749)**	**(9.6)**
Customer deposits **	30,002	29,173	830	2.8
Debt securities issued **	3,805	4,994	(1,189)	(23.8)
Liabilities under insurance contracts	39	20	20	101.1
Central banks and credit institutions **	6,743	11,307	(4,564)	(40.4)
Other liabilities	904	1,351	(447)	(33.1)
Stockholders' equity ***	3,326	2,724	603	22.1
Other managed and marketed customer funds	**2,770**	**2,842**	**(72)**	**(2.5)**
Mutual and pension funds	2,369	2,426	(58)	(2.4)
Managed portfolios	402	416	(14)	(3.3)
Managed and marketed customer funds	**36,578**	**37,009**	**(431)**	**(1.2)**

Ratios (%) and operating means				
RoTE	13.03	12.53	0.50	
Efficiency ratio (with amortisations)	48.7	48.7	0.0	
NPL ratio	8.81	7.46	1.35	
NPL coverage	63.7	99.0	(35.3)	
Number of employees	6,306	6,568	(262)	(4.0)
Number of branches	657	752	(95)	(12.6)

(*).- Including dividends, income from equity-accounted method and other operating income/expenses
(**).- Including all on-balance sheet balances for this item
(***).- Capital + reserves + profit + other accumulated results

PORTUGAL

€399 M
Attributable Profit

2016 HIGHLIGHTS

- **The technological and operational integration of Banco Internacional do Funchal's (Banif) business was completed.**
- **The commercial model continued to be improved in order to become more efficient and enhance the quality of customer attention.**
- **Attributable profit increased 33% thanks to greater revenues and lower provisions.**

Economic environment

The Portuguese economy has been losing momentum since the second half of 2015. GDP growth ended the year at an estimated 1.3% compared to 1.6% in 2015. Investment was stagnant, however, exports had a positive evolution despite unfavourable external conditions.

Domestic demand remained largely unchanged and the jobless rate continued to drop.

Inflation performance was similar to that of 2015, at 0.6% and drove the growth of revenues.

Strategy

The Bank continued to focus on structural improvements to the commercial model so as to increase efficiency and the quality of customer service, via the CRM platform, multi channel and streamlining processes.

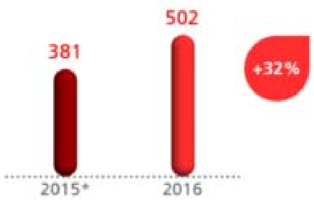
Under our strategy, we made progress in the following areas:

- In banking for individual customers (*Mid and Mass Market* and *Select* segments), the *1|2|3 World* programme continued to support commercial activity, with significant gains in the number of accounts, credit cards and protection insurance.
- We also achieved significant increases in new credit lines for individuals and companies.
- These improvements produced a 21% rise in loyal customers and 32% in digital ones.

In line with the timetable, the technological and operational integration of Banif's business was completed in October. All branches are now operating under the same technological platform. Thanks to this operation, the bank has a more balanced loan portfolio and gained market share in companies.

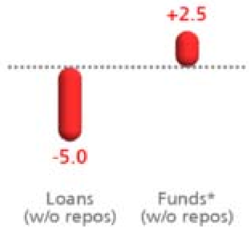
Loyal customers
Thousand

Digital customers
Thousand



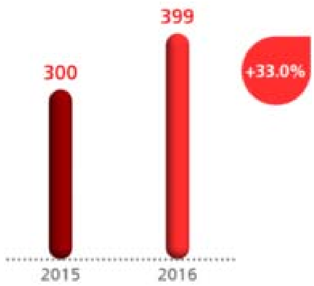
(*) Excluding Banco Internacional do Funchal (Banif)

Activity performance
% var. 2016 / 2015

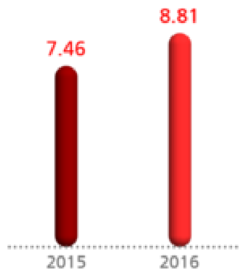


(*) Customer deposits + mutual funds

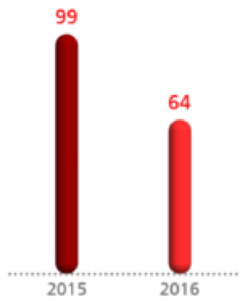
Attributable profit
€ Million



NPL ratio
%

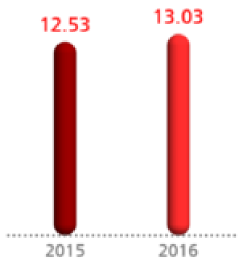


Coverage ratio
%



Cost of credit
%

RoTE
%



Santander Totta's good performance was recognised by the magazine Euromoney with prizes such as Best Bank in Portugal and Best Private Banking Services Overall – Portugal, in the category of big banks, and by the magazine Exame with Best Bank, Most Solid Bank, Most Profitable Bank and Bank which Grows the Most.

Activity

Lending fell 5%. Although new mortgages remained dynamic, the stock was 1% lower, as their volume still does not offset amortisations. The evolution of lending in 2016 also reflects the sale of portfolios.

Total funds increased 2%. Deposits evolved better, underscoring the Bank's good positioning in the Portuguese financial system. Of note here was the 46% growth in demand deposits under the strategy of improving the overall cost of deposits.

Results

Attributable profit was €399 million, 33% more than in 2015, due to the good performance of commercial revenues and provisions and some perimeter impact:

- Gross income grew 19% (rise of 32% in net interest income and 19% in fee income). Gains on financial transactions were 32% lower, down from very high levels in 2015 (greater sales of public debt and of the stake in Banco Caixa Geral Totta Angola).
- Operating expenses were 19% higher, due to the perimeter impact. In real terms they were 5% lower. The efficiency ratio was 49%.
- Loan-loss provisions declined 25% and the cost of credit dropped from 0.29% in 2015 to 0.18% in 2016.
- Lastly, the NPL ratio, affected by Banif's portfolios, started to drop in the second half of the year.

STRATEGY IN 2017

- Continue to increase the number of loyal and digital customers.
- Keep on gaining profitable market share (companies and SMEs) while optimising the cost of funds.
- Continue improving the levels of efficiency and lowering the cost of credit.
- Normalise and adjust the structure of capital to the new regulatory requirements.

United Kingdom

€ Million

Income statement	2016	2015	Variation amount	%	% w/o FX
Net interest income	**4,405**	**4,942**	**(538)**	**(10.9)**	**0.4**
Net fee income	1,032	1,091	(59)	(5.4)	6.5
Gains (losses) on financial transactions	319	302	17	5.7	19.1
Other operating income*	61	47	14	30.7	47.3
Gross income	**5,816**	**6,382**	**(565)**	**(8.9)**	**2.7**
Operating expenses	(2,967)	(3,356)	390	(11.6)	(0.4)
General administrative expenses	(2,656)	(3,009)	353	(11.7)	(0.6)
Personnel	*(1,418)*	*(1,592)*	*174*	*(10.9)*	*0.3*
Other general administrative expenses	*(1,238)*	*(1,417)*	*179*	*(12.6)*	*(1.6)*
Depreciation and amortisation	(311)	(347)	37	(10.5)	0.8
Net operating income	**2,850**	**3,025**	**(176)**	**(5.8)**	**6.1**
Net loan-loss provisions	(58)	(107)	49	(45.7)	(38.9)
Other income	(339)	(354)	15	(4.2)	7.9
Profit before taxes	**2,452**	**2,564**	**(112)**	**(4.4)**	**7.7**
Tax on profit	(736)	(556)	(180)	32.4	49.2
Profit from continuing operations	**1,716**	**2,008**	**(292)**	**(14.6)**	**(3.8)**
Net profit from discontinued operations	—	—	—	—	—
Consolidated profit	**1,716**	**2,008**	**(292)**	**(14.6)**	**(3.8)**
Minority interests	35	37	(2)	(5.8)	6.0
Attributable profit to the Group	**1,681**	**1,971**	**(290)**	**(14.7)**	**(4.0)**

Balance sheet	2016	2015	Variation amount	%	% w/o FX
Customer loans **	251,250	282,673	(31,423)	(11.1)	3.7
Financial assets held for trading (w/o loans)	33,986	40,138	(6,152)	(15.3)	(1.2)
Financial assets available-for-sale	12,336	12,279	57	0.5	17.2
Central banks and credit institutions **	15,305	14,083	1,222	8.7	26.8
Tangible and intangible assets	2,581	3,025	(444)	(14.7)	(0.5)
Other assets	39,502	30,957	8,545	27.6	48.9
Total assets/liabilities & shareholders' equity	**354,960**	**383,155**	**(28,195)**	**(7.4)**	**8.1**
Customer deposits **	212,113	231,947	(19,834)	(8.6)	6.7
Debt securities issued **	71,108	74,260	(3,151)	(4.2)	11.7
Liabilities under insurance contracts	—	—	—	—	—
Central banks and credit institutions **	21,559	23,610	(2,051)	(8.7)	6.5
Other liabilities	34,068	36,162	(2,094)	(5.8)	9.9
Stockholders' equity ***	16,112	17,176	(1,064)	(6.2)	9.4
Other managed and marketed customer funds	**8,564**	**9,703**	**(1,139)**	**(11.7)**	**3.0**
Mutual and pension funds	8,447	9,564	(1,117)	(11.7)	3.0
Managed portfolios	118	139	(22)	(15.5)	(1.4)
Managed and marketed customer funds	**291,785**	**315,910**	**(24,125)**	**(7.6)**	**7.7**

Ratios (%) and operating means	2016	2015	Variation amount	%	% w/o FX
RoTE	10.59	11.83	(1.24)		
Efficiency ratio (with amortisations)	51.0	52.6	(1.6)		
NPL ratio	1.41	1.52	(0.11)		
NPL coverage	32.9	38.2	(5.3)		
Number of employees	25,688	25,866	(178)	(0.7)	
Number of branches	844	858	(14)	(1.6)	

(*).- Including dividends, income from equity-accounted method and other operating income/expenses
(**).- Including all on-balance sheet balances for this item
(***).- Capital + reserves + profit + other accumulated results

UNITED KINGDOM*

€1,681 M
Attributable Profit

* Changes in sterling

2016 HIGHLIGHTS

- Strong business performance, increased cost discipline and good credit quality supported by robust UK economic growth.
- Solid business flows in both retail and corporates. Growth in loans to corporates in a competitive and uncertain operating environment.
- Digital transformation continued to support operational efficiency and improve customer experience.
- Attributable profit impacted by the introduction of the 8% bank corporation tax surcharge.

Economic environment

The United Kingdom economy grew 2.0% in 2016, slightly below the previous year (2.2%). Following the initial uncertainty after the EU referendum in August, the Bank of England cut its base rate by 25 basis points to 0.25% and it added a package of QE measures designed to support growth in the economy.

The unemployment rate continued its downward trend and reached 4.8% in October. Inflation climbed to 1.6% year-on-year in December, the highest level since July 2014, and the pound depreciated 14% against the euro.

Strategy

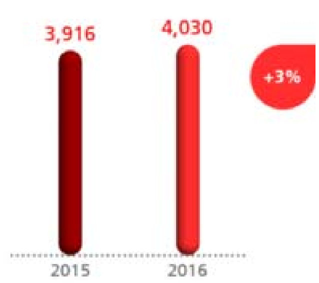
Over the last few years we developed a strategy of ongoing transformation. By leveraging our scale and presence we can offer a full range of products and services and, as a result, our business is more diversified. Underpinning our success is our customer-centred culture.

Our priority is to ensure that we are the best bank, while serving our customers in a Simple, Personal and Fair way. By building upon the strong foundations we already have, Santander UK is well positioned to succeed despite the changeable macro environment. In 2016 we had:

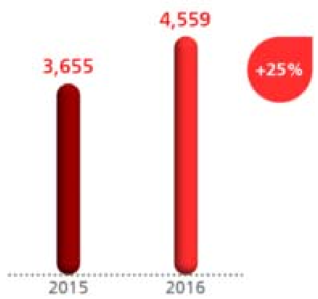
- Developed our digital proposition in 2016, with several enhancements well received by customers, such as the launching of the Investment Hub, our digital end-to-end mortgage application process and the expansion of mobile payment capabilities to include Android Pay.
- Leveraged the *1|2|3 World* strategy, which has transformed our business. *1|2|3 World* customers increased by 483,000 to 5.1 million since the end of 2015. Retail current account balances were up by £11,600 million, and continue to show positive net inflows.
- Driven further improvement in customer relationships and to drive business growth, underpinned by our client-centric infrastructure and an award-winning international proposition. As a result, loyal corporate and SME customers increased by more than 24,000 since the end of 2015.
- Digital customers reached 4.6 million, increasing 25% since the end of 2015.

The UK banking sector faces a very demanding regulatory change agenda, in particular banking reform, where our planning and implementation is well advanced. We have recently revised our approach in order to minimise the impact on customers and maintain long-term flexibility in the changeable macro environment.

Loyal customers
Thousand



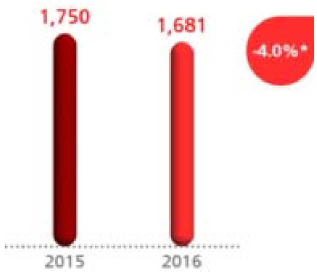
Digital customers
Thousand



Activity performance
% var. 2016 / 2015 (w/o FX)

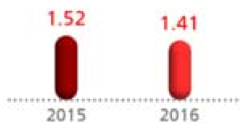
(*) Customer deposits + mutual funds

Attributable profit
Constant € million

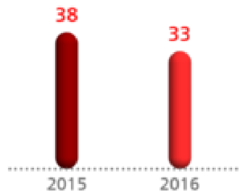


(*) In euros: -14.7%

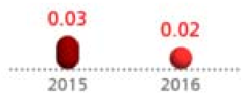
NPL ratio
%



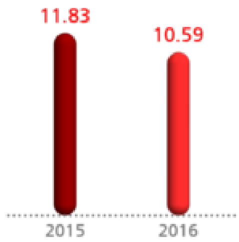
Coverage ratio
%



Cost of credit
%



RoTE
%



Activity

Customer loans increased 2% over the end of 2015, due to lending to companies (+3%) and mortgages (+1%). New gross mortgage loans was £25,800 million and we helped 25,300 first-time buyers purchase their new home.

Good growth in customer deposits excluding repos (+6%) was driven by 1|2|3 current account inflows, more than offsetting lower demand for savings products.

Santander UK is focused on maintaining a strong balance sheet. Our capital strength was demonstrated in the 2016 Prudential Regulation Authority stress test results, which comfortably exceeded regulatory threshold and in which we were by far the most resilient of the UK banks with stressed CET1 drawdown of 170 b.p.

Results

Attributable profit for the year was £1,373 million, down 4%, adversely impacted by the 8% bank corporation tax surcharge. Profit before tax was up 8%, mainly due to fee income growth, increased cost discipline and good credit performance, partially offset by pressure on net interest income.

Following the rise in net interest income in the fourth quarter, it was broadly flat with increased lending volumes and retail liability margin, that offset continued SVR (Standard Variable Rate) attrition and asset margin pressures.

Fee income increased 7% over 2015, with higher 1|2|3 fees in Retail Banking and international and digital payment fees in Commercial Banking, partially offset by regulatory impacts on cards and investment income.

Operating expenses were broadly flat as efficiency improvements absorbed investments in business growth, Banking Reform costs of £85 million, and the continued enhancements to our digital channels.

Credit quality remained strong in all loan portfolios, supported by prudent lending criteria and the low rate environment. The NPL ratio improved to 1.41% at end of 2016, from 1.52% at end of 2015, with provisions down 39%.

STRATEGY IN 2017

- We have a relentless focus on customer loyalty as the key driver for growth.
- We prioritise operational and digital excellence to offer the best experience to our customers.
- We aim to grow our profits in a predictable way while maintaining a strong balance sheet.

Latin America

€ Million

Income statement	2016	2015	Variation amount	%	% w/o FX
Net interest income	**13,346**	**13,752**	**(407)**	**(3.0)**	**6.2**
Net fee income	4,581	4,452	128	2.9	15.2
Gains (losses) on financial transactions	806	517	290	56.1	85.1
Other operating income*	32	36	(4)	(10.9)	(38.0)
Gross income	**18,764**	**18,757**	**8**	**0.0**	**10.2**
Operating expenses	(7,692)	(7,906)	214	(2.7)	8.1
General administrative expenses	(7,007)	(7,230)	223	(3.1)	7.8
Personnel	*(3,886)*	*(3,955)*	*70*	*(1.8)*	*8.8*
Other general administrative expenses	*(3,121)*	*(3,274)*	*153*	*(4.7)*	*6.5*
Depreciation and amortisation	(685)	(676)	(9)	1.3	12.0
Net operating income	**11,073**	**10,851**	**222**	**2.0**	**11.6**
Net loan-loss provisions	(4,911)	(4,950)	39	(0.8)	7.2
Other income	(785)	(893)	107	(12.0)	(7.3)
Profit before taxes	**5,377**	**5,008**	**369**	**7.4**	**19.7**
Tax on profit	(1,363)	(1,219)	(143)	11.7	25.3
Profit from continuing operations	**4,014**	**3,789**	**225**	**5.9**	**17.9**
Net profit from discontinued operations	—	—	—	—	—
Consolidated profit	**4,014**	**3,789**	**225**	**5.9**	**17.9**
Minority interests	628	596	32	5.4	14.3
Attributable profit to the Group	**3,386**	**3,193**	**193**	**6.1**	**18.6**

Balance sheet					
Customer loans **	152,187	133,138	19,049	14.3	3.5
Financial assets held for trading (w/o loans)	43,422	33,670	9,752	29.0	23.6
Financial assets available-for-sale	29,840	25,926	3,914	15.1	1.9
Central banks and credit institutions **	48,612	35,523	13,090	36.8	15.6
Tangible and intangible assets	4,111	3,522	589	16.7	2.2
Other assets	42,596	36,106	6,490	18.0	5.0
Total assets/liabilities & shareholders' equity	**320,768**	**267,885**	**52,884**	**19.7**	**7.6**
Customer deposits **	143,747	122,413	21,334	17.4	6.7
Debt securities issued **	47,436	39,527	7,909	20.0	2.7
Liabilities under insurance contracts	1	1	(1)	(49.1)	(59.5)
Central banks and credit institutions **	47,585	42,393	5,192	12.2	1.6
Other liabilities	57,473	43,872	13,601	31.0	18.1
Stockholders' equity ***	24,526	19,678	4,849	24.6	12.7
Other managed and marketed customer funds	**81,482**	**65,690**	**15,792**	**24.0**	**6.7**
Mutual and pension funds	75,002	61,096	13,906	22.8	5.7
Managed portfolios	6,480	4,594	1,886	41.0	18.8
Managed and marketed customer funds	**272,665**	**227,631**	**45,034**	**19.8**	**6.0**

Ratios (%) and operating means					
RoTE	15.56	15.20	0.36		
Efficiency ratio (with amortisations)	41.0	42.1	(1.2)		
NPL ratio	4.81	4.96	(0.15)		
NPL coverage	87.3	79.0	8.3		
Number of employees	86,312	89,819	(3,507)	(3.9)	
Number of branches	5,818	5,841	(23)	(0.4)	

(*).- Including dividends, income from equity-accounted method and other operating income/expenses
(**).- Including all on-balance sheet balances for this item
(***).- Capital + reserves + profit + other accumulated results

LATIN AMERICA*

€3,386 M
Attributable Profit

* Changes in constant currency

2016 HIGHLIGHTS

- **The region's GDP shrank for the second year running in a complex international environment.**
- **The measures carried out in innovation, streamlining of processes and commercial actions, were reflected in a significant rise in loyal and digital customers.**
- **Santander grew in loans and funds, particularly demand deposits.**
- **Attributable profit in constant euros was 19% higher, with double digit growth in all units, notably Brazil, which rose 15% in a recession environment.**

Economic environment

The economy shrank for the second year running, due to a very varied performance of countries in both GDP and exchange rates, and markets in general. The change in economic policy in Argentina and Brazil and, in general, improvements in inflation and the current account deficit laid the foundations for recovery.

In general, the environment was not propitious for business, mainly due to the depreciation of currencies and in particular the shrinking of Brazil's GDP.

Strategy

The focus remained on deepening the customer relation, improving their experience and satisfaction, as well as accelerating the digital transformation.

The value propositionsd for individual customers were consolidated with the launch of innovative products and agreements with companies supplying services. Plans for SMEs continued on this same path in all countries.

Customer business was solid. Loyal and digital customers in the main countries increased by 13% and 36%.

Activity

Lending without repos increased 5% in constant euros.

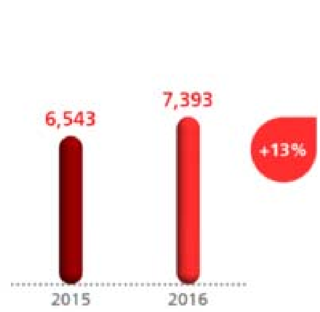
Deposits without repos rose 8%, also in constant euros. Demand deposits were up 13%, time deposits 4% and mutual funds 6%.

Results

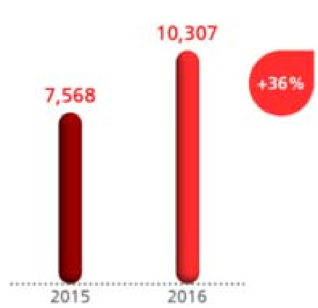
Attributable profit was €3,386 million, up 19%, as a result of:

- Gross income increased 10%, spurred by net interest income and fee income.
- Operating expenses rose 8% due to salary agreements, dollar-indexed expenses and investments. Growth was moderate in real terms.
- Loan-loss provisions rose 7%, and reflected an improved NPL ratio to 4.81% (-15 b.p.) and a coverage ratio (+8 p.p.) to 87%.

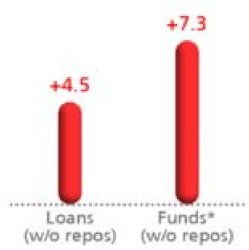
Loyal customers
Thousand



Digital customers
Thousand

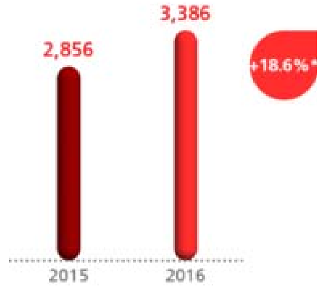


Activity performance
% var. 2016 / 2015 (w/o FX)



(*) Customer deposits + mutual funds

Attributable profit
Constant € million



(*) In euros: +6.1%

Brazil

€ Million

Income statement	2016	2015	Variation amount	%	% w/o FX
Net interest income	**8,062**	**8,320**	**(257)**	**(3.1)**	**1.8**
Net fee income	2,940	2,643	297	11.2	16.9
Gains (losses) on financial transactions	238	42	196	467.9	496.8
Other operating income*	80	135	(55)	(40.8)	(37.8)
Gross income	**11,321**	**11,140**	**180**	**1.6**	**6.8**
Operating expenses	(4,475)	(4,452)	(24)	0.5	5.7
General administrative expenses	(4,046)	(4,040)	(6)	0.1	5.3
Personnel	*(2,253)*	*(2,205)*	*(48)*	*2.2*	*7.4*
Other general administrative expenses	*(1,793)*	*(1,835)*	*42*	*(2.3)*	*2.7*
Depreciation and amortisation	(429)	(411)	(18)	4.3	9.6
Net operating income	**6,845**	**6,689**	**157**	**2.3**	**7.6**
Net loan-loss provisions	(3,377)	(3,297)	(80)	2.4	7.6
Other income	(696)	(878)	182	(20.7)	(16.7)
Profit before taxes	**2,772**	**2,513**	**259**	**10.3**	**15.9**
Tax on profit	(773)	(689)	(84)	12.2	17.9
Profit from continuing operations	**1,999**	**1,824**	**175**	**9.6**	**15.2**
Net profit from discontinued operations	—	—	—	—	—
Consolidated profit	**1,999**	**1,824**	**175**	**9.6**	**15.2**
Minority interests	213	193	20	10.5	16.1
Attributable profit to the Group	**1,786**	**1,631**	**154**	**9.5**	**15.0**

Balance sheet					
Customer loans **	75,474	60,238	15,236	25.3	(0.3)
Financial assets held for trading (w/o loans)	26,007	13,360	12,647	94.7	54.9
Financial assets available-for-sale	16,851	15,814	1,037	6.6	(15.2)
Central banks and credit institutions **	36,430	26,692	9,737	36.5	8.6
Tangible and intangible assets	2,704	2,280	424	18.6	(5.6)
Other assets	24,036	20,150	3,886	19.3	(5.1)
Total assets/liabilities & shareholders' equity	**181,502**	**138,534**	**42,968**	**31.0**	**4.2**
Customer deposits **	72,478	56,636	15,842	28.0	1.8
Debt securities issued **	31,679	26,171	5,507	21.0	(3.7)
Liabilities under insurance contracts	1	1	(1)	(49.1)	(59.5)
Central banks and credit institutions **	27,226	21,600	5,626	26.0	0.3
Other liabilities	34,571	24,085	10,486	43.5	14.2
Stockholders' equity ***	15,547	10,040	5,507	54.8	23.2
Other managed and marketed customer funds	**59,631**	**45,607**	**14,024**	**30.7**	**4.0**
Mutual and pension funds	55,733	42,961	12,772	29.7	3.2
Managed portfolios	3,898	2,646	1,252	47.3	17.2
Managed and marketed customer funds	**163,788**	**128,414**	**35,373**	**27.5**	**1.5**

Ratios (%) and operating means					
RoTE	13.84	14.09	(0.25)		
Efficiency ratio (with amortisations)	39.5	40.0	(0.4)		
NPL ratio	5.90	5.98	(0.08)		
NPL coverage	93.1	83.7	9.4		
Number of employees	46,728	49,520	(2,792)	(5.6)	
Number of branches	3,431	3,443	(12)	(0.3)	

(*).- Including dividends, income from equity-accounted method and other operating income/expenses
(**).- Including all on-balance sheet balances for this item
(***).- Capital + reserves + profit + other accumulated results

BRAZIL*

€1,786 M
Attributable Profit

* Changes in local currency

2016 HIGHLIGHTS

- **Commercial actions, digital innovations and streamlining processes helped to increase transactions and customer loyalty.**
- **Attributable profit of €1,786 million (+15%), with a more dynamic business and growth quarter after quarter.**
- **The preventative risk management is reflected in provisions and credit quality under control. Improved productivity and efficiency helped costs grow below the average inflation rate.**
- **Santander Brasil was recognised as one of the best companies to work for by Great Place to Work and as the best bank for SMEs by the magazine Euromoney.**

Economic environment

Brazil was in recession for the second year running. As the year advanced, the recession weakened and markets showed a clear recovery. This suggested that GDP growth was poised to turn positive.

The central bank secured its credibility: final inflation (6.3%) was below the upper limit of its target range (6.5%). The inflation outlook for 2017 and 2018 is around 4.5% (the central target), which enabled the bank to cut its benchmark rate from 14.25% to 13.75% at the end of the year and point to a downward path. This started in January 2017, with a further cut in interest rates of 75 b.p. to 13%.

As the year ended, the real recovered to BRL 3.43/€1 from BRL 4.31 in 2015.

Strategy

In this difficult political and economic environment, Santander Brasil continued its transformation process, while growing customers and results. The main points are set out below.

Actions to spur digitalisation:

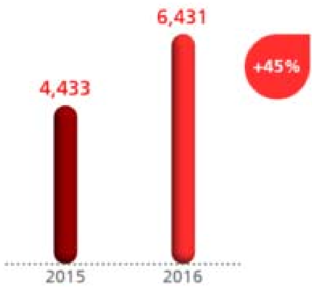
- Speeding up the digital transformation. Thanks to new features in mobile banking for individual customers, we achieved an evaluation of 4.5 stars in the *Apple Store* and 4.2 stars in *Google Play* (before we had two stars) and sales grew threefold via *e-commerce* .
- Launch, in commercial banking, of the digital attention channel for *Van Gogh* and *Empresas 1* customers and, in wholesale banking, a remote channel for all corporate and GCB customers.
- Development of *Santander Way*, an app that enables cards to be managed in real time. We were also the first bank to offer customers *Samsung Pay*.
- We completed the acquisition of 100% of the digital prepayment platform *ContaSuper*.
- In consumer finance, we launched the new digital platform *+Negócios,* a tool that digitizes the whole customer experience and has a big potential to grow business.

Launch of commercial actions to improve or consolidate our presence in the market:

- Increased presence in the credit market in payroll with *Olé Consignado*, which combines the experience of Banco Bonsucesso and Santander.
- Strong growth in credit card business, three times the market's turnover. We announced the commercial agreement with American Airlines for accumulating air miles.

Loyal customers
Thousand

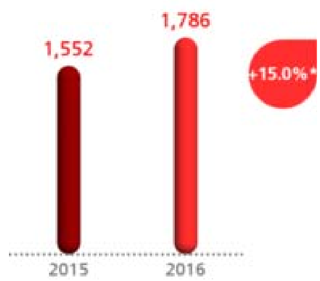
Digital customers
Thousand



Activity performance
% var. 2016 / 2015 (w/o FX)

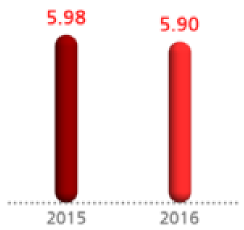
(*) Customer deposits + mutual funds

Attributable profit
Constant € million

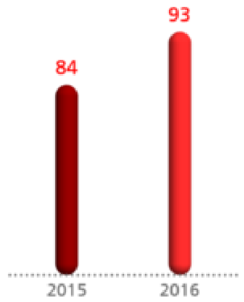


(*) In euros: +9.5%

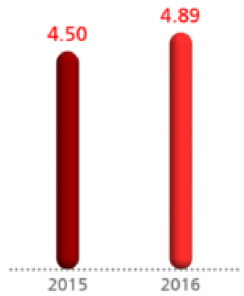
NPL ratio
%



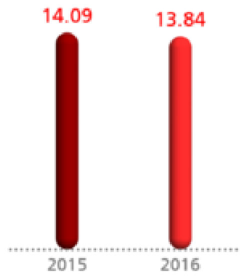
Coverage ratio
%



Cost of credit
%



RoTE
%



- In acquiring business, turnover increased 30% (well above the market). We also offered individual customers the possibility of a current account with a low cost point-of sale terminal.

- In SMEs, *Santander Negócios & Empresas* provided innovative solutions in the Brazilian market, helping customers in their development, internationalisation and training.

- A joint venture was created between Santander Financiamientos and Hyundai.

- *Agri* business was strengthened and we were nominated for the 2016 *Lide Agronegocios* prize.

Internal processes were simplified and we became more efficient and productive via the *CERTO* model and the *Clique Único* (one click) digital platform.

Lastly, in GCB we were recognised as leaders in financial advice in project finance in Brazil. We also continued to be the leading bank in the forex market according to the central bank and in the ranking of the largest M&A operations in 2016, according to Thomson Reuters.

All these strategies played a key role in the business dynamic. The number of loyal customers rose 16% and digital ones 45% to 6.4 million. Of note also was the number of biometric-identified customers (6.3 million) and the rise in transactions through digital channels, which represent 73% of total transactions.

Activity
Lending was stable (+0.4% over December 2015), reflecting a good performance given the economic scenario and after absorbing the negative impact of dollar balances (excluding it: +3%). The trend improved in the last months (+5% in the fourth quarter) and we expect it to continue in 2017.

As regards segments, lending to companies and GCB fell 7% and credit to SMEs started to grow (+1.4%), after three consecutive quarters of falling. Loans to individuals increased 7%, driven by cards (+8%) and mortgages (+5%).

Funds rose 3%, with balanced growth between demand deposits, saving accounts and time deposits.

Results
Attributable profit was 15% higher at €1,786 million. Of note in year-on-year terms were:

- Gross income increased 7% and fee income 17%, notably that from current accounts, mutual funds and cards. Net interest income rose 2%, backed by higher spreads on funds and loans.

- Operating expenses continued their good evolution and increased 6% (3 p.p. less than the average inflation rate), reflecting the discipline in managing them.

- Loan-loss provisions were up 8% within a still weak macroeconomic environment.

- Credit quality ratios remained good: the cost of credit was 4.89%, below the target of 5% announced at the beginning of the year and the NPL ratio was 5.90% (-8 b.p.). In local criteria, both the cost of credit and credit quality evolved better than that of our main competitors.

STRATEGY IN 2017

- Continue to increase our base of active, loyal and digital customers and improve knowledge of their needs.
- Continue the digital transformation, innovating the offer of products and services as well as sell more in digital channels.
- Continue to gain market share, mainly in products such as acquirer business, consumer credit and SMEs.
- Improve profitability, focusing on revenue growth via risk adjusted spreads and fee income.

Mexico

€ Million

Income statement	2016	2015	Variation amount	%	% w/o FX
Net interest income	**2,385**	**2,451**	**(66)**	**(2.7)**	**14.3**
Net fee income	711	800	(89)	(11.1)	4.4
Gains (losses) on financial transactions	149	138	11	8.0	26.9
Other operating income*	(43)	(72)	30	(41.2)	(30.9)
Gross income	**3,203**	**3,317**	**(114)**	**(3.4)**	**13.4**
Operating expenses	(1,274)	(1,370)	95	(6.9)	9.3
General administrative expenses	(1,168)	(1,257)	88	(7.0)	9.2
Personnel	*(606)*	*(662)*	*56*	*(8.4)*	*7.6*
Other general administrative expenses	*(562)*	*(595)*	*33*	*(5.5)*	*11.0*
Depreciation and amortisation	(106)	(113)	7	(5.9)	10.5
Net operating income	**1,928**	**1,947**	**(19)**	**(1.0)**	**16.3**
Net loan-loss provisions	(832)	(877)	45	(5.2)	11.4
Other income	(30)	(4)	(26)	716.5	859.2
Profit before taxes	**1,067**	**1,067**	**0**	**0.0**	**17.5**
Tax on profit	(247)	(236)	(11)	4.8	23.1
Profit from continuing operations	**820**	**831**	**(11)**	**(1.4)**	**15.9**
Net profit from discontinued operations	—	—	—	—	—
Consolidated profit	**820**	**831**	**(11)**	**(1.4)**	**15.9**
Minority interests	191	202	(12)	(5.7)	10.7
Attributable profit to the Group	**629**	**629**	**0**	**0.1**	**17.5**

Balance sheet	2016	2015	Variation amount	%	% w/o FX
Customer loans **	27,315	30,158	(2,843)	(9.4)	4.3
Financial assets held for trading (w/o loans)	14,222	16,949	(2,726)	(16.1)	(3.4)
Financial assets available-for-sale	7,096	5,972	1,124	18.8	36.8
Central banks and credit institutions **	8,562	4,717	3,845	81.5	108.9
Tangible and intangible assets	392	396	(4)	(1.0)	14.0
Other assets	7,524	6,535	990	15.1	32.5
Total assets/liabilities & shareholders' equity	**65,112**	**64,728**	**385**	**0.6**	**15.8**
Customer deposits **	28,910	28,274	636	2.2	17.7
Debt securities issued **	5,393	5,783	(390)	(6.7)	7.3
Liabilities under insurance contracts	—	—	—	—	—
Central banks and credit institutions **	11,269	12,884	(1,615)	(12.5)	0.7
Other liabilities	15,963	12,829	3,134	24.4	43.2
Stockholders' equity ***	3,577	4,957	(1,380)	(27.8)	(16.9)
Other managed and marketed customer funds	**10,242**	**11,477**	**(1,235)**	**(10.8)**	**2.7**
Mutual and pension funds	10,242	11,477	(1,235)	(10.8)	2.7
Managed portfolios	—	—	—	—	—
Managed and marketed customer funds	**44,545**	**45,535**	**(990)**	**(2.2)**	**12.6**

Ratios (%) and operating means	2016	2015	Variation amount	%	% w/o FX
RoTE	15.45	13.19	2.27		
Efficiency ratio (with amortisations)	39.8	41.3	(1.5)		
NPL ratio	2.76	3.38	(0.62)		
NPL coverage	103.8	90.6	13.2		
Number of employees	17,608	17,847	(239)	(1.3)	
Number of branches	1,389	1,377	12	0.9	

(*).- Including dividends, income from equity-accounted method and other operating income/expenses
(**).- Including all on-balance sheet balances for this item
(***).- Capital + reserves + profit + other accumulated results

MEXICO*

€629 M
Attributable Profit

* Changes in local currency

2016 HIGHLIGHTS

- **Strategy centred on being the bank of first choice for customers, increasing the attraction and long-term transaction loyalty.**
- **Focus on multi channel innovation, operational transformation and launching of commercial initiatives (*Santander Plus y Santander-Aeroméxico*).**
- **Profit rose 18%, with an excellent performance of net interest income (+14%).**
- **The strategy in 2016 was to retain customers and capture deposits (+16%).**

Economic environment

Mexico's GDP decelerated a little in 2016 to an estimated 2.3% from 2.6% in 2015. The challenging external environment prompted the adjustment of the fiscal strategy and a tougher monetary policy. The central bank raised its target interest rate throughout 2016, from 3.25% to 5.75%, with the objective of countering the risk that the peso's depreciation posed for prices and financial stability. Inflation rose from 2.1% to 3.3% and the jobless rate was an average of 3.8% for the year.

The peso depreciated 13% against the dollar to MXN 21.8, impacted by oil prices in the first few months of the year and the heightened uncertainties of possible changes in the trade and migration policies of the US in the latter part of 2016.

Strategy

Under the strategy of transformation, innovation and effort to increase customer loyalty, the Bank developed various measures. The main ones included:

Drive in multi channels and digitalisation:

- We installed 836 new ATMs and strengthened strategic alliances with correspondent banks, offering our services via a network of close to 20,000 shops.
- Improvements in electronic banking via the *Portal Público, SuperNet* and *SuperMóvil*.
- A three-year €15,000 million investment plan was announced in December to continue improving the franchise and our systems.

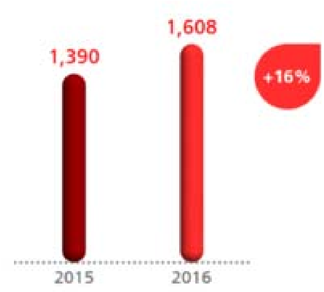
Strengthen business with new commercial actions and the launching of products:

- The commercial strategy focused, on the one hand, on the *Santander Plus* programme, which offers many benefits for those affiliated to it. So far more than 1.1 million customers have registered, half of whom are new.
- The *Santander-Aeroméxico* credit card was launched, following an alliance with Mexico's leading airline. The offer will be exclusive for the next 10 years. So far more than 430,000 cards have been issued, 30% of which were for new customers.
- Other competitive offers were launched such as the *Santander Personal Mortgage*, which offers a tailored interest rate on the basis of each customer profile and needs.

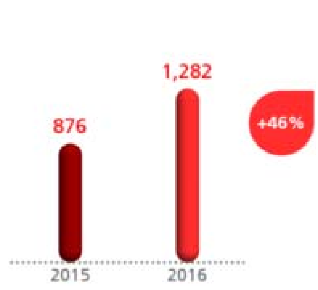
Improvement in the structure of funds and drive in business with companies:

- Demand deposits rose 16% and we continued to promote diversification toward value funds, in line with customers' profile.

Loyal customers
Thousand



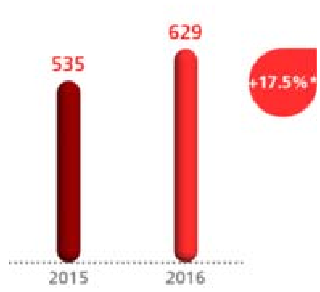
Digital customers
Thousand



Activity performance
% var. 2016 / 2015 (w/o FX)

(*) Customer deposits + mutual funds

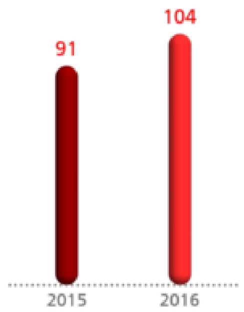
Attributable profit
Constant € million



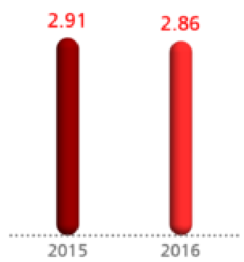
(*) In euros: +0.1%

NPL ratio
%

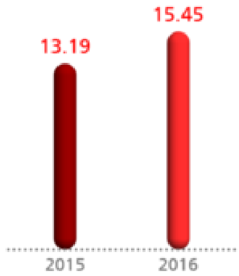
Coverage ratio
%



Cost of credit
%



RoTE
%



- We streamlined the structure and number of series in monetary funds and launched offers to promote the attraction of time deposits.

- In lending, we conducted campaigns to refinance credit lines for SMEs, focused on customers who maintain a good credit profile, and simplifying products.

- As regards companies and institutions, the focus was on transactional loyalty and attracting new customers via confirming products, as well as commercial efforts in the various productive sectors and boosting agribusiness.

All these measures helped to improve customer retention, increase loyal customers by 16% and reach 1.3 million digital customers (+46%).

Activity
Loans rose 8% and deposits excluding repos 16%. Growth benefited from the commercial measures launched at the beginning of 2016 and already commented on.

Lending to individuals rose 8%, as follows: mortgages (+7%); consumer credit (+11%) and credit cards (+8%). We continued to consolidate our leadership in the medium-high income segment.

In deposits, those of individual customers increased 20% and their composition continued to improve, within a policy of reducing their cost. Both demand and time deposits rose 16% while mutual funds were up 3%.

Results
Attributable profit was 18% higher at €629 million, driven mainly by growth in revenues and the lower cost of credit.

- Gross income rose 13%. Of note was the 14% increase in net interest income underpinned by credit growth and a rise in demand deposits, along with higher interest rates since December 2015.

- Operating expenses grew 9%, reflecting the strategic measures taken to position us as the bank of first choice for our customers. Despite this effort, the efficiency ratio improved by 150 b.p. to below 40%.

- All the credit quality ratios improved: the NPL ratio fell 62 b.p. to 2.76%, coverage rose 13 p.p. to 104% and the cost of credit dropped 5 b.p. to 2.86%.

STRATEGY IN 2017

- Improve commercial tools, CRM and digital platforms via the technology plan.
- Strengthen the Santander Plus offer to capture new high potential customers and increase loyalty.
- Boost payrolls and digital customers, while further enhancing customer service quality.
- Consolidate our positioning in mortgage business and recover leadership in SMEs.

Chile

€ Million

Income statement	2016	2015	Variation amount	%	% w/o FX
Net interest income	**1,864**	**1,791**	**73**	**4.1**	**7.4**
Net fee income	353	360	(7)	(1.9)	1.2
Gains (losses) on financial transactions	206	173	33	18.8	22.6
Other operating income*	(1)	12	(12)	—	—
Gross income	**2,422**	**2,336**	**86**	**3.7**	**7.0**
Operating expenses	(986)	(1,004)	17	(1.7)	1.5
General administrative expenses	(895)	(926)	31	(3.4)	(0.2)
Personnel	*(558)*	*(568)*	*10*	*(1.8)*	*1.4*
Other general administrative expenses	*(337)*	*(358)*	*21*	*(5.8)*	*(2.8)*
Depreciation and amortisation	(91)	(77)	(14)	18.2	22.1
Net operating income	**1,435**	**1,332**	**103**	**7.7**	**11.2**
Net loan-loss provisions	(514)	(567)	53	(9.4)	(6.5)
Other income	(27)	3	(30)	—	—
Profit before taxes	**894**	**768**	**126**	**16.4**	**20.2**
Tax on profit	(159)	(114)	(45)	40.0	44.5
Profit from continuing operations	**735**	**655**	**81**	**12.3**	**15.9**
Net profit from discontinued operations	—	—	—	—	—
Consolidated profit	**735**	**655**	**81**	**12.3**	**15.9**
Minority interests	222	199	23	11.3	14.9
Attributable profit to the Group	**513**	**455**	**58**	**12.7**	**16.4**

Balance sheet					
Customer loans **	37,662	32,338	5,324	16.5	6.5
Financial assets held for trading (w/o loans)	3,002	3,144	(142)	(4.5)	(12.7)
Financial assets available-for-sale	4,820	2,668	2,152	80.7	65.2
Central banks and credit institutions **	2,998	3,294	(296)	(9.0)	(16.8)
Tangible and intangible assets	424	355	68	19.2	9.0
Other assets	4,599	4,161	438	10.5	1.1
Total assets/liabilities & shareholders' equity	**53,505**	**45,960**	**7,545**	**16.4**	**6.5**
Customer deposits **	27,317	24,347	2,970	12.2	2.6
Debt securities issued **	10,174	7,467	2,707	36.3	24.6
Liabilities under insurance contracts	—	—	—	—	—
Central banks and credit institutions **	7,172	5,886	1,285	21.8	11.4
Other liabilities	5,476	5,280	196	3.7	(5.1)
Stockholders' equity ***	3,366	2,980	386	13.0	3.3
Other managed and marketed customer funds	**9,903**	**7,370**	**2,533**	**34.4**	**22.9**
Mutual and pension funds	7,321	5,422	1,899	35.0	23.5
Managed portfolios	2,582	1,948	634	32.5	21.2
Managed and marketed customer funds	**47,394**	**39,184**	**8,210**	**21.0**	**10.6**

Ratios (%) and operating means					
RoTE	17.17	15.51	1.65		
Efficiency ratio (with amortisations)	40.7	43.0	(2.2)		
NPL ratio	5.05	5.62	(0.57)		
NPL coverage	59.1	53.9	5.2		
Number of employees	11,999	12,454	(455)	(3.7)	
Number of branches	435	472	(37)	(7.8)	

(*).- Including dividends, income from equity-accounted method and other operating income/expenses
(**).- Including all on-balance sheet balances for this item
(***).- Capital + reserves + profit + other accumulated results

CHILE*

€513 M
Attributable Profit

* Changes in local currency

2016 HIGHLIGHTS

- **Significant progress in transforming the commercial network into a new branch model.**
- **Improved customer satisfaction, narrowing the gap with our competitors.**
- **Greater activity in target segments of loans and funds, gaining market share.**
- **Attributable profit of €513 million, up 16%.**

Economic environment

Economic growth slowed in 2016 to an estimated 1.6% from 2.3% in 2015, despite the good performance of consumer durables, lending and, to a lesser extent, employment (the jobless rate rose from 6.2% to 6.5%). The international context and the mining industry's adapting to an environment of moderate prices were the main factors behind the slowdown.

Inflation fell to an estimated 3% from 4% in 2015, coinciding with the centre of the target range, in a context of sluggish activity.

The currency ended the year at CLP708 per euro, an appreciation of 9%.

The central bank ended 2016 with an interest rate of 3.5%, unchanged since the end of 2015.

Strategy

The Group maintained its strategy of improving long-term profitability against a backdrop of lower spreads and greater regulation. The bank aims to become the most valued in the country by improving the quality of customer attention and transforming the commercial and retail banking segment (36 branches already up and operating in the new network model), particularly in business with medium- and high-income customers and SMEs.

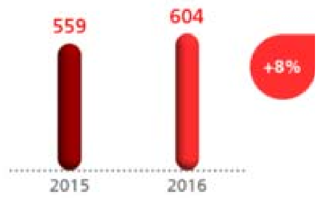
With this in mind, a series of measures were taken:

- A strategy focused more on the customer and streamlining internal processes, adjusting them to a digital and multi channel environment, enabled us to improve customer satisfaction and narrow the gap in quality of service with our competitors.
- In order to make us more attractive to customers, we launched projects such as *WorkCafé*, a new concept of multi-segment branches focused on co-operation and aligned with the SPF culture (Simple, Personal, Fair).
- Increased digitalisation: launch of *123 Click*, a new consumer loan 100% digital.

These measures produced an increase in loyal customers, mainly SMEs (+14%) and high income (+12%), as well as fee income linked to transactions. The number of digital customers rose 4%.

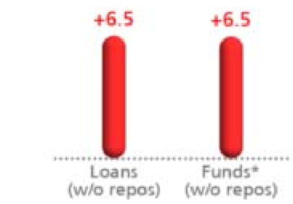
The magazines Euromoney and LatinFinance recognised Santander as the Best Bank in Chile.

Loyal customers
Thousand



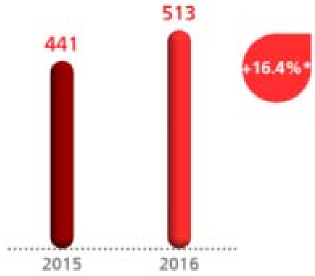
Digital customers
Thousand

Activity performance
% var. 2016 / 2015 (w/o FX)



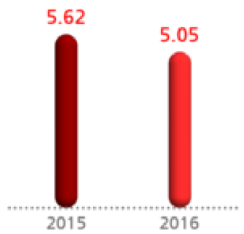
(*) Customer deposits + mutual funds

Attributable profit
Constant € million

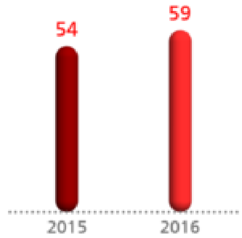


(*) In euros: +12.7%

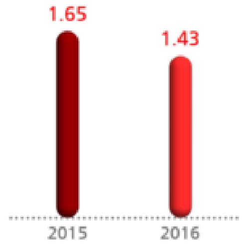
NPL ratio
%



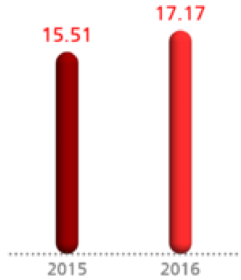
Coverage ratio
%



Cost of credit
%



RoTE
%



Activity

These measures were reflected in higher balances of loans and funds.

Lending rose 7% in local currency, with advances in the target segments. Of note was the 16% growth in loans to high-income customers and 9% to SMEs.

Deposits rose 3% (+2% in demand deposits and +3% in time deposits).

There were gains in market share in various products (+22 b.p. in total loans and 47 b.p. in deposits).

Results

Attributable profit was 16% higher at €513 million, an increase affected by the higher tax charge. Pre-tax profit rose 20% to €894 million, as follows:

- Gross income rose 7%, with growth in all components.

  Net interest income increased 7%, spurred by higher volumes and management of the cost of funds. Gains on financial transactions increased 23% and fee income grew slightly because of the good performance of those linked to means of payment and transactions.

- Operating expenses grew by only 1% despite greater investment in technological developments and indexation of contracts, rentals and salaries to year-on-year inflation.

- Loan-loss provisions fell 6%, with a sustained improvement in the portfolio of individual customers. All credit quality indicators improved, leaving the cost of credit at 1.43%, the NPL ratio at 5.05% and coverage at 59%.

STRATEGY IN 2017

- Consolidate the transformation of commercial and retail banking business via the new branch network model.
- Continue to improve the quality of customer attention and experience.
- Strenthen business with large and medium sized companies.
- Focus on fee income and on long-term profitability in an environment of lower spreads and greater regulations.

ARGENTINA*

2016 HIGHLIGHTS

- The strategy centred on increasing our penetration in the market through expanding the branch network and moving to a more digital bank, focusing on Santander Select and Pymes Advance.
- Agreement for the acquisition of Citibank Argentina's retail banking business and agreement with American Airlines for the AAdvantage® frequent traveller programme.
- Attributable profit was 52% higher at €359 million, driven by higher revenues and a lower cost of credit.

* Changes in local currency

Economic environment

Argentina decisively faced in 2016 its macroeconomic imbalances and microeconomic divisions and also strengthened the institutional framework. The adjustment measures led to GDP shrinkage of 2%, but at the same time began to lay the foundations for control of inflation and the public finances and for growth recovery.

The benchmark interest rate was cut from 33% to 24.5%, while the peso depreciated strongly against the euro.

Strategy

The Group's strategy continued to centre on growing customer business, paying particular attention to loyalty and profitability:

- Agreement with American Airlines for the AAdvantage® programme under which air miles are accumulated through purchases with cards that adhere to the programme.
- Launch of a new line of UVA inflation-indexed mortgages.
- In the high-income segment, the *Select* products were strengthened and new corners and spaces specialised in SMEs opened.
- The expansion and transformation plan of branches continued with the opening of 17 branches (246 already transformed).
- The *Gestión Comercial "+CHE"* system was implemented in the branch network.

In the year, loyal customers rose 6% and digital ones 20%.

In addition, an agreement was signed in October with Citibank Argentina to acquire its retail business, consolidating Santander as the country's main private sector bank as it incorporated 500,000 customers and 70 branches. The transaction is pending the central bank's authorisation.

The magazine Global Finance recognised Santander Río as the "Best Digital Bank in Argentina" and the "Best in Mobile Banking in Argentina". The bank was also ranked first in the Great Place to Work ranking and Euromoney named it "Best Bank in 2016".

Activity

Lending increased 37%, particularly consumer credit. Deposits rose 47%, with demand deposits up 111% and those in dollars 241%, while time deposits fell 23%.

All these factors enabled us to gain market share (10.3% in loans and 10.9% in deposits).

Results

Attributable profit was €359 million (+52%). The commercial strategy pushed up gross income by 42% (net interest income: +28% and fee income: +36%).

Operating expenses rose 37% due to the impact of inflation, the new salary agreement, the opening of new branches and investments in transformation and technology.

Loan-loss provisions increased less than lending, as a result of which the cost of credit dropped by 43 b.p. The quality of credit remained high (NPL ratio of 1.49% and coverage of 142%).

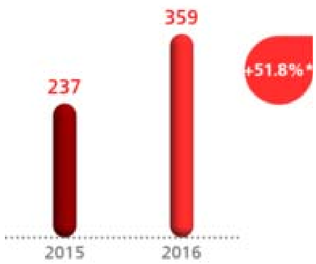
Activity performance

% var. 2016 / 2015 (w/o FX)

(*) Customer deposits + mutual funds

Attributable profit

Constant € million



(*) In euros: -5.0%

STRATEGY IN 2017

- Continue the transformation toward a digital bank, improving efficiency, loyalty and satisfaction.
- Complete the integration of Citibank's retail business.
- Boost lending to companies and households that have a low level of debt, mainly consumer credit, mortgages and financing lines for investments and foreign trade.
- Grow significantly in customer funds, particularly mutual funds

URUGUAY*

€84 M
Attributable profit

* Changes in local currency

2016 HIGHLIGHTS

- Consolidate customer service quality and satisfaction, ranking second.
- Credit card leaders for the third year running.
- Greater lending to target segments and products.
- Profit before tax rose 48%. Excluding the perimeter impact, growth was 35% due to higher commercial revenues.

Economic environment
The economy grew 0.5% (1.0% in 2015) and inflation was 9.2% (9.4% in 2015), above the official target of 3%-7%. The peso ended 2016 at UYU30.6/€, an appreciation of 6%.

Strategy
The Group continued to be the country's leading private sector bank, focusing on growing in retail banking and improving efficiency and the quality of service. In 2016 we continued to offer our customers value-added via the following measures:

- We were ranked second in the customer satisfaction survey.
- The number of loyal customers rose 4% via measures such as the launch of the new *CRM Celestium* and the launch of the customer retention unit.
- As part of the process to digitalise and modernise channels, we developed significant advances in the Santander app and launched a new payments app to increase customer transactions. These measures helped lift the number of digital customers by 50%.
- We consolidated our leadership in consumer finance business (+70 b.p. in consumer credit market share).

Activity
- Lending rose in target segments and products (SMEs and consumer business), as well as consumer credit (+15%).Total loans up 1%.
- Deposits fell 7, because of the exit of non-resident deposits and the strategy of making funds more profitable.

Results
Attributable profit was 32% higher at €84 million, benefiting from the incorporation of Créditos de la Casa in August 2015. Excluding this, profit would have increased 19% because of the higher tax charge.

Profit before tax increased 48% (+35% on a like-for-like basis), spurred by growth in net interest income, fee income and the efficiency plan's measures.

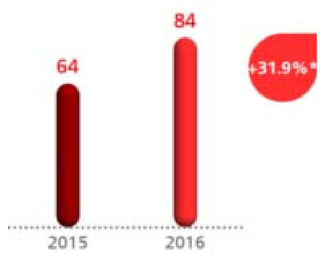
The efficiency ratio was 5.5 p.p. better at 51.4%.

Loan-loss provisions increased 13%, albeit from a low base. The cost of credit was low (1.79%), the NPL ratio was 1.63% and coverage 168%.

Activity performance
% var. 2016 / 2015 (w/o FX)

(*) Customer deposits + mutual funds

Attributable profit
Constant € million



(*) In euros: +19.8%

STRATEGY IN 2017

- Continue to grow in retail business, with excellent levels of quality of service.
- Increase our market share in the segments of individuals and SMEs and in products such as consumer loans, means of payment and payroll.
- Boost revenues, mainly through the drive in fee income due to greater customer loyalty.
- Keep on improving the efficiency ratio through digital transformation.

PERÚ*

€37 M
Attributable Profit

* Changes in local currency

2016 HIGHLIGHTS

- Strategy focused on retail banking with global and corporate customers and the large company segment.
- Attributable profit increased 21%, mainly due to higher net interest income and lower provisions.

Economic environment
GDP growth slowed to 3.9%. Sharp drop in domestic demand. Inflation was around 3.4% and the currency depreciated 6% against the euro.

Public debt stood at 23% of GDP, one of the lowest in the region, and the country's reserves totalled $61,000 million (more than 30% of GDP). The system's loans and deposits grew 4% and 2%, respectively.

Strategy
In this environment, the Group focused on corporate banking and the country's big companies, as well as continuing to provide services to the Group's global customers.

A closer relationship with customers and quality of service were priorities, taking advantage of operational and business synergies with other Group units.

An auto finance company continued to consolidate its activity in Peru. This company has a specialised business model, centred on service and with market shares that enable customers to acquire a new vehicle via most of the brands and dealerships in the country.

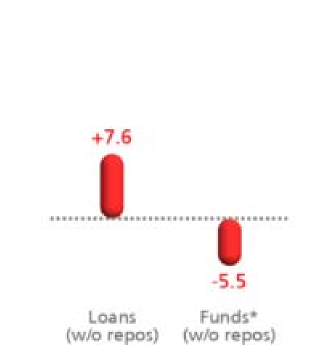
Activity
Lending rose 8% and deposits fell 6%, due to the 10% reduction in time deposits as a result of the funding strategy.

Results
Attributable profit was 21% higher at €37 million.

- Gross income rose 3%., with a good performance of net interest income and fee income , but affected by the fall in gains on financial transactions.
- Operating expenses increased 1% and loan-loss provisions declined 84%.

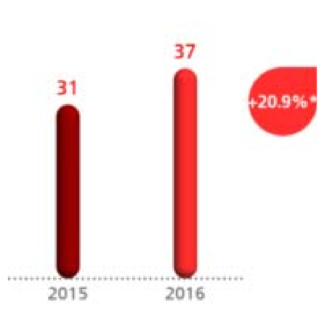
The efficiency ratio was 33 b.p. better at 30.5%, the NPL ratio remained very low (0.37%) and coverage was high.

Activity performance
% var. 2016 / 2015 (w/o FX)



(*) Customer deposits + mutual funds

Attributable profit
Constant € million



(*) In euros: +14.2%

STRATEGY IN 2017

- Continue to increase lending to the corporate segment, global customers and large companies.
- Promote advisory services in investment banking and in public infrastructure works via public and private sector link ups.

COLOMBIA

- The operation in Colombia focuses on growing business with Latin American companies, multinational companies, international desk and big and medium-sized local companies, contributing treasury solutions, risk hedging, foreign trade, financing working capital and confirming, as well as developing investment banking and capital market products.
- Premier Credit focused on increasing its volume of operations by signing commercial agreements with dealership networks. It also launched the project that will give Banco Santander de Negocios Colombia the capacity to finance loans originated by Premier Credit.
- The various businesses generated net operating income of €8 million.

United States

€ Million

Income statement	2016	2015	Variation amount	%	% w/o FX
Net interest income	**5,917**	**6,116**	**(199)**	**(3.3)**	**(3.5)**
Net fee income	1,102	1,086	16	1.5	1.2
Gains (losses) on financial transactions	22	231	(208)	(90.4)	(90.4)
Other operating income*	491	367	124	33.9	33.6
Gross income	**7,532**	**7,799**	**(267)**	**(3.4)**	**(3.6)**
Operating expenses	(3,198)	(3,025)	(173)	5.7	5.5
General administrative expenses	(2,882)	(2,761)	(121)	4.4	4.1
Personnel	*(1,636)*	*(1,543)*	*(93)*	*6.0*	*5.8*
Other general administrative expenses	*(1,247)*	*(1,219)*	*(28)*	*2.3*	*2.1*
Depreciation and amortisation	(316)	(264)	(52)	19.8	19.5
Net operating income	**4,334**	**4,774**	**(440)**	**(9.2)**	**(9.4)**
Net loan-loss provisions	(3,208)	(3,103)	(105)	3.4	3.1
Other income	(90)	(148)	58	(39.1)	(39.3)
Profit before taxes	**1,036**	**1,523**	**(487)**	**(32.0)**	**(32.1)**
Tax on profit	(355)	(516)	161	(31.3)	(31.4)
Profit from continuing operations	**681**	**1,007**	**(326)**	**(32.4)**	**(32.5)**
Net profit from discontinued operations	—	—	—	—	—
Consolidated profit	**681**	**1,007**	**(326)**	**(32.4)**	**(32.5)**
Minority interests	286	329	(43)	(13.0)	(13.2)
Attributable profit to the Group	**395**	**678**	**(283)**	**(41.8)**	**(41.9)**

Balance sheet	2016	2015	Variation amount	%	% w/o FX
Customer loans **	85,389	84,190	1,199	1.4	(1.8)
Financial assets held for trading (w/o loans)	2,885	2,299	586	25.5	21.5
Financial assets available-for-sale	16,089	19,145	(3,056)	(16.0)	(18.6)
Central banks and credit institutions **	1,090	1,046	44	4.2	0.9
Tangible and intangible assets	10,648	9,156	1,491	16.3	12.6
Other assets	21,289	14,747	6,542	44.4	39.8
Total assets/liabilities & shareholders' equity	**137,390**	**130,584**	**6,805**	**5.2**	**1.9**
Customer deposits **	64,460	60,115	4,345	7.2	3.8
Debt securities issued **	26,340	23,905	2,434	10.2	6.7
Liabilities under insurance contracts	—	—	—	—	—
Central banks and credit institutions **	22,233	26,169	(3,936)	(15.0)	(17.7)
Other liabilities	9,897	9,073	823	9.1	5.6
Stockholders' equity ***	14,461	11,321	3,139	27.7	23.7
Other managed and marketed customer funds	**18,827**	**19,478**	**(651)**	**(3.3)**	**(6.4)**
Mutual and pension funds	9,947	7,123	2,824	39.6	35.2
Managed portfolios	8,880	12,355	(3,475)	(28.1)	(30.4)
Managed and marketed customer funds******	**89,200**	**84,238**	**4,961**	**5.9**	**2.5**

Ratios (%) and operating means	2016	2015	Variation amount	%	% w/o FX
RoTE	3.11	6.54	(3.42)		
Efficiency ratio (with amortisations)	42.5	38.8	3.7		
NPL ratio	2.28	2.13	0.15		
NPL coverage	214.4	225.0	(10.6)		
Number of employees	17,509	18,123	(614)	(3.4)	
Number of branches	768	783	(15)	(1.9)	

(*).- Including dividends, income from equity-accounted method and other operating income/expenses
(**).- Including all on-balance sheet balances for this item
(***).- Capital + reserves + profit + other accumulated results
(****).- Excluding debt securities issued of Santander Consumer USA

UNITED STATES*

€395 M
Attributable Profit

* Changes in dollars

2016 HIGHLIGHTS

- **The year's three key priorities were to advance in complying with regulatory requirements, improve the franchise of Santander Bank and optimise the risk adjusted return profile of SC USA.**
- **The revitalising of Santander Bank was reflected in a 4% rise in customer core deposits and 26% in digital customers.**
- **Santander Consumer USA continued to adjust the business mix toward a more attractive risk adjusted return profile, compatible with RoTE levels of 15%.**
- **Attributable profit was 42% lower at €395 million.**

Economic environment

The US economy grew an estimated 1.6% in 2016, partly due to the slow growth at the start of the year. This did not prevent, however, the jobless rate falling to 4.7%, a level regarded as almost full employment, and core inflation of 1.8%.

The outcome of the US election helped to strengthen the dollar to €1/$1.05 ($1.09 at the end of 2015) and spurred the markets.

In this context, in which the economy was already showing some strengthening, the Federal Reserve raised its key rate in December to 0.75% from 0.50% and pointed to gradual hikes in 2017.

Strategy

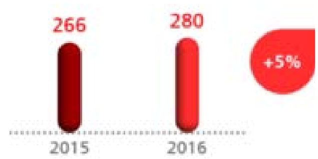
Santander in the US includes Santander Holdings, the Intermediate Holding Company (IHC), and its subsidiaries Santander Bank, Banco Santander Puerto Rico, Santander Consumer USA, Banco Santander International and Santander Investment Securities, as well as the branch of Santander in New York.

Santander Bank is one of the largest banks in the northeast of the country and offers a full range of products such as consumer loans, mortgages and loans for individuals, SMEs and large multinationals. Santander Consumer USA is one of the largest auto finance companies in the US and makes loans to a wide spectrum of customers in the US.

Santander US is focusing on strategic priorities that aim to transform it into a diversified and leading bank in the US. These include:

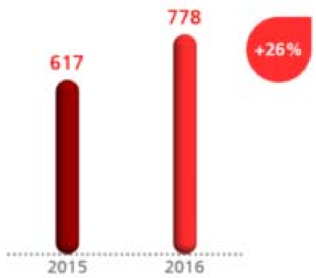
- Improve the profitability of Santander Bank.
- Optimise the auto finance business.
- Grow GCB's business with customers established in the US by leveraging the connectivity of the Group's global footprint.

Loyal customers*
Thousand



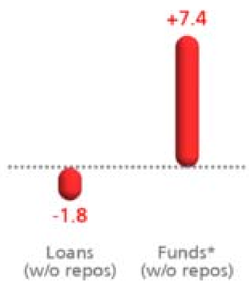
(*).- Santander Bank

Digital customers*
Thousand



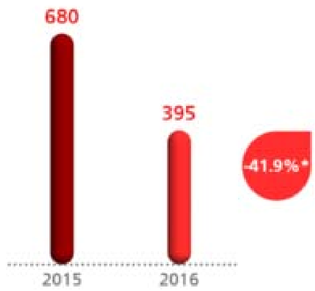
(*).- Santander Bank

Activity performance
% var. 2016 / 2015 (w/o FX)



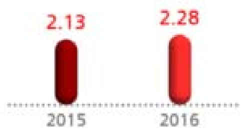
(*) Customer deposits + mutual funds

Attributable profit
Constant € million

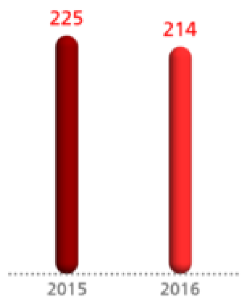


(*) In euros: -41.8%

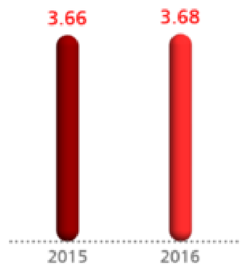
NPL ratio
%



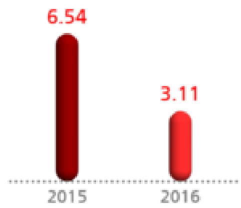
Coverage ratio
%



Cost of credit
%



RoTE
%



Santander US continued to progress in 2016 in complying with its regulatory obligations. The IHC holding was created, unifying the main units in the country under the same management and governance structure in order to manage risk in the US more effectively.

The commercial transformation continued in order to improve the technological and financial capacities and create a successful business while complying with all the regulatory requirements.

Santander Bank continued to improve the franchise and build closer and deeper relations with customers, through a simplified and full suite of products, as well as enhancing customer satisfaction. We are beginning to see results such as the rise in digital customers (+26%) and in core deposits (+4%).

Santander Consumer USA's ongoing strategy continues to be to leverage its efficient, scalable infrastructure to underwrite, originate and service profitable assets. This strategy evolved with the focus on regulatory compliance and customer protection, optimisation of assets retained versus sold and serviced for others, realising the full value of Chrysler Capital.

Banco Santander Puerto Rico launched a new customer onboarding program that simplifies and personalises customer service. It also improved the e-banking platforms and apps and provided customers with the necessary tools to manage their banking needs from anywhere and at any time.

Activity

Santander Bank's lending fell 2%, as growth of 16% in Corporate and Commercial Banking partially offset sales of portfolios. Customer deposits increased 2% while treasury deposits declined.

The fall in Santander Consumer USA lending was due to lower originations because of the competitive environment and improving the risk adjusted returns of non prime originations. In addition, certain consumer lending portfolios were sold, such as Lending Club.

Results

Attributable profit was $437 million, with an evolution that reflected the Group's strategy during 2016.

Significant investments were made in technology to enhance customer experience and improve risk management and capital planning in order to comply with regulatory obligations, causing costs to remain high. Santander Bank also repurchased costly liabilities, which had a negative impact on gains on financial transactions.

Santander Consumer USA changed its business mix to a low risk profile (with impact on revenues) which was made compatible with obtaining a RoTE of 18% in 2016.

These factors, combined with certain non-recurring costs and an increase in provisions, partly due to those made in the first quarter for oil and gas related business, produced a 42% fall in the attributable profit. Profit before taxes was 32% lower.

STRATEGY IN 2017

- Improve customer experience and loyalty through an efficient sales force, simple products and continued development of digital channels at Santander Bank.
- Maintain leadership in auto finance with continued focus on improving Chrysler channel to support growth of prime originations.
- Continue to improve management of capital, risk and liquidity in order to comply with regulatory requirements and build a strong US business.

Corporate Centre

€ Million

Income statement	2016	2015	Variation amount	%
Net interest income	**(739)**	**(627)**	**(112)**	**17.8**
Net fee income	(31)	(13)	(18)	137.3
Gains (losses) on financial transactions	(243)	150	(393)	—
Other operating income*	(52)	(5)	(47)	980.8
Gross income	**(1,066)**	**(495)**	**(571)**	**115.3**
Operating expenses	(450)	(547)	97	(17.7)
Net operating income	**(1,516)**	**(1,042)**	**(474)**	**45.5**
Net loan-loss provisions	2	27	(25)	(94.2)
Other income	(75)	(507)	433	(85.3)
Underlying profit before taxes	**(1,589)**	**(1,523)**	**(66)**	**4.3**
Tax on profit	141	59	82	138.5
Underlying profit from continuing operations	**(1,448)**	**(1,464)**	**16**	**(1.1)**
Net profit from discontinued operations	0	—	0	—
Underlying consolidated profit	**(1,448)**	**(1,464)**	**16**	**(1.1)**
Minority interests	(9)	30	(38)	—
Underlying attributable profit to the Group	**(1,439)**	**(1,493)**	**54**	**(3.6)**
Net capital gains and provisions	(417)	(600)	183	(30.5)
Attributable profit to the Group	**(1,856)**	**(2,093)**	**237**	**(11.3)**

Balance sheet				
Financial assets held for trading (w/o loans)	1,203	2,656	(1,453)	(54.7)
Available-for-sale financial assets	2,774	3,773	(1,000)	(26.5)
Goodwill	26,724	26,960	(236)	(0.9)
Capital assigned to Group areas	79,704	77,163	2,541	3.3
Other assets	21,750	37,583	(15,833)	(42.1)
Total assets/liabilities & shareholders' equity	**132,154**	**148,136**	**(15,981)**	**(10.8)**
Customer deposits**	858	5,205	(4,347)	(83.5)
Marketable debt securities**	30,922	37,364	(6,442)	(17.2)
Other liabilities	16,014	21,052	(5,038)	(23.9)
Stockholders' equity ***	84,361	84,515	(154)	(0.2)
Other managed and marketed customer funds	**10**	**—**	**10**	**—**
Mutual and pension funds	10	—	10	—
Managed portfolios	—	—	—	—
Managed and marketed customer funds	**31,790**	**42,569**	**(10,779)**	**(25.3)**

Operating means				
Number of employees	1,724	2,006	(282)	(14.1)

(*).- Including dividends, income from equity-accounted method and other operating income/expenses
(**).- Including all on-balance sheet balances for this item
(***).- Capital + reserves + profit + other accumulated results

CORPORATE CENTRE

-€1,856 M
Attributable Profit*

* Before non-recurring results: -€1,439 M

2016 HIGHLIGHTS

- **The purpose of our corporate centre is to improve efficiency and contribute value-added for the operating units. It also develops functions related to financial and capital management.**
- **In year-on-year terms, lower revenues from centralised management of the various risks (mainly interest rate risk), offset by reduced costs and provisions.**
- **It includes the negative impact of €417 million of the net non-recurring results, set out in page 101 of this report.**

Strategy and functions

Banco Santander subsidiaries' model is complemented by a corporate centre that has support and control units which carry out functions for the Group in matters of risk, auditing, technology, human resources, legal affairs, communication and marketing, among others.

The Corporate Centre 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 among the most efficient in the sector.
- By sharing best commercial practices, launching global commercial initiatives and driving digitalisation, the 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 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 units of the Group 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 in euros for the next 12 months. Net investments in equity are currently covered by €21,680 million (mainly Brazil, UK, Chile, Mexico and Poland) with different instruments (spot, forex swaps and forwards).
- **Total management of capital and reserves:**
  - Capital assigned to each of the units. Lastly, and marginally, the corporate centre reflects the stakes of a financial nature that the Group makes under its policy of optimising investments.

Results

We reformulated the centre's role in the Group, in order to improve the transparency and visibility of both the centre's accounts and the Group's, as well as the responsibility of the operating units. The centre generated 22% of the Group's profits (23% in 2015).

In year-on-year terms:

- Lower revenues due to reduced results from centralized management of the different risks (mainly interest rate and exchange rate risk).
- Costs were 18% lower, due to the restructuring carried out in the second quarter and the continued streamlining of the corporation begun in 2015.
- Other results and provisions recorded losses of €75 million, compared to a loss of €507 million in 2015. These amounts included provisions of different nature, as well as capital gains, capital losses and impairment of financial assets. The figure normalized in 2016, as in 2015 it was higher than average.
- The losses in 2016 were €1,439 million compared to losses of €1,493 million in 2015. After including the impact of the net non-recurring positive and negative results of €417 million (€600 million negative in 2015), the total loss was €1,856 million, down from one of €2,093 million in 2015.

RETAIL BANKING

€6,297 M
Attributable Profit

2016 HIGHLIGHTS

- We continued to transform our commercial and retail banking model into a more Simple, Personal and Fair model.
- Focus on three lines: customer loyalty and satisfaction, digital transformation and operational excellence.
- The Group had 15.2 million loyal customers and 20.9 million digital customers at the end of 2016.
- The magazine Euromoney recognised Santander as the Best Bank in the World for SMEs.
- Profit before tax of €10,201 million and attributable profit of €6,297 million.

Commercial activity

The programme to transform commercial and retail banking is structured around three principles:

1.- Customer loyalty and satisfaction
2.- Digital transformation of our channels, products and services
3.- Operational excellence of our processes.

The following measures were adopted in 2016, and summarise those commented on in this annual report:

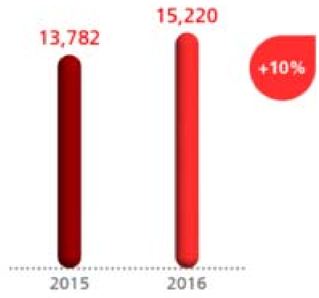
1.- In order to improve **customer loyalty and satisfaction** continuously, the following measures were adopted in 2016, among others:

Retail Banking
€ Million

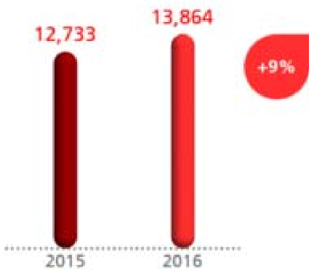
Income statement	2016	2015	Variation amount	%	% w/o FX
Net interest income	**29,090**	**29,857**	**(767)**	**(2.6)**	**2.9**
Net fee income	8,745	8,562	183	2.1	8.9
Gains (losses) on financial transactions	664	1,360	(697)	(51.2)	(49.3)
Other operating income*	557	375	182	48.5	45.5
Gross income	**39,055**	**40,154**	**(1,099)**	**(2.7)**	**2.8**
Operating expenses	(18,476)	(18,675)	199	(1.1)	5.0
Net operating income	**20,580**	**21,479**	**(900)**	**(4.2)**	**0.9**
Net loan-loss provisions	(8,693)	(9,247)	554	(6.0)	(2.2)
Other income	(1,686)	(1,751)	65	(3.7)	1.2
Profit before taxes	**10,201**	**10,482**	**(281)**	**(2.7)**	**3.6**
Tax on profit	(2,798)	(2,626)	(172)	6.6	12.4
Profit from continuing operations	**7,402**	**7,855**	**(453)**	**(5.8)**	**0.6**
Net profit from discontinued operations	—	—	—	—	—
Consolidated profit	**7,402**	**7,855**	**(453)**	**(5.8)**	**0.6**
Minority interests	1,105	1,114	(9)	(0.8)	3.6
Attributable profit to the Group	**6,297**	**6,741**	**(444)**	**(6.6)**	**0.1**

(*).- Including dividends, income from equity-accounted method and other operating income/expenses

Loyal customers
Thousand

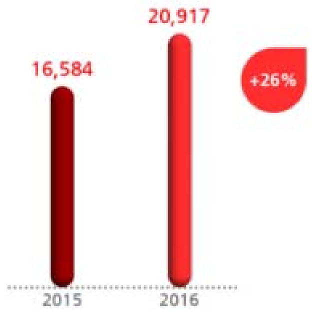


Retail loyal customers
Thousand



SMEs & corporate loyal customers. Thousand

Digital customers
Thousand



- The 1|2|3 strategy in Spain, Portugal and the United Kingdom which continued the good pace of opening accounts.

- Consolidation of value propositions for individual customers in Mexico such as *Santander Plus* and the alliance with Aeroméxico, which has already attained more than 430,000 cards and the *Superpuntos* programme in Chile that offers significant advantages for customers.

- The pioneer *Digital Suite* platform launched in Mexico, which integrates a fully digital offer of banking services and financial education; the *sina* financial app that Germany offers its customers to manage their savings and the investment centre launched by Santander UK which enables customers to manage their investments online.

- The launch of the *Select Global Value* offer, which complements the local offer with non-financial services and makes available to customers a homogeneous and exclusive service in all countries where the Group operates.

- The continuous evolution of plans for SMEs in all countries – *Breakthrow* in the United Kingdom, *Firmowe Ewolucje* in Poland, *Avançar* in Brazil and *Advance* in Chile, Spain, Argentina and Portugal, among others – with constant improvements such as the *Business Evolution* platform in Poland, the *factoring web* for SMEs and companies in Chile, and the *Santander Trade Network* global proposition, a comprehensive service to help companies internationalise. Santander UK was recognised as the Best International Provider of Solutions in the Business Money Facts prizes and as Best Trade Finance Provider in Mexico, Argentina, Chile by the magazine Global Finance.

2.- In order to create a simpler bank for our customers, we continued to foster the **digital transformation and multi channels:**

- Santander Mexico already has 1.3 million digital customers. *SuperMóvil* enables them to access all services from any mobile device and with the same password.

- In Brazil, more than 6 million customers already access our channels through biometric identification. Of note was the launch of the new commercial *+negocios* model for the consumer finance segment.

- In Spain, *Santander Personal* was launched as a specialised and personalised attention channel, while in Poland we launched the new online bank with a *Customer Attention* section that allows personal attention.

- Various payment solutions were launched such as, in Spain, the *Wallet* app that allows payments to be made from a mobile phone in any establishment, the contactless wristband for payments, the *Apple Pay* service and *Bizum* which allows direct P2P payments; or in Brazil the *Santander Way* app which provides card users with speed, control and security.

- The magazine Global Finance again chose Santander Río as the best digital bank in Argentina. It was also recognized as the best bank for SMS and having the best designed website in Latin America.

- Progress was also made in transforming branches under the *Smart Red* programme. Spain, Brazil, Mexico, the United Kingdom and Argentina have already inaugurated new branch models, Portugal already has specialised spaces for companies and Chile inaugurated the first *WorkCafé*, a novel branch format where customers can take advantage of their visits to use the co-working zone. New ATMs, which enable customers to carry out basic operations simply and agilely, also continued to be installed at a good pace.

- The *NEO CRMs* were consolidated as the reference CRM tool in the market, with new improvements such as Santander Río's transactional *CRM+Che*, the new multi channel CRM in Poland's contact centre, the *NEO Jupiter* that is already deployed in all offices in Mexico and the *NEO CRM* recently launched in the United Kingdom which was developed in record time, with a dedicated multi discipline team and working with *Agile* methodology.

3.- The satisfaction and experience of our customers is one of our priorities, which is why we continue to work on improving **operational excellence,** with new processes that are simpler, more efficient and omnichannel, developed with *Agile* methodology, and also on improving the quality of service. These efforts are reflected in our improved position in the customer satisfaction rankings where eight of the Group's nine core countries are already among the Top 3 in each market.

These constant advances earned Santander many recognitions, such as Bank of the Year in the Americas, Portugal and Argentina by The Banker magazine; Best Bank in the World for SMEs, and Best Retail Bank in Argentina, Portugal, Poland, Puerto Rico and Chile by Euromoney. Santander Private Banking was also recognized by Euromoney as Best Bank in Asset Management in Latin America.

Results

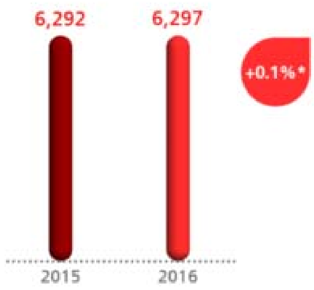
Profit before tax was a little lower at €10,201 million because of the exchange rate impact (+4% excluding it). The sharp rise in the tax charge left attributable profit at €6,297 million, virtually unchanged in constant euros.

The P&L account was characterised by the spur of net interest income, good performance of fee income in almost all units, discipline in costs and lower loan-loss provisions.

Activity performance
% var. 2016 / 2015 (w/o FX)

(*) Customer deposits + mutual funds

Attributable profit
Constant € million



(*) In euros: -6.6%

STRATEGY IN 2017

- Continuous improvement in our financial solutions in order to increase customer satisfaction.
- Keep on driving the integration of channels in order to offer our customers a homogenous and personal experience.
- Continue to promote the digital transformation in order to make available to customers simple products, services and solutions that distinguish us for our operational excellence.
- Progress the offer of differentiated value that gives us global presence.
- Consolidate our culture of service: Simple, Personal and Fair.

GLOBAL CORPORATE BANKING

€2,089 M
Attributable Profit

2016 HIGHLIGHTS

- **Reference positions in export finance, corporate loans, project finance and issuance, among others, in Europe and Latin America.**
- **Attributable profit of €2,089 million, 30% more in constant euros.**
- **Positive evolution in revenues, maintaining an efficiency in costs that leverages the strengths of our model.**

Strategy

The main lines of action were:

- Progress in changing our model toward a business lighter in capital, with the creation of an area solely dedicated to rotation of assets and optimisation of capital (ARCO) in order to strengthen the division's distribution capacity.
- Creation of an innovation area to drive new solutions and meet the challenge of new non-banking players. We are involved in various blockchain technology projects to position us in the financial sector's transformations that this technology could introduce (Digital Assets Holding, Utility Settlement Coin, Ripple Payments, etc). In GTB receivables, big-data is used for risk scoring of companies based on information sources available in the market.
- Strengthening our leadership position in Latin America, where we are the leader in export finance, debt capital markets (DCM), equity capital markets (ECM), mergers and acquisitions (M&A) and project finance. We participated in the largest repo in Argentina's history and in the bond issue of this country's central bank.
- In the region, we are number one in project finance advisory operations and number two in project bonds.
- Progress in facilitating the international connectivity of retail and commercial banking customers. The Flame platform for FX, designed and installed in the United Kingdom, was installed in Mexico and in 2017 will be so in the United States and Chile. Various measures were adopted to internalise the flows in Santander's countries, we defined solutions so that commercial corridors capture flows of export letters of credit and we created a

Global Corporate Banking

€ Million

Income statement	2016	2015	Variation amount	%	% w/o FX
Net interest income	**2,781**	**3,001**	**(220)**	**(7.3)**	**(0.5)**
Net fee income	1,465	1,483	(18)	(1.2)	4.6
Gains (losses) on financial transactions	1,293	724	569	78.6	96.8
Other operating income*	286	268	18	6.8	5.0
Gross income	**5,825**	**5,476**	**349**	**6.4**	**13.7**
Operating expenses	(1,951)	(2,114)	163	(7.7)	(2.2)
Net operating income	**3,874**	**3,362**	**512**	**15.2**	**23.8**
Net loan-loss provisions	(660)	(681)	21	(3.1)	1.1
Other income	(77)	(93)	16	(16.8)	(15.9)
Profit before taxes	**3,137**	**2,589**	**549**	**21.2**	**31.5**
Tax on profit	(876)	(732)	(144)	19.6	31.1
Profit from continuing operations	**2,261**	**1,857**	**405**	**21.8**	**31.7**
Net profit from discontinued operations	—	—	—	—	—
Consolidated profit	**2,261**	**1,857**	**405**	**21.8**	**31.7**
Minority interests	172	119	53	44.9	55.9
Attributable profit to the Group	**2,089**	**1,738**	**352**	**20.2**	**30.0**

(*).- Including dividends, income from equity-accounted method and other operating income/expenses global tool *(ORBE)* for facilitating information to the commercial network on countries and banks with which the Group can operate.

Activity

SGCB used the strengths of its model to attain good results and maintain levels of cost efficiency leaders in the industry, thanks to its customer-centric model that combines global and local capacities with active management of risk, capital and liquidity.

Notable actions included:

- In ***trade finance***, export finance measures that put the Group among the main players in this business (5th in international rankings).
- Of note in ***trade & working capital solutions***, was the increased demand for working capital solutions. Latin America was the main engine of growth in receivables finance as well as in confirming. Brazil registered double-digit growth.
- ***International financial institutions*** increased the Group's scope to operate with other international banks in a more agile way, be more efficient from a risk standpoint and adapt to the new regulatory requirements. The Group stepped up its capacity to accompany export customers in those countries and banks where they do business.
- ***Cash management***, recorded double-digit growth in revenues from transactions and from funds. The investment effort was maintained in order to improve the global and local platforms and specific commercial plans were implemented to consolidate Banco Santander's leadership in its 10 core markets.
- In ***syndicated corporate loans***, we maintained our reference position in Europe and Latin America, with participations in significant transactions, such as: the loan granted to AT&T to purchase Time Warner and to Henkel for acquiring Sun Products in the United States; the refinancing by Acciona; the syndicated loan to Danone to buy WhiteWave Foods and support for Shire in the bridging loan for the merger with Baxalta.
- Noteworthy in ***corporate finance***, within equity capital markets was our participation in the listing of Innogy, the renewable energy subsidiary of the RWE Group, which was the largest IPO (€4,600 million) in Europe of the last five years.
- In ***structured financing,*** we continued to enjoy a clear position of leadership in both Latin America and Spain. Notable operations included the purchase of 20% of Gas Natural by Global Infrastructure Partners and the financial advice and finance provided to the consortium comprising Vinci, ADP and Astaldi to build the new international terminal in Chile.
- In ***debt capital markets*** Santander led the Latin American ranking as it took part in the region's main operations. Also noteworthy were the US dollar operations of Brazilian, Argentinian and Chilean issuers. Santander also participated in AB Inbev's issues. In Europe, Santander remained active in the market, supporting both financial issuers (Commerzbank, Unicredit, CFF) as well as corporate ones (BP, Cellnex, EDP, Ferrovial, Iberdrola).
- As regards ***markets***' activity, good results with positive evolution of income from sales business, especially in the corporate segment with strong growth in the United Kingdom, Brazil and Mexico. Greater contribution from management of books, notably Spain, United Kingdom, Brazil, Argentina and Mexico.

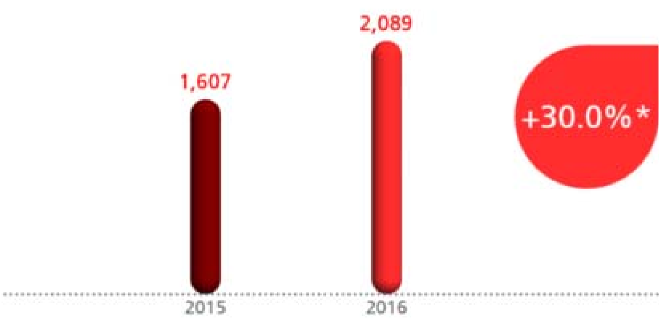
Gross income breakdown

Constant € million

(*) In euros: total revenues: +6%; customers: +6%

Attributable profit

Constant € million



(*) In euros: +20.2%

Results (in constant euros)

GCB's results were fuelled by the strength and diversification of customer revenues. Profit was 30% higher over 2015 at €2,089 million.

- The area generated 13% of revenues and 25% of the attributable profit of the Group's operating areas.
- Gross income grew 14%, with growth in all products. Global Transaction Banking increased 13% against a backdrop of containment of spreads and low interest rates, Financing Solutions and Advisory 1%, reflecting the soundness of the various businesses, and Global Markets 21% (good performance in Europe and particularly the Americas).
- Operating expenses were 2% lower thanks to the efficiency plans implemented, particularly in Spain and the United States and provisions increased 1%.

Ranking in 2016

Source	Área	Award / Ranking
Global Finance	GTB	Cash Management Best Bank in the Americas
EFMA	GTB	Cash Management Global Distribution & Marketing Innovation awards for Financial Services
TFR	GTB	Best Trade Bank in Spain
TFAnalytics	GTB	Best Trade Bank in LATAM
TFR	GTB	TFR Deals of the Year 2016 -ECA highly commended : Enel Green Power US$111
IFR	FS&A	Latin America Bond of the Year: Argentina's US$16.5bn four-tranche bond
Global Finance Magazine	Global Markets	World's Best FX Providers 2016 in Portugal
LatinFinance	Global Markets	Sovereign Issuer and Sovereign Bond of the Year. The Republic of Argentina bond
LatinFinance	Global Markets	Corporate Liability Management of the Year : Petrobras liability management
LatinFinance	Global Markets	Bank of the Year Chile
PFI	FS&A	Americas Oil & Gas Deal of the Year: FERMACA
PFI	FS&A	Latin American Power Deal of the Year: Transmisora Eléctrica del Norte
PFI	FS&A	Power Deal of the Year in Europe: MGT Power deal
Global Capital	FS&A	2016 Corporate Bond Deals of the Year: Corporate Deal of the Year by a European Issuer - Anheuser-Busch InBev
IJ GLOBAL	FS&A	Latin America Transport Deal of the Year: Santiago Airport PPP Expansion
IJ GLOBAL	FS&A	Latin America Transmission Deal of the Year: TEN Transmission Project
PEI	FS&A	Infrastructure Investor annual awards : Latin America Bank of the year
Global Finance	FS&A	Best Debt Bank Latam
Latin Finance	Corporate Finance	Deals of the Year: Equity Follow-On of the Year: Telefonica Brasil BRL16.1 bn | May 2015
Global Capital	Corporate Finance	Deals of the Year: Equity Follow-On of the Year: Telefonica Brasil BRL16.1 bn | May 2015
LatinFinance	Corporate Finance	Cross-Border M&A Deal of the Year: State Power Investment Corp/Pacific Hydro

(GTB) Global Transaction Banking: includes the business of cash management, trade finance, basic financing and custody.

(FS&A) 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), and asset & based finance.

(GM) 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.

STRATEGY IN 2017

- **Focus on efficiency in capital, improving the capacities of origination and distribution, developing high-value added products and low consumption of capital.**
- **Continue the integration with the commercial and retail banking network and the offer of products, focusing on the least mature economies.**
- **Launch in supply chain finance of a new model based on purchasing orders, as well as a global programme to buy receivables that will enable the offer of hedged products and customers to be increased.**

5 Risk management report

Executive summary

Pillars of the risk function

pages 164 to 164

Through its forward-looking risk management, Grupo Santander ensures it maintains robust control whilst continuing to build its future.

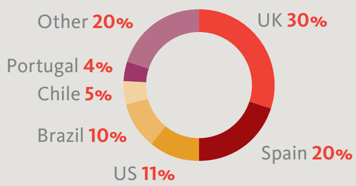
- A risk culture integrated throughout the organisation, comprising attitudes, values, skills and guidelines for action to cope with all risks.
- Business strategy determined by a comprehensive review of risk appetite.
- Forward-looking vision of all risk types.
- Independence of risk function from business functions.
- Best in class for processes and infrastructure.
- Risks managed by units which generate them, using advanced models and tools.

Continuing improvement in credit risk profile

pages 183 to 214

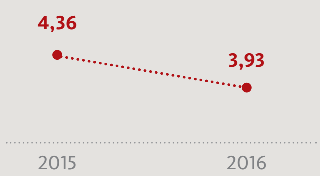
Customer credit risk by country

%



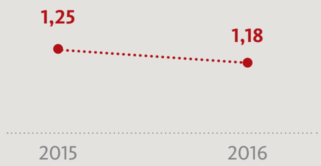
NPL ratio

%



Cost of credit[1]

%



- Over 80% of risk relates to retail banking. Significant geographic and sector diversification.
- Continuing improvement in main credit quality indicators, which at December 2016 stood at:
  - Group NPL ratio falls further to 3.93%, down 43 bp on the previous year, with noteworthy reductions in Spain, Poland, SCF and Brazil.
  - The coverage ratio remains at around 74%.
  - Annual provisions are down to EUR 9,518 million, with the biggest reduction in Spain.
  - Cost of credit drops to 1.18% (-7 bp), in line with the improvement in credit profile.

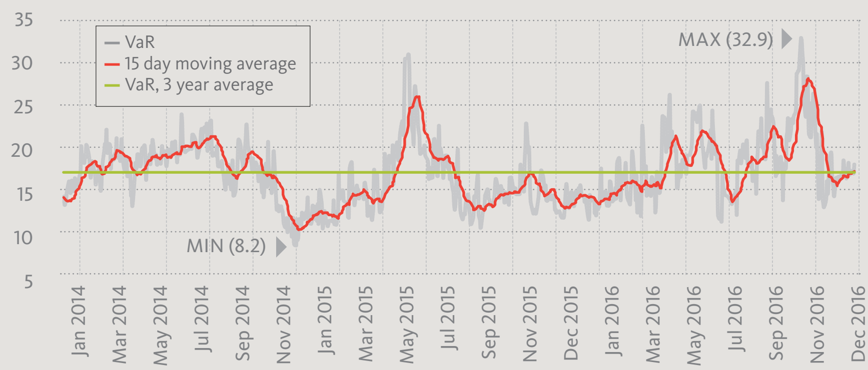
Trading market risk and structural risks

pages 215 to 234

- Due to customer service operations and geographical diversification, average VaR in the SGCB trading business remains at low levels.
- An appropriate balance sheet structure ensures that the impact of changes in interest rates on net interest income and equity value are contained.
- Coverage levels for the core capital ratio stand at around 100% for changes in exchange rates.

VaR 2014-2016: change over time

Million euros. VaR at a 99% confidence interval over a one day horizon.



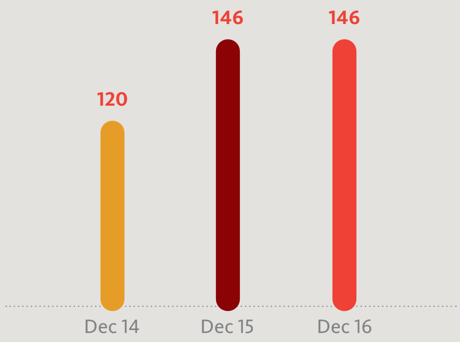
1. Cost of credit = loan-loss provisions twelve months / average lending.

Liquidity risk and funding

pages 235 to 242

Short-term liquidity coverage ratio (LCR)

%



- Santander has a strong liquidity position, based on its structure of autonomous sudsidiaries and retail business model with strong customer deposits.
- As of December 2016, the Group's LCR ratio stood at 146%, comfortably exceeding the regulatory requirement. The liquidity reserve amounted to EUR 265,913 million.
- The loan-to-deposit ratio remains at very comfortable levels (114%).
- Market environment similar to 2015 in terms of costs, although because of the ECB's and BoE's monetary policies, there has been less use of medium and long-term wholesale funding: 23 issuing units in 16 countries and 13 currencies.

Non-financial risks

pages 243 to 262

Operational risk

- Transformation project for the advanced measurement approach to risk.
- Investing in measures against cyber-risk, data security and fraud.
- Roll-out of new risk self-assessment process and controls throughout the organisation.

Compliance and conduct risk

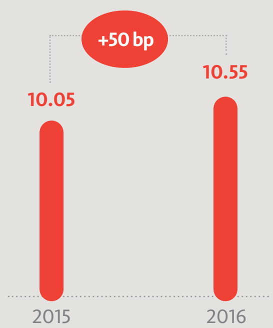
- Increased consumer protection not only driven by regulatory requirements but also reinforced with our internal policies aligned to SPF culture.
- Development of reputational risk model and elements used to mitigate it.
- New challenges associated with digitalisation.

Regulatory capital

pages 266 to 274

Evolution CET1 (%FL)

%



CET1 is at a level of 10.55%, in line with the outlook for organic growth. The Group has a higher ratio than the minimum prudential capital requirement set by the ECB for 2017.

- In the EBA stress test:
  - Santander demonstrated great resilience, due to its retail and commercial banking model and geographic diversification.
  - In the adverse scenario, Santander is the bank wich destroys the least capital among its peers.

This management report provides extensive information on the risks faced by the Group, the manner in which it manages and controls these and the way that they affect the Group's activity and results.

the Group's activity and results. The report also provides details of the actions taken by the entity to minimise the occurrence of such risks and mitigate their severity.

Following best practice in the market, the following navigation map is a guide to the main issues addressed in this risk management report through the various documents the Group publishes: the annual report, the audit report, the annual financial statements and the Prudential Relevance Report (PRR or Pillar III). To further foster transparency, the PRR also includes a glossary of the basic risk terminology used in this section and the PRR itself.

The appendix to the risk management report includes a table indicating the location of the recommendations of the EDTF (Enhanced Disclosure Task Force, fostered by the Financial Stability Board) in the information published by Grupo Santander.

Map of Grupo Santander documents with information on risk management and control

Block	Points	Annual report	Audit report and annual accounts	PRR (Pilar III)
Pillars of the risk function	Pillars of the risk function	Pag. 164	Note 54.a and other notes and related information	Section 3*
Risk control and management model	Risk map	Pag. 166	Note 54.b and other notes and related information	Section 3*
	Risk governance	Pag. 166		
	Lines of defence	Pag. 166		
	Risk committees structure	Pag. 167		
	Structural organisation of the risk function	Pag. 167		
	The Group's relationship with subsidiaries in risk management	Pag. 168		
	Management processes and tools	Pag. 169		
	Risk appetite and structure of limits	Pag. 169		
	Risk Identification Assessment (RIA)	Pag. 172		
	Analysis of scenarios	Pag. 172		
	Recovery and resolution plans and the Special situations management framework	Pag. 173		
	Risk Data Aggregation and Risk Reporting Framework (RDA & RRF)	Pag. 175		
	Risk culture	Pag. 175		
Background and upcoming challenges	Background and upcoming challenges	Pag. 177		Section 1
Credit risk	Introduction to credit risk treatment	Pag. 183	Note 54.c and other notes and related information	Section 3*
	Key figures and change over time	Pag. 184		
	Details of main geographies: United Kingdom, Spain, United States, Brazil	Pag. 192		
	Other credit risk optics (credit risk from activities in financial markets, concentration risk, country risk, sovereign risk and environmental risk)	Pag. 202		
	Credit risk cycle (pre-sale, sale and post-sale)	Pag. 209		
	Study of risk and credit rating process; planning and establishment of limits	Pag. 210		
	Decisions on operations (credit risk mitigation techniques)	Pag. 211		
	Monitoring, measurement and control	Pag. 213		
	Recovery management	Pag. 214		
Trading market risk and structural risks	Activities subject to market risk and types of market risk	Pag. 215	Note 54.d and other notes and related information	Section 5
	Trading market risk	Pag. 217		
	Key figures and change over time	Pag. 217		
	Methodologies	Pag. 226		
	Systems for controlling limits	Pag. 228		
	Structural balance sheet risks	Pag. 229		
	Key figures and change over time	Pag. 229		
	Methodologies	Pag. 232		
	Systems for controlling limits	Pag. 233		
	Pension and actuarial risk	Pag. 233		
Liquidity risk and funding	Liquidity management in Grupo Santander	Pag. 235	Note 54.e and other notes and related information	Section 7.1*
	Funding strategy and evolution of liquidity in 2016	Pag. 236		
	Funding outlook for 2017	Pag. 242		
Operational risk	Definition and objectives	Pag. 243	Note 54.f and other notes and related information	Section 6*
	Operational risk management and control model (management cycle, identification model, risk measurement and assessment, model roll-out, reporting system)	Pag. 243		
	Evolution of the main metrics. Mitigation measures. Business continuity plan	Pag. 248		
	Other aspects of operational risk control and monitoring	Pag. 252		
Compliance and conduct risk	Scope, aim, definitions and objective	Pag. 254	Note 54.g and other notes and related information	Section 7.2*
	Compliance and conduct risk control and oversight	Pag. 255		
	Governance and the organisational model	Pag. 255		
	Regulatory compliance	Pag. 257		
	Product governance and consumer protection	Pag. 259		
	Anti-money laundering and terrorist financing	Pag. 260		
	Reputational risk	Pag. 261		
	Risk assessment model of compliance and risk appetite	Pag. 261		
	Transversal corporate projects	Pag. 261		
Model risk	Model risk	Pag. 263	Note 54.h	Section 3.7.1
Strategic risk	Strategic risk	Pag. 265	Note 54.i	Section 3*
Capital risk	Regulatory framework	Pag. 268	Note 54.j and other notes and related information	Section 2
	Regulatory capital	Pag. 268		
	Economic capital	Pag. 271		
	Capital planning and stress tests	Pag. 273		
Appendix: EDTF Transparency	EDTF recommendations table	Pag. 275		Section 3

* Sections with cross-references to this chapter of the annual risk report

A. Pillars of the risk function

Seeking to achieve excellence in risk management has been a priority for Grupo Santander throughout its 160 year history. In 2016, it continued to evolve to stay one step ahead of economic, social and regulatory changes affecting its activities.

Through its forward-looking risk management, Grupo Santander ensures it maintains robust control whilst continuing to build its future. Risk management is one of the key functions in ensuring that the Group remains a robust, safe and sustainable bank, trusted by its employees, customers, shareholders and society as a whole.

The risk function is based on the following pillars, which are aligned with Grupo Santander's strategy and business model, and incorporate the recommendations of supervisory bodies, regulators and best practices in the market:

1. Business strategy is defined by risk appetite. The board of Banco Santander determines the quantity and type of risk it considers reasonable to assume in the execution of its business strategy and sets targets that are objective, comparable and consistent with its risk appetite for each key activity.

2. All risks have to be managed by the units which generate them, using advanced approaches and tools that are integrated into the businesses. Grupo Santander fosters advanced risk management using models and innovative metrics, and also a control, reporting and escalation framework in order to pinpoint and manage risks from different standpoints.

3. The forward-looking approach for all risk types must be part of the risk identification, assessment and management processes.

4. The independence of the risk function encompasses all risks and provides an appropriate separation between the risk generating units and units responsible for controlling these risks. This means that the risk function has sufficient authority and direct access to the management and governance bodies responsible for establishing and overseeing risk strategy and policies.

5. Risk management has to have the best processes and infrastructures. Grupo Santander aims to set a benchmark model in developing risk management support infrastructure and processes.

6. A risk culture integrated throughout the organisation, composed of a series of attitudes, values, skills and guidelines for action to cope with all risks. Grupo Santander believes that advanced risk management cannot be achieved without a strong and steadfast risk culture, which is found in each and every one of its activities.

B. Risk control and management model – *Advanced Risk Management*

The Group's risk management model establishes a **control environment** which ensures the risk profile is maintained within the levels set in the risk appetite and other limits.

The **main elements** that ensure effective control are:

1. Robust governance, with a clear committee structure that separates decision making, on one side, from risk control, on the other, all encompassed and developed within a solid risk culture.

2. A set of key, inter-related processes in the planning of the Group's strategy (budget processes, risk appetite, regular assessment of liquidity and capital adequacy, and recovery and resolution plans).

3. Aggregated supervision and consolidation of all risks.

4. Regulatory and supervisory requirements are incorporated into day-to-day risk management.

5. Independent assessment by internal audit.

6. Decision making based on appropriate management of information and technological infrastructure.

To ensure progress towards advanced risk management, the Group launched an Advanced Risk Management (ARM) programme in 2014. This provides the basis for the best model for comprehensive risk management in the industry. This programme was completed in 2016. The advanced risk management model is now a reality in Grupo Santander.

The advanced risk management model will enable Grupo Santander to do more business, and do it better, within a robust control framework, enhancing management capacity, developing talent and providing greater autonomy for Group units.

Continuing this work, in 2016 we continued to evolve towards a more consistent and granular version of the risk appetite.

The independence of the risks function and the control environment have been enhanced through the risks governance model, ensuring separation of control and risk decisions at all levels.

Progress has also been made in all management models to offset all of the risks faced by the bank in its day-to-day operations:

- Significant boost to operational risk management. The foundations of the operational risk framework have been implemented in all countries.

- Progress in management of model risk. The unit set up to control model risk has been beefed up. This unit is independent of the model-development function and users of the model, ensuring a robust and efficient double layer of control.

- Improved credit risk management. Strategic commercial plans (SCPs) have been drawn up for the main lending portfolios, providing an important tool for day-to-day management of credit risk. Progress has also been made with the management of the end-to-end credit risk lifecycle, in line with business models.

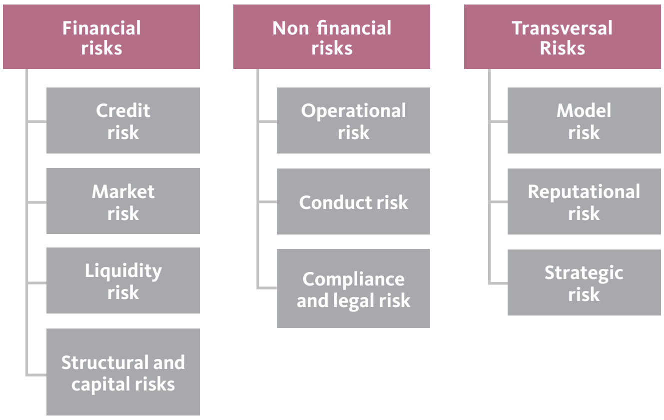
- Optimisation of the Group's capacity to anticipate and identify risks, by improving scenario analysis and stress testing in all countries.

The definition of a new special situations management framework is also being developed jointly with the Finance Division, to enhance the measures at the Bank's disposal to respond to serious and unexpected situations of whatever type.

B.1. Risk map

Identifying and evaluating all risks is a corner stone for controlling and managing risks. The risks map covers the main risk categories in which Grupo Santander has its most significant current and/or potential exposures, facilitating their identification.

The first level includes the following risks:



Financial risks

- **Credit risk:** risk of losses from non-compliance with contractual obligations agreed in financial transactions.
- **Market risk:** resulting from the possibility of changes in market factors affecting the value of trading book positions.
- **Liquidity risk:** risk of non-compliance with payment obligations in time or at an excessive cost.
- **Structural and capital risks:** risk occasioned in the management of the various balance sheet items, including those concerning sufficient equity levels and those resulting from insurance and pension activities.

Non-financial risks

- **Operational risk:** risk of losses resulting from inadequate or failed processes, people and internal systems, or from external events.
- **Conduct risk:** risk caused by inadequate practices in the Bank's relationships with its customers, the treatment and products offered and their adequacy for each specific customer.
- **Compliance and legal risk:** risk owing to the breach of the legal framework, norms or regulators' and supervisors' requirements.

Transversal risks

- **Model risk:** consists of losses arising from decisions mainly based on results of models, due to errors in the design, application or usage of such models.
- **Reputational risk:** risk of damages to the way the bank is perceived by public opinion, its customers, investors or any other interested party.
- **Strategic risk:** risk associated with strategic decisions and with changes in the entity's general conditions, which have an important impact on its business model in both the medium and long term.

All risks should be referenced to the basic risk categories established in the Risk Map, in order to organise their management, control and related information.

B.2. Risk governance

The governance of the risk function should safeguard adequate and efficient decision making and effective risk control, and ensure that they are managed in accordance with the risk appetite defined by the Group's senior management and its units, as applicable.

For this purpose, the following principles are established:

- Segregation between risk decisions and control.
- Stepping up the responsibility of risk generating functions in the decision making process.
- Ensuring that all risks decisions have a formal approval process.
- Ensuring an aggregate overview of all risk types measured against the Group´s aggregate risk appetite.
- Bolstering risk control committees.
- Maintaining a simple committee structure.

» B.2.1. Lines of defence

Banco Santander's management and control model is based on three lines of defence.

The business functions or activities that create or generate exposure to a risk are the first line of defence. The acceptance or generation of risk in the first line of defence should fit with the risk appetite and limits defined. In order to tend to this function, the first line of defence must have the resources to identify, measure, manage and report the risks assumed.

The second line of defence consists of the risk control and oversight function and the compliance function. This line vouches for effective control of risks and ensures they are managed in accordance with the defined risk appetite.

Internal audit is the third line of defence. As the last layer of control in the Group, it regularly assesses policies, methods and procedures to ensure they are adequate and are being implemented effectively.

The risk control function, the compliance function and the internal audit function are sufficiently separated and independent from each other and from the other functions that they control or supervise for the performance of their duties, and they have access to the board of directors and/or its committees through the heads thereof.

» B.2.2. Risk committees structure

Ultimately, the board of directors is responsible for risk control and management, and, in particular, for setting the risk appetite for the Group, and it can delegate its powers to committees. The board uses the Risk Supervision, Regulation and Compliance Committee (Board Risk Commitee, BRC), as an independent risk control and oversight committee. The Executive Committee of the Group also pays special attention to managing the Group's risks.

The following bodies form the highest level of risk governance:

Bodies for independent control

Board Risk Committee (BRC):
The purpose of this committee is to assist the board in the sphere of risk supervision and control, define the Group's risk policies, relations with the supervisory authorities and matters of regulation and compliance, sustainability and corporate governance.

It is made up of external non-executive directors (a majority of whom are independent) and is chaired by an independent director.

The functions of the Board Risk Committee are:

- Support and advise the board in defining and assessing the risk policies that affect the Group and in determining the risk appetite and risk strategy.

- Provide assistance to the board for overseeing implementation of the risk strategy and its alignment with strategic commercial plans.

- Systematically review the exposures with the main customers, economic sectors, geographic areas and types of risk.

- Understand and assess management tools, ideas for improvement, progress with projects 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 as regards supervisors and regulators in the various countries where the Group operates.

- Oversee compliance with the General Code of Conduct, manuals and procedures for money laundering and combating terrorism financing, and, in general, the rules of governance and the Company's compliance programme, and make proposals as necessary for improvements. 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 proposed regulations and regulatory developments that result from their implementation and the possible consequences for the Group.

Risk Control Committee (RCC):
This collegiate body is responsible for the effective control of risks, ensuring they are managed in accordance with the level of risk appetite 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 strategic risks, and gauging their impact on the Group's risk profile.

This committee is chaired by the Group Chief Risk Officer (GCRO) and is made up of members of senior management. The risk function, which chairs the committee, and the compliance, financial accounting and management control and financial management functions are all represented. The CROs of local entities take part in committee meetings on a regular basis to report on the risk profile of the entities and other tasks.

The Risk Control Committee reports to the Board Risk Committee and assists it in its function of supporting the board.

Decision making bodies

Executive Risk Committee (ERC):
This collegiate body is responsible for risk management, due to the powers assigned to it by the board of directors, and, within its field of action and decision making, it addresses all matters relating to risks.

It takes part in risk decisions at the highest level, ensuring that risk decisions 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.

This committee is chaired by an executive vice chairman of the board, and includes the chief executive officer, executive directors, and other directors of the entity. The risk function, financial function and compliance function, inter alia, are represented. The GCRO has a right to veto the decisions taken by this committee.

» B.2.3. Structural organisation of the risk function

The **Group Chief Risk Officer (GCRO)** is responsible for the risk function and reports to the Bank's executive vice chairman, who is a member of the board of directors and chairman of the executive risk committee.

The GCRO advises and challenges the executive line and also reports independently in the Risk, Regulatory and Compliance Committee and to the board.

In 2016, the GCRO took a leading role in driving forward the consolidation of advanced risk management, based on a holistic and forward-looking approach to risks, intensive use of models, and a robust control environment and risk culture in the Group, whilst ensuring compliance with the requirements of regulators and supervisors.

The **risk management and control model is structured** on the following pillars:

- Coordination of the relationship between the local units and the Corporation, assessing the effective deployment of the risk management and control model in each unit, and ensuring these are aligned to achieve strategic risk targets.
- Enterprise Risk Management (ERM) provides consolidated oversight of all risks to senior management and the Group's governance bodies, and the development of the risk appetite and the risk identification and assessment exercise.
- Control of financial, non-financial and transversal risks (see risk map in section B.1 Risk map), verifying that risk management and exposure are as set by senior management, by risk type. The control environment for non-financial risks has been enhanced, with measures implemented to beef up control of operational risk, including strengthening of the cyber-risk function, which is taking on increasing importance against the backdrop of digital transformation.
- Transversal development of internal regulations, methodologies, scenario analyses, stress tests and data infrastructure, and robust risk governance.

» B.2.4. The Group's relationship with subsidiaries in risk management

Regarding the alignment of units 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 relations between the subsidiaries and the Group, including the role played by the latter in taking important decisions by validating them.

Over and above these 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, so creating a recognisable management model for common risks in Grupo Santander.

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 act as centralisers and conveyors of these practices.

Furthermore, the Group-Subsidiary Governance Model and good governance practices provide for regular interaction and functional reporting by each local CRO to the GCRO. They also stipulate that the Group must take part in the process of appointing, setting targets for, and assessment and remuneration of local CROs, in order to ensure risks are adequately managed in the Group.

Regarding the structure of committees

The Group-Subsidiaries 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 best corporate governance practices, consistently with those already in place in the Group.

The governance bodies of subsidiary entities are structured in accordance with local regulatory and legal requirements and the dimension and complexity of each subsidiary, being consistent with those of the parent company, as established in the internal governance framework, thereby facilitating communication, reporting and effective control.

The administration bodies of the subsidiaries, in accordance with the internal governance framework established in the Group, define their own models for risk powers (quantitative and qualitative). These local models for assigning powers must follow the principles contained in the reference models and frameworks developed at the corporate level.

Given its capacity for comprehensive (enterprise wide) and aggregated oversight of all risks, the Corporation exercises a validation and questioning role with regard to the operations and management policies of the subsidiaries, insofar as they affect the Group's risk profile.

B.3. Management processes and tools

Risk appetite

- **Improvement of metrics** with greater granularity and inclusion of additional metrics.
- New **corporate appetite framework** reinforcing integration into management.

Risk identification and Assessment (RIA)

- More **robust** and **systematic risk profile assessment.**
- Approach based on:
  - Risk performance.
  - Assessment of the control environment.
  - Identification of top risks.

Scenario analysis

- Make strategic planning more robust by **challenging** the **model.**
- Draw up **improvement plans** for **processes and procedures** backed by **self-assessment exercises**.

Recovery and resolution plans

- **Adaptation to new international guidelines.**
- New **Special situations management framework.**

Risk Data Aggregation & Risk Reporting Framework (RDA/RRF)

- **Compliance** with the **principles** set down in **BCBS* guidelines**.
- **Structural and operational improvements** to enhance reporting of all risks at all level.

* Basel Committee on Banking Supervision.

» B.3.1. 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. Severe scenarios are taken into account that could have a negative impact on the levels of capital, liquidity, profitability and/or the share price.

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 of the Group as well as for each of the main business units in accordance with a corporate methodology adapted to the circumstances of each unit/market. At the local level, the boards of the subsidiaries are responsible for approving the respective risk appetite proposals once they have been validated by the Group.

The whole organisation shares the same corporate risk appetite framework. This sets out common requirements for processes, metrics, governance bodies, controls and corporate standards for integration into management, cascading down in an effective and traceable way to all management policies and limits.

Work continued in 2016 to extend the scope of the metrics, adding new metrics for strategic risk, operational risk, compliance, product governance, consumer protection and the prevention of money laundering. Metrics were also incorporated to enhance alignment between the declared risk appetite and crisis management plans.

Management systems were also bolstered in 2016 with a specific development of control risk appetite limits, enabling early identification of potential excesses and ensuring robust escalation of these.

Banking business model and fundamentals of the risk appetite
The definition and establishment of the risk appetite in Grupo Santander is consistent with its risk culture and banking 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 and commercial banking and with an internationally diversified presence and with important market shares, and a wholesale banking business model that gives priority to relations with customers in the Group's main markets.

- A stable and recurrent earnings and shareholder remuneration policy, underpinned by a sound base of capital and liquidity and an effective diversification strategy in terms of sources of funding and maturities.

- An organisational structure based on subsidiaries that are autonomous 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 jeopardises the Group's solvency.

- An independent risk function with very active involvement of senior management that guarantees a strong risk culture focused on protection and ensuring an adequate return on capital.
- A management model that ensures a global and inter-related view of all risks, through an environment of control and robust monitoring of risks with responsibilities with a global scope: all risks, all businesses, all countries.
- The Group's business model is focused on products where the Group has expertise and where it can exercise active management through its systems, processes and resources.
- Development of activity on the basis of a conduct model that protects the interests of customers and shareholders.
- Adequate and sufficient availability of staff, systems and tools that guarantee a risk profile compatible with the established risk appetite is maintained, both at the global and local levels.
- A remuneration policy that has the necessary incentives to ensure that the individual interests of employees and executives are aligned with the corporate risk appetite framework, and that these are consistent with the evolution of the Bank's long-term performance.

Corporate risk appetite principles

The following principles govern Grupo Santander's risk appetite in all its units:

- **Responsibility of the board and of senior management.** The board is the most senior body responsible for setting the risk appetite and supporting regulations, as well as supervising 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 risk profile and that envisaged in business and strategic plans, and its consistency with 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 probable circumstances as well as stress scenarios.
- **Link with strategic and business plans and integration in management** (three-year plan, annual budget, ICAAP, ILAAP, and crisis and 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 focus:
  - 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 the 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 the 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 adapting to the best practices and regulatory requirements.** 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 set, 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 metrics (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 prepared 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 adequacy of the risk profile with the risk appetite authorised.

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 provoke 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 sections D.1.5.2. Planning (Strategic Commercial Plan), D.2.2.3. and D.2.3.3. Systems of controlling limits in this report, have a direct and traceable relation with the principles and limits defined in the risk appetite.

In this way, changes in the risk appetite reflect in the limits and controls used in Santander's risk management and each of the business and risk areas is responsible for 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.

Pillars of the risk appetite

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 broad areas that define the positioning that Santander's senior management wants 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 admit.
- Non-financial and transversal risks.

Risk appetite pillars and main metrics

Volatility of results	Solvency	Liquidity	Concentration	Complementary aspects

• Maximum loss the Group is prepared to accept under a scenario of acute stress	• Minimum capital position the Group is prepared to accept under a scenario of acute stress
	• Maximum leverage the Group is prepared to accept under a scenario of acute stress
		• Minimum structural liquidity position
		• Minimum liquidity horizon position that the Group is prepared to accept under a scenario of acute stress
		• Minimum liquidity coverage position
			• Concentration by individual customer
			• Concentration in non-investment grade counterparties
			• Concentration in large exposures
				• Qualitative non-financial risk indicators:
				  • Fraud
				  • Technology
				  • Security and cyber-risk
				  • Litigation
				  • Other...
				• Maximum operational risk losses
				• Maximum risk profile

Volatility of results

The objective 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.

Stress tests included at this level measure the maximum level of the decrease in profits under adverse conditions, for the main types of risk to which the Bank is exposed, with a feasible probability of occurring, by risk type (so that they can be aggregated).

Solvency

The object of this axis is to ensure that risk appetite adequately considers the maintenance and upkeep of the entity's equity, keeping capital higher than the levels marked by regulatory requirements and market demand.

Its purpose is to determine the minimum level of capital which the entity considers it needs to maintain to cope with potential losses under both normal and stressed conditions and arising from its activity and from its business and strategic plans.

This capital focus included in the risk appetite framework 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 chapter D.8. Capital risk and the Prudential Relevance Report (PRR), Pillar III).

Liquidity position

Grupo Santander has developed a funding model based on autonomous subsidiaries that are responsible for covering their own liquidity needs.

On this basis, liquidity management is conducted by each subsidiary within a corporate framework of management that develops its basic principles (decentralisation, equilibrium in the medium and long term of sources-applications, high weight of customer deposits, diversification of wholesale sources, reduced recourse to short-term funds, sufficient reserve of liquidity) and revolves around three main pillars (governance model, balance sheet analysis and measurement of liquidity risk, with management adapted to business needs). Further information on the corporate management framework and its principles and pillars is set out in section D.3. Liquidity risk and funding.

Santander's liquidity risk appetite establishes demanding objectives in terms of positions and time frames for 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 retail and commercial banking focus with a high degree of international diversification.

This level includes 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

The objective is to limit exposure to the non-financial and transversal risks in the corporate risk map.

This involves qualitative and quantitative metrics that help pinpoint exposure to non-financial risks. These include specific indicators for fraud, technology risk, security and cyber risk, prevention of money laundering, regulatory compliance, product governance and customer protection.

» B.3.2. Risk identification and assessment (RIA)

Grupo Santander is continuously evolving its identification and assessment of different types of risks. It involves different lines of defence in the execution of these to foster advanced and proactive risk management. It also sets itself management standards that not only meet regulatory requirements but also reflect best practice in the market. The RIA is a mechanism for disseminating the risk culture and involving the business lines of the units in its management.

In addition to **identifying and assessing the Group's risk profile** by risk factor and unit, RIA analyses the evolution of risks and identifies areas for improvement in each of the blocks of which it is composed.

- **Risk performance,** enabling understanding of residual risk by risk factor through a set of metrics calibrated using international standards.

- **Assessment of the control environment,** measuring the implementation of a target management model, pursuant to advanced standards.

- **Forward-looking analysis of the unit,** based on stress metrics and/or identification and/or assessment of the main threats to the strategic plan **(Top Risks)**, putting in place and monitoring specific action plans to mitigate potential impacts.

The RIA initiative is being increasingly integrated into risk management, developing each of the methodological blocks independently, and increasing their application to the Group's risks, pursuant to the risk map.

Significant progress has been made in the uses of this exercise: the risk profile is being used as a strategic metric in the local and Group risk appetite; it has been included in the generation of strategic plans and analysis of potential threats; analysis of the internal vision of the risk profile and contrast with the perception of external agents; risks identified in the RIA are being used as inputs in the generation of idiosyncratic scenarios in capital, liquidity, and recovery and resolution plans; it includes the diversification effect of the Group's business model, and internal audit planning now considers exploitation of the risk control environment.

The RIA has become a major risk management tool. Through the implementation of a demanding control environment and monitoring of the weaknesses detected, it enables Grupo Santander to undertake more and better business in the markets in which it operates, without putting at risk its income statement or its strategic objectives, whilst reducing the volatility of its earnings.

The RIA methodology is being consolidated, improved and simplified as part of the Group's continuous improvement and review process. It has been extended to all of the Group's risks and units, and is being more closely integrated into day-to-day risk management. One of its priorities is to order and manage the various risk assessments in the Group in general, and the Risk division in particular, establishing a benchmark assessment model that ensures the robustness and consistency of the assessments carried out, whilst governing the various exercises carried out in different management areas.

» B.3.3. Analysis of scenarios

Banco Santander conducts advanced management of risks by analysing the impact that different scenarios could provoke on the environment in which the Bank operates. These scenarios are expressed both in terms of macroeconomic variables as well as other variables that affect management.

Scenario analysis is a very useful tool for management at all levels. It enables the Bank's resistance to stressed environments or scenarios to be assessed, and puts into effect measures to reduce the Bank's risk profile in these scenarios. The objectives is to maximise the stability of the income statement and capital and liquidity levels.

The robustness and consistency of scenario analysis exercises are based on the following pillars:

- Developing and integrating mathematical models that estimate the future evolution of metrics (for example, credit losses), based on both historic information (internal to the Bank and external from the market), as well as simulation models.

- Including the expert judgement and know-how of portfolios, questioning and back testing the result of the models.

- The backtesting of the results of the models against the observed data, ensuring that the results are adequate.

- The governance of the whole process, covering the models, scenarios, assumptions and rationale for the results, and their impact on management.

The application of these pillars of the EBA (European Banking Authority) stress test executed and reported in 2016 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 (see table 1 section C. Background and upcoming challenges).

Uses of analysis of scenarios

- **Regulatory uses:** scenario stress tests are performed using the guidelines set by the European regulator or each one of the national supervisors who oversee the Bank's activity.

- **Internal exercises** of self-assessment of capital (ICAAP) or liquidity (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 does not want to exceed. These exercises are related to those for capital and liquidity, although they have different frequencies and present different granularity levels. The Bank continues to work to improve the use of analysis of scenarios in risk appetite and ensure an adequate relation of these metrics with those used in daily risk management. For more detail see sections B.3.1. Risk appetite and structure of limits and D.3. Liquidity risk and funding.

- **Daily risk management.** Scenario analysis is used in budgeting processes and strategic planning, in the creation of commercial policies for risk admission, in the global analysis of risks by senior management and in specific analysis of the profile of activities or portfolios. Further details are provided in the sections on credit risk (section D.1.5.2. Planning (Strategic Commercial Plan), market risk (D.2.2.1.6. and D.2.2.2.3. Analysis of scenarios) and liquidity risk (D.3.1. Liquidity management in Grupo Santander).

In order to improve management through metrics and advanced approaches, the scenario analysis project is structured around five axes:

- **Tool for analysing scenarios**: installation of an advanced tool for estimating losses with greater soundness and computerisation of information handling, with the capacity to aggregate various types of risk and with an environment of multi user execution.

- **Governance:** review of the governance framework for scenario analysis exercises in order to adjust to their growing importance, greater regulatory pressure and best market practices.

- **Models:** preparing plans to develop statistical stress models that have sufficient precision and granularity to meet requirements, not only of current regulation and supervision, but also to improve predictive risk capacity in accordance with advanced management approaches.

- **Processes and procedures:** continuous self-assessment exercises and improvement plans to evolve processes in the context of advanced scenario analysis management.

- **Integration into management:** fostering and improving the use of scenario analysis in the various scopes of risk management.

» B.3.4. Recovery and resolution plans and the Special situations management framework

In 2016, the Bank prepared the seventh version of its corporate recovery plan, the most important part of which envisages the measures available to emerge on its own from a very severe crisis. This plan has been prepared in accordance with applicable European Union[1] regulations. The plan also considers the non-binding recommendations made in this area by international bodies such as the Financial Stability Board (FSB[2]).

As with the previous versions from 2010 to 2015, the Group presented the plan to the relevant authorities (for the second time, to the European Central Bank (ECB) in September, unlike previous years when it was only submitted to the Bank of Spain) for it to be assessed in the fourth quarter of 2016.

The plan encompasses the corporate plan (covering Banco Santander) and the individual plans for the main local units (UK, Brazil, Mexico, US, Germany, Argentina, Chile, Poland and Portugal), thereby meeting the commitment made by the Bank with the authorities in 2010. It is important to note the cases of the countries referred to above belonging to the European Union, where, apart from the fact they mandatorily form part of the corporate plan, they also need to be completely developed in accordance with regulatory requirements arising from the transposition of Directive 2014/59/EU (European Union Crisis Management Directive) into local legislation.

Two of the most important objectives in the plan are to verify: firstly, the feasibility, effectiveness and credibility of the recovery measures identified in the plan; and, secondly, the adequacy of the specific

1. Directive 2014/59/EU ("Directive establishing a framework for the recovery and resolution of credit institutions and investment firms");prevailing European Banking Authority regulations dealing with recovery plans (EBA/RTS/2014/11; EBA/GL/2014/06; EBA/GL/2015/02); recommendations from the European Banking Authority to the Commission in relation to key business lines and critical functions (EBA/op/2015/05); European Banking Authority regulations pending approval (EBA/CP/2015/01 on the ITS for procedures, forms and templates for resolution plans); European Banking Authority regulations not directly related to recovery but with significant implications in this field (EBA/GL/2015/03 on triggers for early intervention measures); and local Spanish regulations: Act 11/2015, on credit entities and investment service firms recovery and resolution, and Royal Decree 1012/2015 implementing this Act.

2. FSB: Key attributes of effective resolution regimes for financial institutions (15 October 2014, updating the initial publication of October 2011), "Guidance on Identification of Critical Functions and Critical Shared Services" (15 July 2013) and "Guidance on recovery triggers and stress scenarios" (15 July 2013).

indicators and limits defined for triggering the governance process established in the plan for stress situations.

To this end, the corporate plan has defined different macroeconomic and financial crisis scenarios that would represent idiosyncratic or systemically important events for the entity, as established in article 5.6 of Directive 2014/59/EU. These scenarios refer to crisis situations that could impact the Group's viability, as set out in applicable regulations. The plan has been designed under the premise that there would be no extraordinary public support in the event of it being activated, as established in article 5.3 of Directive 2014/59/EU.

It is also important to state that the plan should not be interpreted as being independent from other structural mechanisms in place to measure, manage and oversee the risk undertaken by the Group.

The Group's recovery plan is integrated, among others, with the risk appetite framework, risk appetite statement, risk identification and evaluation process, business continuity management system and internal capital and liquidity adequacy assessments.

Works continued in 2016 to adapt the structure and content of the plan to new international guidance. This involved including a number of improvements: (i) in the governance section (mainly, a more detailed description of the Special Situations Management Framework - explained in greater detail below – and on the structure of recovery indicators); (ii) in the scenarios chapter which now includes a crisis situation that leads to the breach of the liquidity indicators and a multi-local systemic crisis affecting two of the units most relevant to the Group; and (iii) finally, greater granularity and detail in the sections on strategic analysis and measures.

The Group's senior management is fully involved in preparing and regularly monitoring the content of the plans, through specific committees of a technical nature, as well as monitoring at the institutional level, guaranteeing that the content and structure of the documents are adapted to local and international regulations in crisis management, which have been in continuous development for the last years.

The board of directors of Banco Santander S.A. is responsible for approving the corporate plan, once the plan's content and data have been previously submitted and discussed in the bank's main management and control committees (Board Risk Committee, Global ALCO Committee and Capital Committee). The individual plans are approved by the local bodies and always in coordination with the Group, as these plans must be part of the corporate plan.

The main conclusions that can be drawn from the 2016 corporate plan are:

- There are no material inter-dependencies among the Group's countries.
- The available measures provide ample recovery capacity in all of the scenarios considered in the plan. The Group's geographic diversification model is a plus from a recovery perspective.
- Every subsidiary has sufficient recovery capacity to emerge from a recovery situation using its own means. This enhances the resilience of the Group's model, based on autonomous subsidiaries, in terms of capital and liquidity.
- None of the Bank's subsidiaries, should they fail, are considered of sufficient relevance to breach the most severe levels established for the recovery indicators that could trigger the activation of the corporate recovery plan.

From this, we can conclude that the Group's model of geographic diversification - based on a model of autonomous subsidiaries, in terms of liquidity and capital - remains resilient from a recovery perspective. The Group plans to continue to evolve its plans in line with recommendations from supervisors and best practices in the industry in relation to recovery plans in 2017.

In relation to the governance of crisis situations set out in the Group's recovery plans, the Group formally approved and implemented its **Special Situations Management Framework** in 2016 - in both the corporation and the Group's main countries, which together with its implementing documents:

i. sets out the main common principles for the identification, escalation and management of events that could pose a serious risk to Santander or any of its entities, or that could affect their robustness, reputation, activity, liquidity, solvency or present or future viability;

ii. defines basic roles and responsibilities in this area and identifies the planning elements required and the key processes; and

iii. sets down essential governance elements, seeking to ensure coordinated action among all Group entities and, where necessary, the participation of the Corporation, as the parent company of Grupo Santander.

This framework has a holistic nature and applies to crisis events and situations of any kind (e.g. financial and non-financial, systemic or idiosyncratic, and slowly evolving or rapidly emerging, etc.) that might give rise to exceptional situations other than what might be expected or that should arise in the normal course of business, and that might compromise the development of the activity of the entity or Group, or lead to a serious deterioration in its financial situation, as it involves a serious deviation from the defined risk appetite and limits.

Regarding resolution plans, the authorities which take part in the Crisis Management Group (CMG) have adopted a common approach on the strategy to follow for the Group's resolution plan that, given the legal and business structure through which Santander operates, corresponds to the so-called multiple point of entry (MPE); they have signed the cooperation agreement on resolution (COAG); and have developed the first resolution plans. In particular, the 2016 corporate resolution plan was analysed in a meeting of the CMG held on 7 November 2016.

As an exception to the above, resolution plans for the USA are prepared by the entities themselves. The Group filed the third version of its local resolution plans in December 2015. However the FRB (Federal Reserve Board) and the FDIC (Federal Deposit Insurance Corporation) have stated that plans for 2016 should not be filed, as they are still in the process of commenting on earlier plans, and are preparing guidance for plans to be filed in December 2017.

The Group continues to cooperate with the competent authorities in the preparation of resolution plans, providing all the information that the authorities might require. Meanwhile, the Group has also continued to develop projects to improve its resolution capacity. These include measures to guarantee operational continuity in resolution situations. In this respect:

i) In November 2016, Banco Santander S.A. became a signatory to the ISDA protocol for the settlement of derivatives in resolution situations;

ii) the market infrastructures to which the Group is connected have been analysed to assess their criticality and the continuity of such services in the event of resolution;

iii) operational continuity clauses have been strenghtened in agreements with internal suppliers; and

iv) further progress has been made in automating the information requested by the supervisory authority.

» B.3.5. Risk Data Aggregation & Risk Reporting Framework (RDA/RRF)

In recent years, the 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 allows the Group's senior management to assess risk and act accordingly.

Against this background, Santander believes that regulatory requirements are aligned with the strategic risk transformation plan, and hence at the current date the Group complies with the standards set forth in the BCBS 239 regulation. Once the objectives of the Risk Data Aggregation (RDA) project had been achieved at the end of 2015, in 2016 work continued to consolidate the comprehensive data and information management model, and its transposition to the countries where the Group operates.

Risks reports contain an appropriate balance between data, analysis and qualitative comments, include forward-looking measures, risk appetite data, limits and emerging risks, and are distributed in due time and form to senior management.

The Group applies a common reporting taxonomy which covers all the significant risk areas within the organisation, and which is in keeping with the Group's size, risk profile and activity.

B.4. Risk culture - *Risk Pro*

Our internal culture includes a Santander way of managing risks, a Santander risk culture, which we call *risk pro*, which is one of our main competitive advantages in the market.

Grupo Santander's robust risk culture is one of the key reasons why it has been able to cope with changes in economic cycles, customers' new demands and increased competition, and why it is considered to be an entity that earns the trust of its employees, customers, shareholders and society.

Against a background of constant changes, with new types of risks and more demanding requirements from regulators, Grupo Santander wishes to maintain an excellent level of risk management in order to achieve sustainable growth.

Excellence in risk management is thus one of the strategic priorities that have most shaped the Group's development. This involves promoting a robust risk culture throughout the organisation, which is understood and applied by all Grupo Santander employees.

This risk culture is defined through five principles which must necessarily form part of all the Group's employees' day-to-day activities:

Responsibility, because all units and employees (no matter what function they perform) should know about and understand the risks incurred in their daily activities, which they are responsible for identifying, assessing, managing and reporting.

Resilience, which is a combination of prudence and flexibility. All employees have to be prudent and steer clear of any risks they are not familiar with or which are in excess of the established risk appetite. They must also be flexible, because risk management has to quickly adapt to new environments and unexpected scenarios.

Challenge, because ongoing debate is encouraged throughout the Group. We always ask ourselves how we can manage risks in a proactive, positive and open way, giving us an overview that allows us to anticipate future challenges.

Simplicity, because universal risk management needs clear processes and decisions which are documented and easily understood by employees and customers.

Customer focus. Because all risks actions are focused on the customer, on his or her long term interests. Our aim at Grupo Santander is to be the best retail and commercial bank that earns the lasting loyalty of our people, customers, shareholders and communities. We can achieve this goal by making a proactive contribution to help our customers prosper with excellent risk management.

The risk pro risk culture is being reinforced in all Grupo Santander units through four drivers:

- **The employee lifecycle.** This involves generating awareness of the importance of risk management and personal responsibility for it in each new employee, starting from the selection and recruitment stage, and reinforcing this continually.

  A risk component is therefore included in the training plans for all employees. In addition, the Risk Pro Banking School, together with the other local risk schools, helps to spread the risk culture, developing the best talent and training the Group's professionals. In 2016, 55,497 hours of training were given, benefiting 20,690 Group employees.

  As a result, Grupo Santander's 2016 global commitment survey found that 95% of employees felt directly responsible for managing their risks, irrespective of their position in the Bank.

- **Communication.** The main channels of communication are used to foster the principles of the risk culture among all employees, providing all the information needed for advanced risk management in a clear and comprehensible format. These channels are also used to spread behaviours, actions and decisions that exemplify the risk culture.

- **Risk assessment and measurement.** Banco Santander carries out systematic and consistent assessment of the Group's risk culture to identify potential improvements and implement action plans. It has put in place specific indicators to measure the penetration and spread of the risk culture in the Group. It also carries out surveys to measure the perceptions of employees in relation to their knowledge of, and responsibilities for, risk management.

- **Advanced Risk Management (ARM) programme.** The final phase of the ARM programme was reached in 2016. This has developed an advanced risk management model in all units, based on a strong risk culture. For Grupo Santander, advanced risk management is a priority in its long-term objective of continuing to be a solid and sustainable bank.

All Group units and all employees carry out their activities under the umbrella of our risk culture - *risk pro* - with a common purpose: to build the future through the forward-looking management of all risks, and to protect the present through a robust control environment.

C. Background and upcoming challenges

Growth in the advanced economies was weak in 2016 and slower than in the previous year. This slowdown affected the USA, the European Union and Japan, and was concentrated in the first half of the year, with a degree of recovery in the second half. The USA is in an advanced stage of the cycle. Expectations for 2017 are positive, buoyed by expectations of fiscal expansion that is likely to lead to further increases in interest rates. The UK is facing uncertainty stemming from the impact of its decision to leave the European Union. The eurozone is growing slowly, but proving resistant to episodes of instability, with core inflation of less than 1%. Monetary policy remains very expansionary, with no outlook for higher interest rates.

Growth in emerging economies as a whole was similar to 2015, although the picture at the end of the year was more positive, as in the advanced economies. Progress continued in correcting imbalances, improving the outlook for 2017. However, performance differed markedly across different areas.

Banking activity continues to be affected by historically low interest rates, the stimulus measures implemented by central banks in most developed markets, uncertainty about the solvency of the financial sector, increased competition in some markets (mainly on the asset side), and an ever more demanding regulatory environment.

Against this backdrop, Banco Santander has maintained its medium-low risk profile. The Bank's robust risk culture is reflected in all of its lending-quality metrics. Its NPL ratio stands at 3.93% (-43 bp compared to December 2015), its cost of credit at 1.18% (-7 bp compared to December 2015) and its coverage ratio remains stable at 74%.

There was a lot of activity on the **regulatory front** in 2016. The year's highlights include:

- The Basel Committee has continued its review of the frameworks for calculating capital requirements for credit, market and operational risk. In April, it presented a final proposal for the review of regulatory treatment of the interest rate for the held-to-maturity portfolio.

- The European Banking Authority (EBA) has continued to issue standards¬ and guidance developing aspects of European capital regulations (CRR/CRD IV), helping to ensure harmonised implementation of minimum capital requirements across the European Union. In July, the EBA also published the results of its stress tests of the 51 leading banks in the European Union (see table 1. Stress tests).

- Various modifications and interpretations by domestic and international bodies of the definition and treatment of the non-performing loans and the forbearance portfolio.

Top Risks

As indicated in section B.3.2 Risk Identification and Assessment, as part of its traditional forward-looking risk management, the Group uses this regular exercise to identify, assess and monitor potential future risk events.

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:

Macroeconomic and political risks:
The **European economy** is finally on the road to recovery, although it is expected to remain weak over the coming years. This backdrop of low growth is characterised by weak demand and influenced by the uncertain results of elections in various eurozone countries, and the complicated negotiations between the UK and the EU. All of these factors are conducive to a continuation of low interest rates for a prolonged period.

Confidence in the **Brazilian economy** is improving, as political uncertainty diminishes and a general perception that growth will be positive in 2017 takes hold, underpinned by a continuous improvement in the latest confidence indexes for companies and consumers.

But some structural threats to the economy persist, such as the structural deficit and the increase in international financial volatility following the results of the US elections: these have increased risk aversion (flight to quality) and could affect the outlook for growth in Brazil.

Following the referendum result in June to leave the EU, the **UK economy** could be affected by the prolonged and complex negotiations between the UK government and the EU. Whilst the result has no immediate effect on the current structure of the Bank or its operations, it has increased volatility in the markets, including a depreciation of the pound, and may continue causing uncertainty as the negotiations progress.

Finally, the **US election results** may imply a degree of uncertainty because of their potential impact on emerging economies, particularly in Latin America, and the US economy itself, although this needs to be considered in tandem with the robustness of the region.

Against the backdrop of these macroeconomic and political risks, the Banco Santander business model, based on geographic diversification - balanced between mature and emerging markets - and on retail banking, underpins the stability of its results, helping it to maintain its medium-low risk profile.

Competitive environment and customer relations
The Bank is facing the challenge of adapting the way it does business to meet the new needs of its customers, against the backdrop of the rapid rise of disruptive innovation and new technology that is revolutionising the financial industry.

The ever increasing digitalisation of the sector requires constant innovation to keep the Bank one step ahead of the changes taking place and to protect its market share against the entry of new digital competitors - financial start-ups, technology giants, etc. - and the publication of new regulations that foster financial disintermediation, such as the new payment services directive (PSD2), which comes into effect in January 2018.

The identification and assessment of the impact of this risk to its business has enabled Banco Santander to turn this threat into an opportunity. Innovation and digital transformation are one of the cornerstones of our business model.

Increasing supervisory and regulatory pressures are affecting aspects of behaviour, transparency, consumer protection and the sale of appropriate products, due in part to certain cases of poor practices in the sector over recent years.

Given this situation, the Bank has developed a robust governance structure, in which the compliance and conduct function reports directly to the board of directors, and which is subject to the product-approval process and the general system set out in its Code of Conduct. Section D.5, on conduct and compliance risks details the functions involved in managing this risk.

Moreover, **regulators are focusing increasing attention on the accumulation of assets in the financial sector that do not generate adequate returns** and which are difficult to transfer, potentially causing liquidity difficulties in the market. The Bank has set up a specific area dedicated to the management and sale of potentially problematic assets, so as to reduce its exposure.

Regulatory environment
Over recent years, there has been intense activity in the regulatory field to improve the capitalisation of banks, mainly in response to the financial crisis. This impacts in particular on banks considered to be systemic.

This new regulation focuses mainly on capital, liquidity and resolution requirements, consistent information management and the adequacy of the internal governance of entities.

Entities have had to make significant efforts to respond to this changing and more demanding backdrop, which has had a significant impact on their profitability.

For the financial industry, it is crucial to have a stable and enduring regulatory framework, allowing banks to apply valid mid-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.

Threats to the systems (cyber risk)
Just like any other organisation, the Bank may be subject to cyber-attacks that impact on its banking services, including digital attacks that threaten its internal information and customer data, or that reveal security weaknesses. These attacks have increased.

The Bank works tirelessly to enhance protection based on international standards and preventive measures, so that it is ready to respond to incidents of this type. These measures are set out in section D.4.4 Operational risk mitigation measures.

» Table 1: Stress tests

In July, the European Banking Authority (EBA) published the results of its stress tests of the 51 leading banks in the European Union.

This time, no minimum capital requirements were set for passing the test. Instead, the final results were used as a variable by the ECB to determine the minimum capital requirements for each bank (under the Supervisory Review and Evaluation Process - SREP).

This exercise used two macroeconomic scenarios (base case and adverse), taking the bank's balance sheet at year-end 2015 as the starting point, with a three-year horizon, ending in 2018. These tests are not comparable to the 2014 exercise, as they are based on a more demanding scenario and different assumptions.

The adverse scenario - which has a very low likelihood of occurring - considers a major deterioration in macroeconomic conditions and financial markets in Europe and the other countries where Banco Santander is active. For example, it considers an accumulated fall of 3% in GDP for the eurozone as a whole, major falls in securities markets (-30%) and house prices (-11%), and wider credit spreads on public debt.

Santander once again received excellent results, as in the other stress tests carried out over recent years.

In the adverse scenario, Santander is the bank that least destroys capital among its peers, with the fully loaded CET1 capital ratio falling by 199 basis points (vs. -335 on average) from 10.2% in 2015 to 8.2% in 2018.

In the baseline scenario, Santander generates the second highest capital amongst its peers. Therefore, it not only destroys less capital, it also generates more.

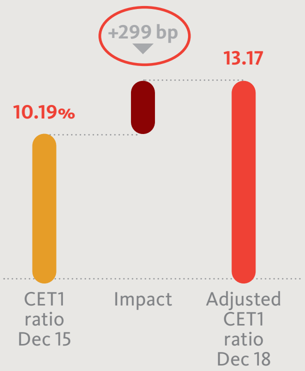
We can conclude that Santander is more resilient than its competitors, due to its strong generation of recurrent revenue and results, based on its retail and commercial banking model and its unique geographic diversification.

The result is that our stable and predictable business model requires less capital and entails a lower cost of capital.

EBA stress test results

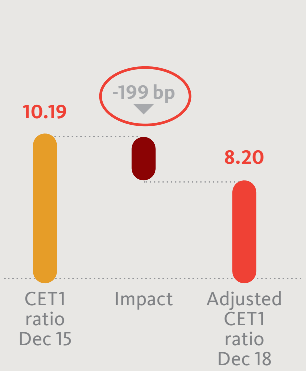
Fully loaded CET1 ratio, base ST

%



Fully loaded CET1 ratio, adverse ST

%



We can conclude that Santander is more resilient than its competitors[3], due to its strong generation of recurrent revenue and results, based on its retail and commercial banking model and its unique geographic diversification.

CET1 variation 2015 vs. base case scenario (bp)

CET1 variation 2015 vs. adverse scenario (bp)

3. Peers: BBVA, BNP, Soc Gen, C.Agricole, Deutsche Bank, Commerzbank, Unicredit, Intensa Sanpaolo, ING, Nordea, Lloyds, HSBC, Barclays y RBS

» Table 2: New model of classification and measurement of financial instruments (IFRS 9)

1. Introduction:

In July 2014, the International Accounting Standards Board (IASB) approved the International Financial Reporting Standard 9 - Financial Instruments (IFRS 9), to replace IAS39 – Financial instruments: recognition and assessment, in accordance with the guidelines which were prepared during the G-20 meeting in April 2009.

IFRS 9 sets out the requirements for recognition and measurement of both financial instruments and certain types of contracts for the sale of non-financial items. It will be applicable from 1 January 2018 on. It has been endorsed by the European Commission in November 2016 .

2. Model proposed by IFRS 9

The main new developments of the standard are as follows:

2.a Classification of financial instruments

The criterion for classifying financial assets will depend both on their business management model and the features of the contractual flows. Consequently, the asset will be measured at amortized cost, at fair value with changes in other comprehensive income (equity), or at fair value with changes in profit/loss for the period. IFRS 9 also establishes the option of designating an instrument at fair value with changes in P/L under certain conditions.

The main activity of Santander Group is the concession of retail banking operations and does not concentrate its exposure on complex financial products. The main objective of the Group is to achieve a homogeneous implementation of the classification of financial instruments of the portfolios established under IFRS 9 and, for this purpose, it has developed standardized guidelines to enable a homogeneous analysis in all of its units.

The Group is currently implementing an analysis of its portfolios under the mentioned guidelines in order to identify and classify the financial instruments into their corresponding portfolio under IFRS 9.

Based on current analysis, since no significant changes are expected in the composition of until 2018, it is considered that there will be no significant changes with respect to the classification that was being carried out under the pre-existing regulation:

- Financial assets classified as loans and advances and held-to-maturity under IAS 39 will generally be classified into amortized cost.

- Available for sale debt instruments will generally continue to be classified into fair value with changes in other comprehensive income, unless cash flows features imply its classification into other portfolio.

- Available for sale capital instruments will be classified at fair value, with changes reported in profit and loss for the year, unless the Group decides, for non-trading assets, to classify at fair value, with changes reported in other comprehensive income (irrevocably).

- IAS 39 financial liabilities classification and measurement criteria remains substantially under IFRS 9. Nevertheless, in most cases, the changes in the fair value of financial liabilities designated at fair value with changes reported in profit and loss for the year, due to the entity credit risk, will be classified on other comprehensive income.

2.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 asset impairment model is applicable to financial assets valued at amortised cost, to debt instruments valued at fair value through other comprehensive income, to leasing receivables, and to contingent risks and commitments not valued at fair value.

Application of practical expedients under IFRS 9

IFRS 9 contains a set of practical expedients that might be used by the entities to facilitate its implementation. However, in order to achieve full and high quality implementation of the standard, considering industry best practices, these practical solutions 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 will be used as an additional – but not primary - indicator of significant risk increase.

- Financial instruments that have low credit risk at the reporting date: this solution will not be implemented and the Group will analyse the credit quality of all financial assets.

4. Official Journal of the European Commission, Commission Regulation (EU) 2016/2067 of 22 November 2016.

Impairment estimation methodology

The portfolio of financial instruments subject to impairment will be divided into three categories, based on the stage of each instrument with regard to its level of credit risk:

- Stage 1: a financial instrument will be considered to be in this phase where there has been no significant increase in risk since its initial recognition. In this case, the value correction will reflect expected credit losses arising from defaults over the 12 months from the reporting date.

- Stage 2: financial instruments are included in this stage when there has been a significant increase in risk since the date of initial recognition, but the impairment has not materialised. In this case, the value correction for losses will reflect the expected losses from defaults over the residual life of the financial instrument. The existence of a significant increase in credit risk will be determined by considering the quantitative indicators used in the ordinary management of credit risk, together with other qualitative variables, such as the indication of whether refinanced transactions are considered non-impaired and transactions included in special debt sustainability agreements.

- Stage 3: financial instruments are catalogued in this stage when they show effective signs of impairment as a result of one or more events that have already occurred that will result in a loss. In this case, the amount of the value correction will reflect the expected losses for credit risk over the expected residual life of the financial instrument.

The methodology required for quantification of expected loss for credit events will be based on an unbiased and weighted consideration of the occurrence of a range of 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. GNP, house pricing, unemployment rate, etc.).

In estimating the parameters used in the expected loss calculation (EAD, PD, LGD and discount rate), the Group leverages its experience of developing internal models for calculating parameters for regulatory and management purposes. The Group is aware of the differences between such models and regulatory requirements for provisions. As a result, it is focusing on preparing for, and adapting to, such requirements as it develops its IFRS 9 models.

Use of present, past and future information

In addition to considering both present and past information, the Group currently uses forward-looking information in internal management and regulatory processes, considering several scenarios. In this sense, the Group will leverage its experience in the management of such information and maintain consistency with the information used in the other processes.

Impairment registration

The main change with respect to the current standard related to assets measured at fair value with changes in other comprehensive income. For these assets, 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.

2.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, so allowing there 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.

According to the analysis performed until now, the Group expect to maintain the application of IAS 39 in hedge accounting.

2.d Transition

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.

2.e IFRS 9 implementation strategy

The Group has established a global workstream with the aim of adapting its processes to the new classification standards for financial instruments, accounting of hedges and estimating credit risk impairment, so that such processes are applicable in a uniform way for all Group units, and, at the same time, can be adapted to each unit's individual features.

Accordingly, the Group is 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.

In principle, the governance structure currently implemented at both corporate level and in each one of the units, complies with the requirements set out in the new standards.

Regarding the governance structure, the Group has set up a regular committee to manage the project governance structure, and a task force which is responsible for its tasks, and also assuring that the pertinent responsible teams take part.

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. Both the Internal Audit division and the External Auditor are also involved in the project, having shared the implementation plan and keeping regular meetings about the status of the project.

2.f The project's main phases and milestones

During this exercise, the Group has successfully completed the design and development phase of the implementation plan. The major milestones achieved include:

- Complete the definition of functional requirements as well as the design of an operational model adapted to the requirements of IFRS 9.
- Development a training plan for all the staff who could be involved or impacted with the standards application.
- At the IT environment, the technological needs have been identified as well as the necessary adaptations to the existing control environment.

The Group is currently in the implementation phase of the models and requirements defined.

The objective of the Group at this stage is to ensure an efficient implementation, optimizing its resources as well as the designs elaborated in previous stages.

Once the implementation phase is completed, the Group will ensure the effective performance of the model through several simulations and ensuring that the transition to the new operating model meets the objectives established in the previous phases. This last stage includes the parallel execution of the provisions calculation, as a complement to the internal simulations that the Group has been carrying out during the different phases of the project and to the participation of the Group in the different impact assessments that the regulators have carried out.

2.g Guidelines and complementary rules

In addition to the standards issued by IASB, a number of regulatory and supervisory bodies have issued further considerations both in regard to the impairment model for financial instruments in IFRS 9, and items directly relating to it. These include the following documents and initiatives:

- **European Banking Authority (EBA) – Draft guidelines on credit institutions' Credit risk management practices and accounting for Expected Credit Losses (July 2016, under consultation):** the aim of the document is to transpose the guidelines developed by the Basel Committee on Banking Supervision into European regulatory framework, providing appropriate practices for credit risk management in relation to the implementation of the calculation of expected credit losses.
- **European Banking Authority (EBA) – The EBA 2017 Annual Work Programme (September 2016):** it establishes a work plan that includes, among others, a quantitative and qualitative analysis of IFRS 9 as a result of the technical standards and guidelines that the EBA will develop to provide advice in the areas of accounting and auditing.
- **European Central Bank – Draft guidance to banks on non-performing loans (September 2016, under consultation):** this document presents supervisory guidelines in relation to Non-Performing Exposures establishing the best practices for risk management of European entities.
- **Basel Committee on Banking Supervision – Discussion paper on regulatory treatment of accounting provisions (October 2016, under consultation):** the objective of the document is to propose alternatives for the interaction between regulatory capital and provisions after the entry into force of the expected loss models for the calculation of provisions. The document proposes different approaches as well as a particular treatment of provisions during the transition period.
- **Financial Accounting Standards Board (FASB) – Accounting Standard Update Number 2016-13, Financial Instruments, credit losses (Jun 2016, Final report):** the final version of the American accounting regulation that include the calculation of the expected loss for entities that shall issue their financial reports under the requirements of FASB.

D. Risk profile

D.1. Credit risk

» Organisation of this section

After an **introduction** to the concept of credit risk and the segmentation that the Group uses for its treatment, the **key figures for 2016 and change over time** will be presented [pag. 184-191].

This is followed by a look at the **main geographies**, setting out their main features from the credit risk standpoint [pag. 192-201].

The qualitative and quantitative aspects of **other credit risk matters** are then presented, including information on financial markets, risk concentration, country risk, sovereign risk and environmental risk [pag. 202-209].

Lastly, there is a description of the **credit risk cycle** in Grupo Santander, with a detailed explanation of the various stages in the pre-sale, sale and post-sale phases, as well as the main credit risk metrics [pag. 209-214].

» D.1.1. Introduction to credit risk treatment

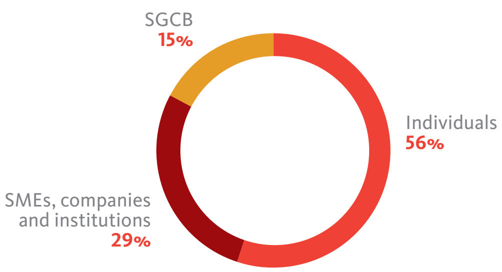
Credit risk arises from the possibility of losses stemming from the total or partial failure of customers or counterparties to comply with the financial obligations they have agreed with the Group.

The credit risk function is organised on the basis of three types of customers:

- The **individuals** segment includes all physical persons, 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, companies and institutions** segment includes companies and physical persons with business activity. It also includes public sector activities in general and non-profit making private sector 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, countries of operation, product types, volume of revenues it represents for the bank, length of relation with the customer, etc).

The following chart shows the distribution of credit risk on the basis of the management model.

Credit risk distribution



The Group's risk profile is mainly retail, accounting for 85% of total risk generated by the retail and commercial banking business.

» D.1.2. Key figures and change over time

D.1.2.1. Global map of credit risk, 2016

The table below sets out the global credit risk exposure map in nominal amounts (except for exposure for derivatives and repos, which are expressed in credit risk equivalent) at 31 December 2016.

Gross credit risk exposure classified by geographies
Million euros

	Customer loans		Loans to entities[2]		Fixed income[3]		Derivatives and Repos	
	Drawn[1]	Undrawn	Drawn	Undrawn	Sovereign	Private	REC[4]	Total
Continental Europe	**334,720**	**80,126**	**27,960**	**809**	**52,405**	**11,927**	**18,861**	**526,807**
Spain	205,961	65,370	20,923	368	38,490	6,306	16,708	354,126
Germany	34,562	1,099	2,032	-	203	103	-	37,999
Portugal	31,827	4,756	1,425	378	6,119	4,076	1,868	50,448
Other	62,370	8,902	3,579	63	7,594	1,442	286	84,235
UK	**239,446**	**46,574**	**20,921**	**-**	**12,208**	**8,539**	**17,968**	**345,656**
Latin America	**163,484**	**44,454**	**32,889**	**24**	**32,645**	**6,981**	**7,695**	**288,171**
Brazil	78,941	26,636	20,011	23	20,344	5,090	4,583	155,628
Chile	40,401	10,310	2,889	0	3,517	1,608	1,322	60,046
Mexico	28,809	6,461	4,575	-	7,345	270	1,765	49,224
Other	15,334	1,048	5,414	-	1,439	14	25	23,273
US	**83,912**	**26,966**	**10,513**	**230**	**9,255**	**8,226**	**30**	**139,132**
Rest of the world	**681**	**302**	**79**	**-**	**-**	**56**	**-**	**1,118**
Group total	**822,244**	**198,421**	**92,361**	**1,062**	**106,513**	**35,730**	**44,554**	**1,300,885**
% Total	63.2%	15.3%	7.1%	0.1%	8.2%	2.7%	3.4%	100.0%
Var. vs. Dec-15	(2.1%)	1.8%	3.7%	67.6%	11.3%	(5.7%)	(14.5%)	(0.7%)

Gross credit risk exposure: change over time
Million euros

	2016	2015	2014	Change on 14	Change on 13
Continental Europe	**526,807**	**529,030**	**480,551**	**(0.4%)**	**9.6%**
Spain	354,126	365,071	333,227	(3.0%)	6.3%
Germany	37,999	35,069	32,929	8.4%	15.4%
Portugal	50,448	53,622	43,754	(5.9%)	15.3%
Other	84,235	75,267	70,641	11.9%	19.2%
UK	**345,656**	**382,366**	**349,169**	**(9.6%)**	**(1.0%)**
Latin America	**288,171**	**248,292**	**264,459**	**16.1%**	**9.0%**
Brazil	155,628	131,673	160,532	18.2%	(3.1%)
Chile	60,046	49,034	46,084	22.5%	30.3%
Mexico	49,224	46,681	43,639	5.4%	12.8%
Other	23,273	20,905	14,204	11.3%	63.8%
US	**139,132**	**149,609**	**123,758**	**(7.0%)**	**12.4%**
Rest of the world	**1,118**	**896**	**450**	**24.8%**	**148.1%**
Group total	**1,300,885**	**1,310,193**	**1,218,387**	**(0.7%)**	**6.8%**

1. Balances with customers include contingent risks (details in note 35 to the Annual Financial Statements and Audit Report) but exclude repos (EUR 14,244 million) and other customer lending financial assets (EUR 19,023 million).
2. Balances with credit entities and central banks include contingent risks but exclude Repos, the trading portfolio and other financial assets.
3. Total fixed income excludes the trading portfolio.
4. CRE (Credit Risk Equivalent: net value of replacement plus maximum potential value. Includes mitigants).

Gross exposure (lending to customers, entities, fixed income, derivative and repos) to credit risk in 2016 amounted to EUR 1,300,885 million. The highest proportion, accounting for 86% of the total, is credit to customers and credit entities.

Risk is diversified among the main regions where the Group operates: Continental Europe (40%), UK (27%), Latin America (22%) and the US (11%).

In 2016, credit risk exposure fell by 0.7%, due mainly to lower exposure in the UK (caused by exchange rate effects).

Changes in scope

In 2016, the inclusion of the agreement with PSA (50% joint venture between Banque PSA Finance and Santander Consumer Finance - SCF) in the consumer finance business was completed. The core purpose of this agreement is financing of vehicles manufactured by Peugeot, Citroën and DS and bought by end customers, and also of second-hand vehicles sold in these 3 French brand dealerships. This incorporation increased exposure by some EUR 8,176 billion, as of December 2016.

This alliance has enabled SCF to enhance its position in the market, improving its presence in countries to which it was already exposed, such as Germany and Italy, whilst entering new markets, such as Belgium, increasing its scope.

The portfolio incorporated had a non-performing loans ratio of around 1.9% at the end of December, continuing the trend seen in the previous year. The coverage of the new incorporation is around 100%, similar to levels for SCF. The incorporations carried out in 2016 completed the incorporation process for this business.

D.1.2.2. Main figures in 2016

The table below sets out the main items related to credit risk derived from our activity with customers:

Key figures of credit risk arising from activity with customers

	Credit risk with customers[2] (million euros)			Non-performing loans (million euros)			Non-performing loans rate (%)		
	2016	2015	2014	2016	2015	2014	2016	2015	2014
Continental Europe	**331,706**	**321,395**	**310,008**	**19,638**	**23,355**	**27,526**	**5.92**	**7.27**	**8.88**
Spain	172,974	173,032	182,974	9,361	11,293	13,512	5.41	6.53	7.38
Santander Consumer Finance [1]	88,061	76,688	63,654	2,357	2,625	3,067	2.68	3.42	4.82
Portugal [5]	30,540	31,922	25,588	2,691	2,380	2,275	8.81	7.46	8.89
Poland	21,902	20,951	18,920	1,187	1,319	1,405	5.42	6.30	7.42
UK	**255,049**	**282,182**	**256,337**	**3,585**	**4,292**	**4,590**	**1.41**	**1.52**	**1.79**
Latin America	**173,150**	**151,302**	**161,974**	**8,333**	**7,512**	**7,767**	**4.81**	**4.96**	**4.79**
Brazil	89,572	72,173	90,572	5,286	4,319	4,572	5.90	5.98	5.05
Mexico	29,682	32,463	27,893	819	1,096	1,071	2.76	3.38	3.84
Chile	40,864	35,213	33,514	2,064	1,980	1,999	5.05	5.62	5.97
Argentina	7,318	6,328	5,703	109	73	92	1.49	1.15	1.61
US	**91,709**	**90,727**	**76,014**	**2,088**	**1,935**	**1,838**	**2.28**	**2.13**	**2.42**
Puerto Rico	3,843	3,924	3,871	274	273	288	7.13	6.96	7.45
Santander Bank	54,040	54,089	45,817	717	627	647	1.33	1.16	1.41
SC USA	28,590	28,280	22,782	1,097	1,034	903	3.84	3.66	3.97
Group total	**855,510**	**850,909**	**804,084**	**33,643**	**37,094**	**41,709**	**3.93**	**4.36**	**5.19**

	Coverage ratio (%)			Net ASR provision[3] (million euros)			Cost of credit (% /risk)[4]		
	2016	2015	2014	2016	2015	2014	2016	2015	2014
Continental Europe	**60.0**	**64.2**	**57.2**	**1,342**	**1,975**	**2,880**	**0.44**	**0.68**	**1.01**
Spain	48.3	48.1	45.5	585	992	1,745	0.37	0.62	1.06
Santander Consumer Finance [1]	109.1	109.1	100.1	387	537	544	0.47	0.77	0.90
Portugal [5]	63.7	99.0	51.8	54	72	124	0.18	0.29	0.50
Poland	61.0	64.0	60.3	145	167	186	0.70	0.87	1.04
UK	**32.9**	**38.2**	**41.9**	**58**	**107**	**332**	**0.02**	**0.03**	**0.14**
Latin America	**87.3**	**79.0**	**84.5**	**4,911**	**4,950**	**5,119**	**3.37**	**3.36**	**3.70**
Brazil	93.1	83.7	95.4	3,377	3,297	3,682	4.89	4.50	4.91
Mexico	103.8	90.6	86.1	832	877	756	2.86	2.91	2.98
Chile	59.1	53.9	52.4	514	567	521	1.43	1.65	1.75
Argentina	142.3	194.2	143.3	107	148	121	1.72	2.15	2.54
US	**214.4**	**225.0**	**193.6**	**3,208**	**3,103**	**2,233**	**3.68**	**3.66**	**3.31**
Puerto Rico	54.4	48.5	55.6	96	85	55	2.58	2.12	1.43
Santander Bank	99.6	114.5	109.4	120	64	26	0.23	0.13	0.06
SC USA	328.0	337.1	296.2	2,992	2,954	2,152	10.72	10.97	10.76
Group total	**73.8**	**73.1**	**67.2**	**9,518**	**10,108**	**10,562**	**1.18**	**1.25**	**1.43**

1. SCF includes PSA in figures for 2015 and 2016.
2. Includes gross lending to customers, guarantees and documentary credits.
3. Recovered Written-Off Assets (EUR 1,582 million).
4. Cost of credit = loan-loss provisions twelve months / average lending
5. Portugal includes Banif in figures for 2015 and 2016

NOTE: The figures for 2014 have been recalculated because of the transfer of the Banco Santander International units and the New York branch to USA.

In 2016, credit risk with customers rose slightly by 0.6%, largely due to the increases in Brazil, SCF and Chile, which offset the fall in the United Kingdom, mainly due to the exchange rate effect. There is growth across the board in local currency, with the UK standing out.

These levels of lending, together with lower non-performing loans (NPLs) of EUR 33,643 million (-9% vs. 2015) reduced the Group's NPL ratio to 3.93% (-43 bp vs. 2015).

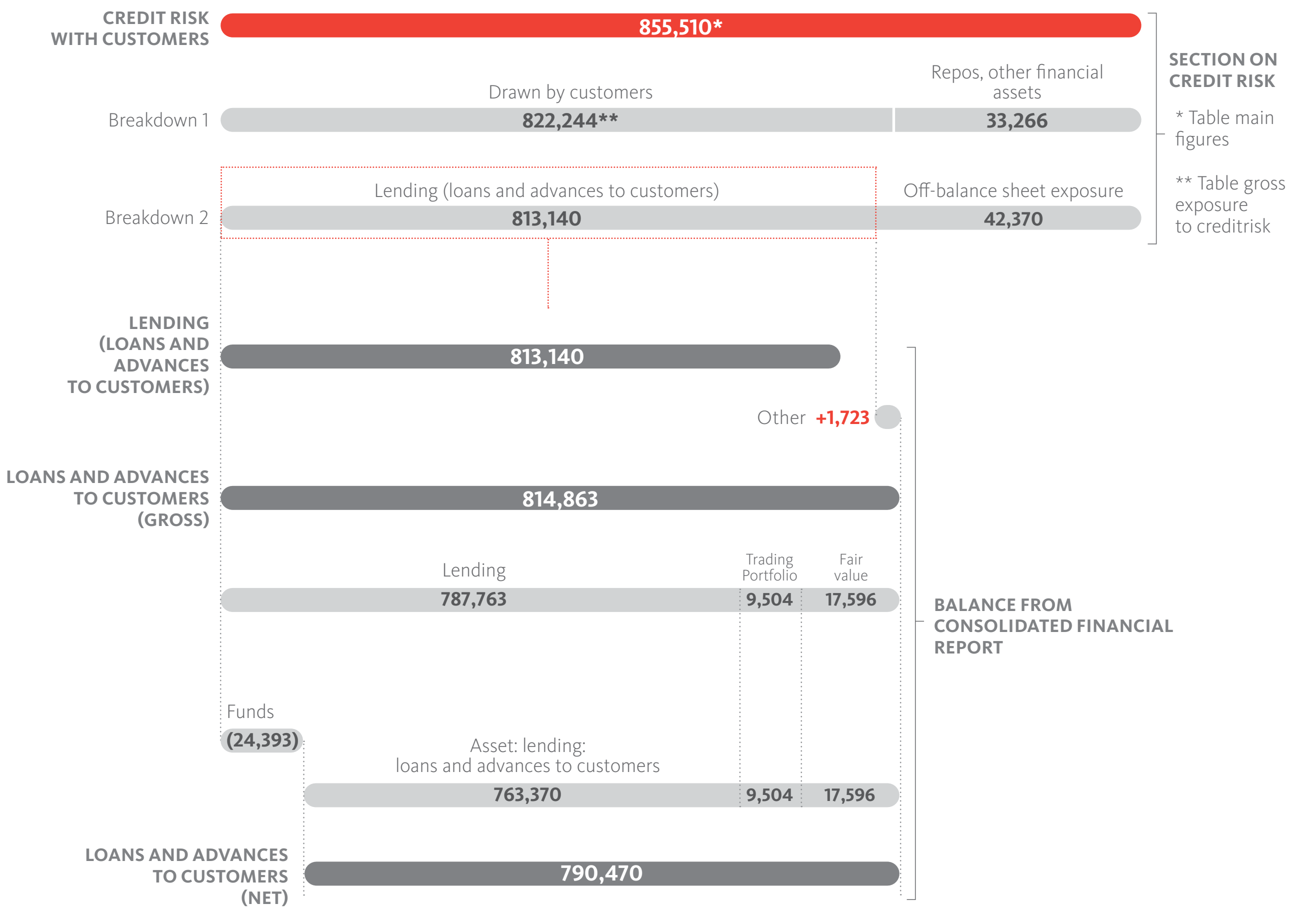
For coverage of these NPLs, the Group recorded net credit losses of EUR 9,518 million (-6% vs. 2015), after deducting write-off recoveries. This fall is reflected in a fall in the cost of credit to 1.18% (7 bp less than the previous year).

Total loan-loss provisions were EUR 24,835 million, bringing the Group's coverage ratio to 74%. It is important to bear in mind that this ratio is affected downwards by the weight of mortgage portfolios (particularly in the UK and Spain), which require fewer provisions as they have collateral.

Reconciliation of the main magnitudes

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 chart shows the relation between the concepts that comprise these magnitudes.

Million euros

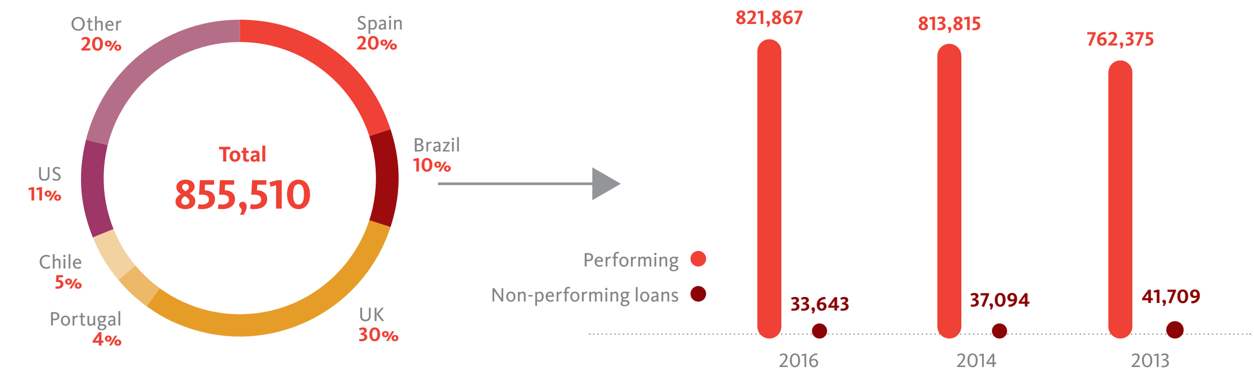


Geographic distribution and segmentation

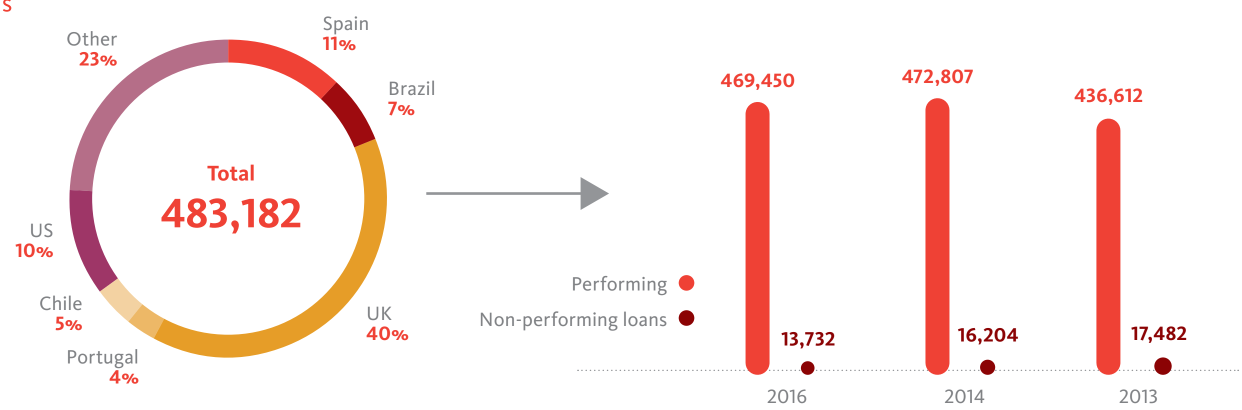
On the basis of the aforementioned segmentation, the geographic distribution and situation of the portfolio is shown in the following charts.

Million euros

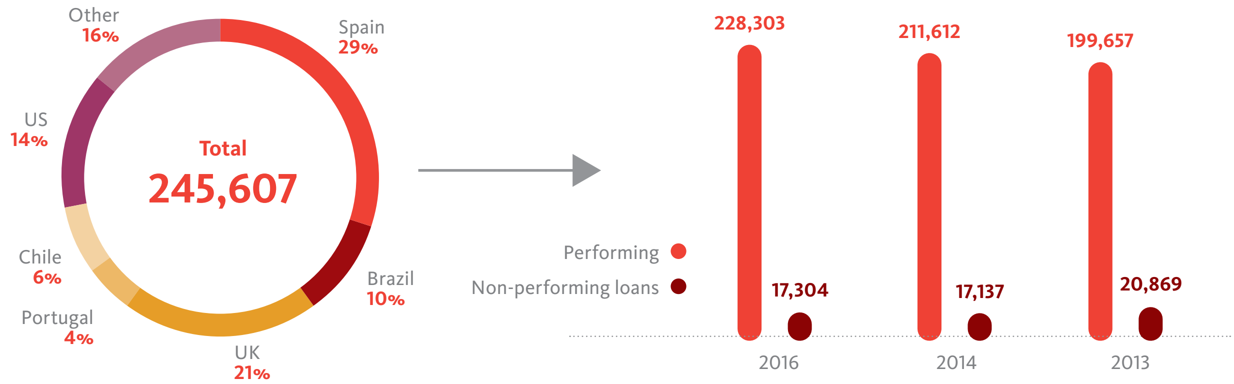
Total



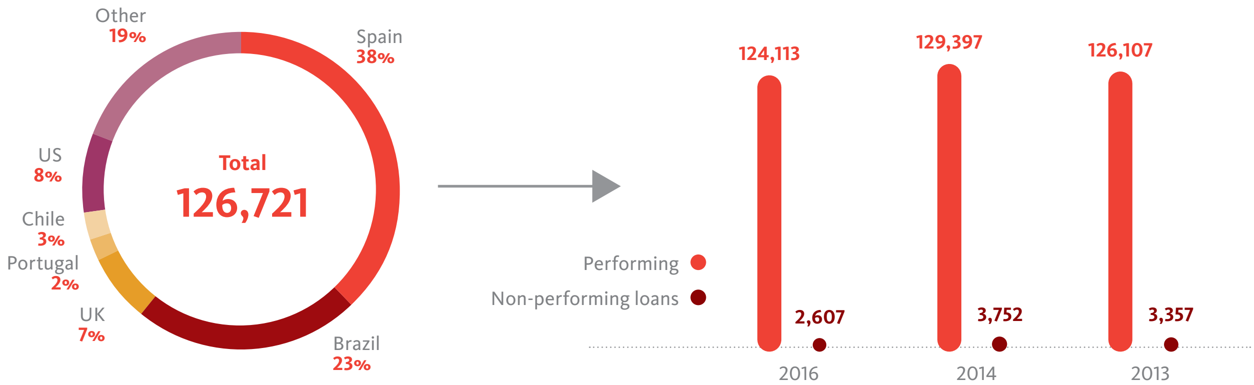
Individuals



SMEs, companies and institutions



SGCB



The structure of the main magnitudes by geographic area:

- **Continental Europe**

  - In **Spain**[5], the NPL ratio stood at 5.41 % (-112 bp compared to 2015), as a result of the favourable performance of non-performing loans due to fewer new entries in most portfolios and, to a lesser extent, portfolio sales and forbearance positions returning to normal. The coverage ratio remains at 48% (stable over the year).

  - **Portugal**, downward trend in non-performing loans due to fewer new entries in main segments and from portfolio sales. After the adjustments due to the acquisition of Banif, non-performing loans stand at 8.81%, (+135 bp vs. 2015) with a coverage ratio of 64%.

  - In **Poland** the down turn in the NPL ratio continue to 5.42% (-88 bp vs. 2015). The coverage ratio was 61%.

  - In **Santander Consumer** the NPL ratio, following the increase in the perimeter, was 2.68% (-74 bp in the year), with a generally strong performance by portfolios in most countries. The coverage ratio remains at 109%.

- The **UK**[6] reduced its NPL ratio to 1.41% (-11 bp in the year), due to strong performance across all segments, particularly SMEs and individual customers. The coverage ratio was 33%.

- **Brazil**[7], against an adverse macroeconomic background, the NPL ratio was reduced to 5.90% (-8 bp in the year) using proactive risk management. The coverage ratio was 93%.

- **Chile** has reduced its NPL ratio to 5.05 % (-57 bp in the year), thanks to the strong performance in non-performing loans across most segments, particularly individual customers. The coverage ratio was 59%.

- Non-performing loans in **Mexico** fell to 2.76% (-62 bp in the year), due to a fall in the NPL ratio mainly in individuals and wholesale. The coverage ratio was 104%.

- The NPL ratio in the **United States**[8] stood at 2.28% (+15 bp), with the coverage ratio remaining high, at 214%.

  - The NPL ratio at Santander Bank stood at 1.33% (+16 bp), driven by the increase in the oil and gas sector in the first quarter, although the trend has been positive since then. The coverage ratio rose to 100%.

  - In SC USA, the high rotation of the portfolio and the unit's forward-looking NPL management brought the NPL ratio to 3.84% and the coverage ratio increased to 328%.

  - Puerto Rico's NPL ratio increased to 7.13%, whilst its coverage ratio rose to 54%.

Portfolio with normal status: amounts past due

Amounts past due by three months or less represented 0.32% of total credit risk with customers. The following table shows the structure at 31 December 2016, classified on the basis of the maturity of the first maturity:

Amounts past due pending collection

Million euros

	Less than 1 month	1 to 2 months	2 to 3 months
Loans and advances to credit institutions	20	1	-
Loans and advances to customers	1,672	659	393
Public administrations	8	2	-
Other private sector	1,664	657	393
Debt instruments	-	-	-
Total	**1,692**	**660**	**393**

Non-performing loans and provisions: change over time and mix

Non-performing assets are classified as:

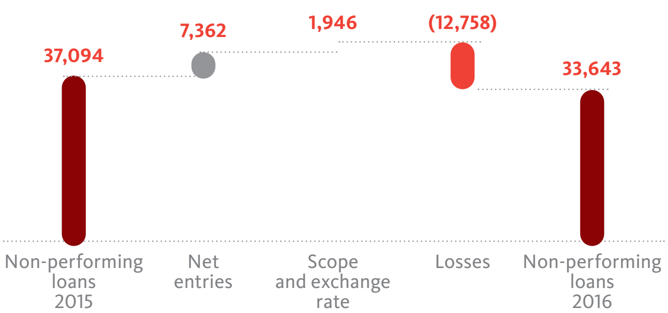
- **Assets classified as non-performing due to the delinquency of the counterparty**: debt instruments that are more than 90 days past due, irrespective of their holder or collateral. In the case of individually significant exposures, these assets are covered for the difference between the carrying value 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 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 D.1.3.2. Spain.
6. Further details in section D.1.3.1. UK.
7. Further details in section D.1.3.4. Brazil.
8. Further details in section D.1.3.3. US

The table below shows the change over time in non-performing loans by constituent items:

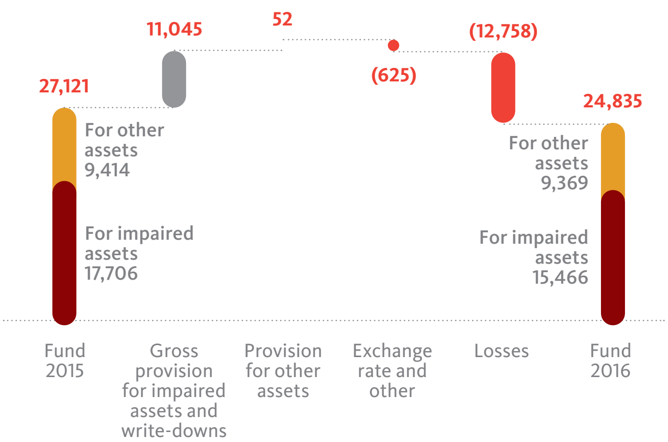
Change over time in non-performing loans loans by constituent item
Million euros



Performance 2014-2016
Million euros

	2014	2015	2016
NPL (start of period)	**41,652**	**41,709**	**37,094**
Net inflows	9,652	7,705	7,362
Scope	497	106	734
Exchange differences and other	1,734	(65)	1,211
Losses	(11,827)	(12,361)	(12,758)
NPL (end of period)	**41,709**	**37,094**	**33,643**

Change over time in loan loss provisions, according to constituent item
Million euros



Performance 2014-2016
Million euros

	2014	2015	2016
Fund (start of period)	**25,681**	**28,046**	**27,121**
For impaired assets	19,118	19,786	17,706
For other assets	6,563	8,260	9,414
Gross provision for impaired assets and write-downs	**11,766**	**10,670**	**11,045**
Provision	11,766	10,670	11,045
Write-downs	-	-	-
Provision for other assets	**156**	**814**	**52**
Exchange differences and other	**2,271**	**(48)**	**(625)**
Losses	**(11,827)**	**(12,361)**	**(12,758)**
Fund (end of period)	**28,046**	**27,121**	**24,835**

Forbearance portfolio

Forbearance is defined as the modification of the payment conditions of a transaction which allow a customer who is experiencing financial difficulties (current or foreseeable) to fulfil its payment obligations, on the basis that whether this modification was not to be made it would be reasonably certain that it would not be able to meet its financial obligations. The modification could be done in the same original transaction or through a new transaction which replaces the previous one. The aforementioned modifications are driven by concessions from the bank to the customer (concessions more favourable than those that are established in the market).

The Bank has a detailed corporate policy for forbearance which acts as a reference in the various local transpositions of all the financial institutions that form part of the Group. These share the general principles established in the new Bank of Spain circular 4/2016 and the technical criteria published in 2014 by the European Banking Authority, developing them in a more granular way on the basis of the level of customer impairment.

This policy sets down rigorous criteria for the evaluation, classification and monitoring of such transactions, ensuring the strictest possible care and diligence in their granting and follow up. These forbearance principles:

- Must be focused on recovery of the amounts due; must adapt the payment obligations to the customer's actual situation; and must recognise a loss as soon as possible, if any amounts are deemed irrecoverable.
- Forbearances may never be used to delay immediate recognition of losses or to hinder appropriate recognition of risks of default.
- Further forbearance may also be granted if it is deemed appropriate in order to maximise recoveries, providing this does not in any way represent an incentive for non-payment by the customer.

- Restructuring must always envisage maintaining existing guarantees and, if possible, improving them.

- Forbearance decisions must be based on analysis of the transaction at a suitable level of the organisation other than that which granted the initial transaction, or must be reviewed by a higher decision-making level or body.

Instances have been established for considering transactions to be experiencing financial difficulties, and therefore to be eligible for consideration for forbearance. Although the consideration of financial difficulties remains the responsibility of the analyst or manager, based on a number of risk indicators (high indebtedness, falling turnover, narrowing margins, impaired access to markets, operations included in a debt sustainability accord, risks relating to holders declared bankrupt with no liquidation filing, etc.), an operation can be considered for forbearance if it has been past due for more than 30 days at least once in the three months prior to the modification.

Classification criteria have also been defined for forborne transactions, in order to ensure risks are recognised appropriately. Transactions not classified as non-performing loans at the time of the forbearance are in general considered normal but under special monitoring. Those operations that remain classified as non-performing loans for not meeting the requirements for their reclassification to another category at the time of forbearance must fulfil a 12-month schedule of prudent payments, to ensure with reasonable certainty that the customer has recovered their payment capacity and is no longer non-performing loans.

The operation is no longer considered non-performing loans once this period has been completed, but remains subject to a trial period of special monitoring. This monitoring continues: whilst it is considered that the customer might still be experiencing financial difficulties; for at least two years; until the holder has paid all principal and interest outstanding from the date of the restructuring or refinancing; and providing that the holder has no other operations with amounts more than 30 days past due at the end of the trial period.

The forbearance portfolio stood at EUR 48,460 million at the end of December, as follows[9].

Forbearance volume
Million euros

	Performing	Non-performing loans	Total risk	
	Amount	Amount	Amount	% coverage/ total
Total forbearance	**29,770**	**18,690**	**48,460**	**23%**

The Group's forbearances were down 14.5%, continuing the trend from recent years. In terms of credit quality, 39% of the forbearance portfolio is classified as non-performing loans, with average coverage for these amounts of 59% (23% of the total portfolio).

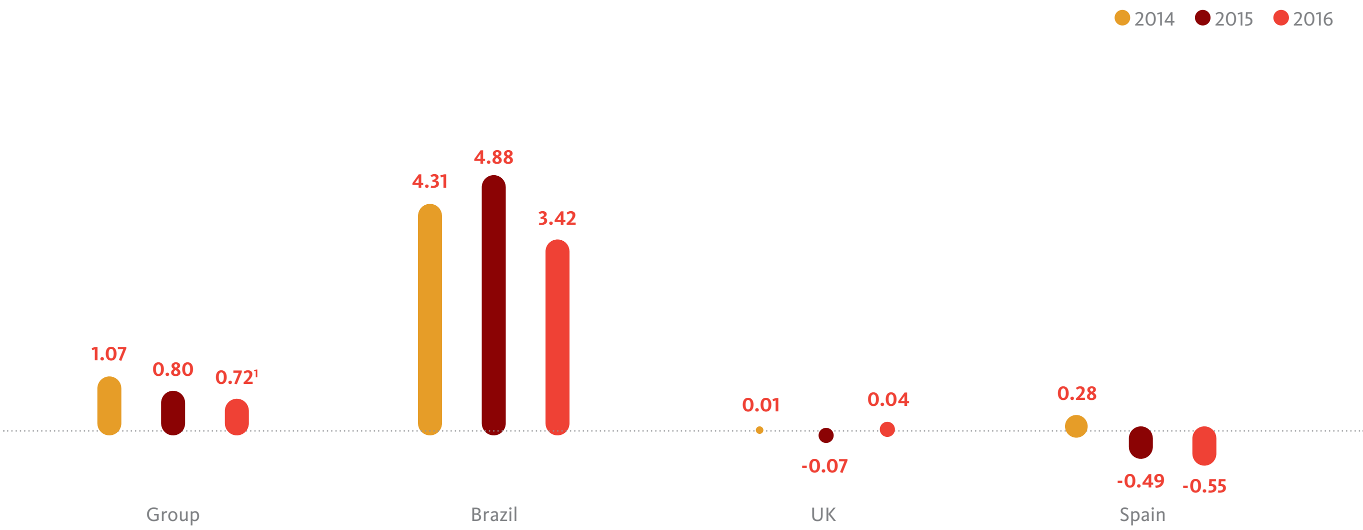
Management metrics[10]
Credit risk management uses other metrics to those already commented on, particularly change in managed non-performing loans variation plus net write-offs (known in Spanish as VMG) and expected loss. Both enable risk managers to form a complete idea of the portfolio's evolution and future prospects.

VMG is the result of subtracting the initial balance of non-performing loans from the final balance for the period under consideration, plus the write-offs in this period, less loan loss recoveries in the same period. It is often considered in relation to the average lending on which it is based, giving rise to what is known as the **risk premium**, the change in which over time can be seen below.

9. For more detail on the real estate portfolio consult note 54 of the auditor's report and the annual financial statements.
10. For further details of these metrics refer to section D.1.5.6. Measurement and control in this chapter.

Risk premium (VMG/average balances)

Figures at constant exchange rate.



(1) Management adjustment due to change in scope.

The Group´s risk premium continued its downward trend in 2016, falling across most greographies.

Expected loss is an estimate of future losses on the portfolio over the coming year, for a particular moment in time. It reflects the characteristics of the portfolio compared to exposure (EAD), probability of default (PD) and severity or recovery in the event of default (LGD).

The table below sets out the distribution by segments in terms of EAD, PD and LGD. For example, it can be seen that the consideration of LGD in the metrics makes portfolios with mortgage guarantees generally produce a lower expected loss, as a result of the recovery that occurs in the event of default via the mortgaged property.

The expected loss with portfolio customers classified as being in a normal situation is 1.12% (1.00% in 2015) and 0.88% for the whole of the Group's credit exposure (0.79% in 2015), maintaining a medium-low risk profile.

Credit risk exposure: segmentation

Segment	EAD[1]	% EAD total	PD Medium	LGD Medium	EL
Sovereign debt	184,387	16.5%	0.30%	6.26%	0.02%
Banks and other financial entities	62,037	5.5%	0.38%	38.05%	0.14%
Public sector	3,688	0.3%	1.83%	21.50%	0.39%
Corporate	151,836	13.6%	0.75%	31.16%	0.23%
SMEs	169,243	15.1%	3.26%	41.31%	1.35%
Mortgages, individuals	317,533	28.4%	2.44%	7.15%	0.17%
Consumer, individuals	168,387	15.0%	6.36%	48.98%	3.12%
Credit cards, individuals	46,911	4.2%	3.80%	65.62%	2.49%
Other assets	15,812	1.4%	2.46%	34.47%	0.85%
Pro memoria customers[2]	857,596	76.6%	3.15%	35.66%	1.12%
Total	**1,119,832**	**100.0%**	**2.51%**	**35.08%**	**0.88%**

Figures to December 2016.

1. Excludes non-performing assets.

2. Excludes Sovereign debt, Banks and other financial entities and Other assets.

» D.1.3. Details of main geographies

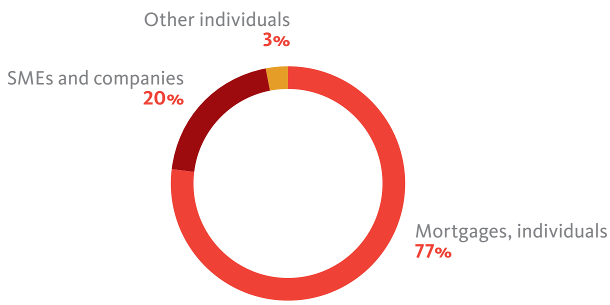
The portfolios of the geographies where Grupo Santander has the highest risk concentrations are set out below, based on the data in section D.1.2.2. Main figures in 2016.

D. 1.3.1. UK

1.3.1.1. Overview of the portfolio
Credit risk with customers in the UK amounted to EUR 255,049 million at the close of December 2016, accounting for 30% of the Group total.

The Santander UK portfolio is divided into the following segments:

Segmentation of the portfolio
%



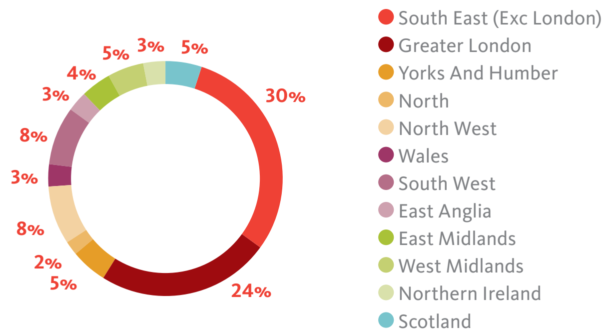
1.3.1.2. Mortgage portfolio
It is worth highlighting the mortgage portfolio because of its importance not only for Santander UK but for all of the Group's lending. This stood at EUR 180,476 million at the end of December 2016.

This portfolio consists of mortgages for acquisition or reforming homes, granted to new as well as existing customers and always constituting the first mortgage. There are no operations that entail second or successive charges on mortgaged properties.

The mortgaged property must always be located within UK territory, regardless of the destiny of the financing except in the case of some one-off operations in the Isle of Man. Mortgages can be granted for properties outside the UK, but the collateral for such mortgages must consists of a property in the UK.

Most of the credit exposure is in the south east of the UK, and particularly in the metropolitan area of London, where housing prices have risen over the last year.

Geographic concentration
%

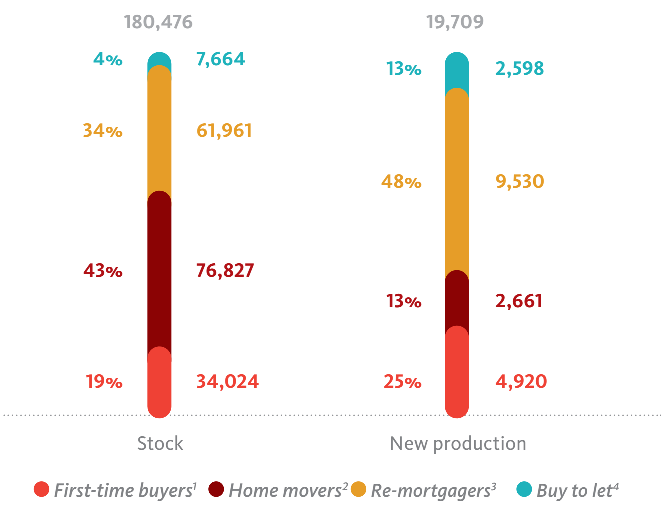


All the properties are valued independently before each new operation is approved, in accordance with the Group's risk management principles.

Mortgages that have already been granted are subject to a quarterly updating of the value of the property in guarantee, by an independent agency, using an automatic valuation system in accordance with the market's usual practices and in compliance with prevailing legislation.

The distribution of the portfolio by type of borrowers is shown in the chart below:

Mortgage portfolio loan types
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-mortgagers:* customers who switch the mortgage from another financial entity.
4. *Buy to let:* houses bought for renting out.

There are many different types of products with different risk profiles, all of them subject to the limits inherent to the policies of a prime lender such as Santander UK. The features of some of these are described below (in brackets the percentage of the portfolio of the mortgage portfolio they represent):

- **Interest only loans** (36.5%)[11]: the customer pays the interest every month and amortises the capital at maturity. An appropriate repayment vehicle such as a pension plan, mutual funds, etc. is needed. This is a regular product in the UK market for which Santander UK applies restrictive policies in order to mitigate the inherent risks. For example: a maximum LTV of 50%, higher cut-off in the admission score or the evaluation of the payment capacity, simulating the amortization of capital and interest payments instead of just interest.

- **Flexible loans** (11.3%): The contract for this type of loan enables the customer to modify their monthly payments or make additional provision of funds up to a pre-established limit, as well as having access to disbursements from previously paid amounts above that limit.

- **Buy to Let** (4.2%): Buy to let mortgages (purchase of a property to rent out) account for a small percentage of the total portfolio. Admission was halted between 2009 and 2013, when it was reactivated following the improvement in market conditions, with approval subject to strict rick policies. In December 2016, they represented around 13% of total admissions.

There was growth of 0.9% in local-currency terms in 2016, against a backdrop of uncertainty in the second half of the year, although prices increased in the real estate market.

The NPL rate fell from 1.44% in 2015 to 1.35% in December 2016.

The decrease was sustained by the evolution of non-performing loans, which improved thanks to a more favourable economic environment, as well as increased NPL exits due to the improved efficiency of recovery teams. The volume of non-performing loans thus dropped by 6%, continuing the trend seen in 2015.

It is also necessary to point out the more conservative focus adopted in Santander UK's definition of an NPL, in line with the criteria set by the Bank of Spain and Grupo Santander, with regard to the standard applied in the UK market. This focus includes classification of the following operations as non-performing loans:

- Customers with payment delays of between 30 and 90 days and who have been declared publicly insolvent (via a bankruptcy process) in the previous two years.

- Operations where, once the maturity date is reached, there is still loan capital pending payment with a maturity of more than 90 days, although the customer remains up to date with their monthly payments.

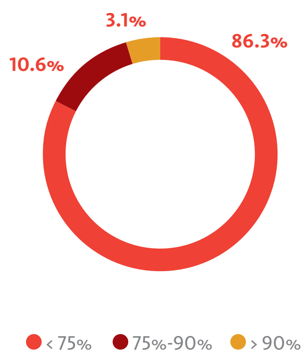
- Forbearance operations which, in accordance with the corporate policy, are considered as "payment agreements" and thus classified as non-performing loans.

Excluding these concepts, which are not included in calculating the NPL ratio in the UK market, and under which EUR 637 million was classified as NPLs at the end of December 2016, the ratio of the mortgage portfolio was 1.01%.

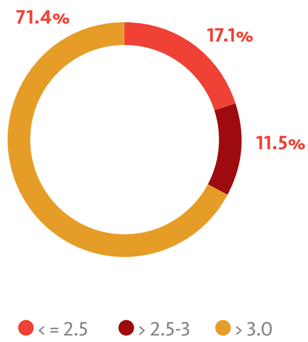
The strict credit policies mentioned limit the maximum loan-to-value (LTV) to 90% for those loans that amortise interest payments and capital, and to 50% for those that amortize interest regularly and the capital at maturity. These policies were applied, bringing the simple arithmetic average LTV of the portfolio to 42.9% and the average weighted LTV to 38.9%. The proportion of the portfolio with an LTV of more than 100% was down to 1.2%, from 1.7% in 2015.

The following charts show the LTV structure for the stock of residential mortgages and their distribution in terms of the income multiple for new loans as of December 2016:

Loan to value
(average 42.9%)[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 the customer's annual gross income declared in the loan application.

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

11. Percentage calculated for loans with total or some interest only component.

customers. For example, as of 2009 mortgages with a loan-to-value of more than 100% have not been allowed.

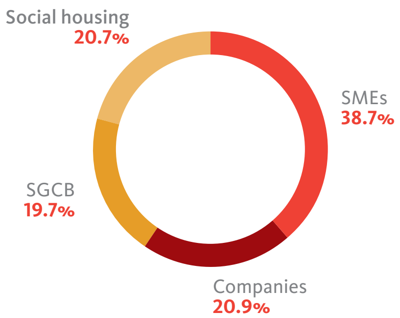
An additional indicator of the portfolio's strong performance is the reduced volume of foreclosed properties, which in December 2016 amounted to EUR 42 million, less than 0.03% of total mortgage exposure. Efficient management of these cases and the existence of a dynamic market for this type of housing enables sales to take place in a short period of time (around 18 weeks on average), contributing to the good results.

1.3.1.3 SMEs and business

As shown in the chart on the segmentation of the portfolio at the beginning of this section, lending to SMEs and companies (EUR 47,234 million) represented 20% of the total at Santander UK as of December 2016.

The following sub-segments are included in these portfolios:

SME and business portfolio: segments



SMEs: this segment includes small firms belonging to the business lines of small business banking and regional business centres. Total lending at December 2016 was EUR 18,295 million, with an NPL ratio of 3.4%.

Companies: This includes companies to which a risk analyst is assigned. It also includes portfolios considered as not strategic (legacy and non-core). Lending at December 2016 was EUR 9,867 million, with an NPL ratio of 2.3 %.

GCB: includes companies under the Santander Global Corporate Banking risk management model. Lending at December amounts to EUR 9,314 mn with an NPL ratio of 0.01%.

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. Outstanding lending in December stood at EUR 9,758 million.

D. 1.3.2. Spain

1.3.2.1. Overview of the portfolio

Total credit risk (including guarantees and documentary credits) in Spain (excluding the real estate unit, which is discussed later) amounted to EUR 172,974 million (20% of the Group total), with an adequate level of diversification by both product and customer segment.

In 2016, total credit risk was in line with the previous year, after successive falls in recent years. The growing volume of new lending in the main individual and business segments portfolios offsets the lower funding to government bodies and the pace of repayments, still higher than growth of new lending in the individuals segment. Meanwhile, the companies segment returned to growth.

Credit risk by segment

Million euros

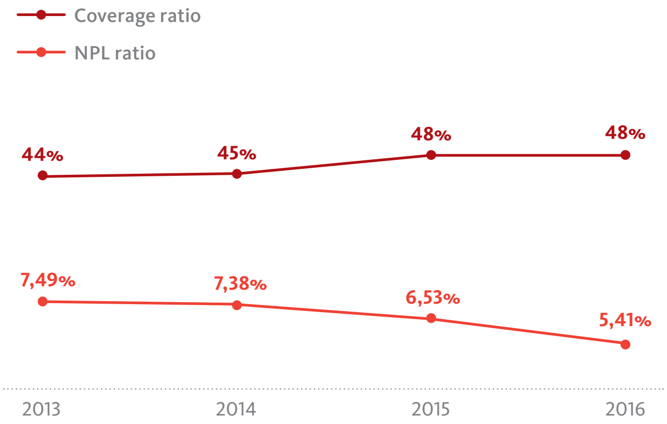
	2016	2015	2014	Var 16/15	Var 15/14
Total credit risk*	172,974	173,032	182,974	0%	(5%)
Household mortgages	46,219	47,924	49,894	(4%)	(4%)
Other credit for individuals	16,608	16,729	17,072	(1%)	(2%)
Companies	96,081	92,789	96,884	4%	(4%)
Public administrations	14,065	15,590	19,124	(10%)	(18%)

* Including guarantees and documentary credits

NPL ratio for the total portfolio was 5.41%, 112 bp lower than at year-end 2015, due to the trend of falling delinquency. This pattern is due to the lower gross NPL entries in the individual and business segments, which are 24% lower than 2015, and, to a lesser extent, the normalisation of several restructured positions and portfolio sales.

The coverage ratio remained at 48%, similar to year-end year end 2015.

NPL and coverage ratio



Below are the main portfolios.

1.3.2.2. Home mortgages

Lending to households to acquire a home in Spain amounted to EUR 46,864 million at the end of 2016 (27% of total credit risk). 99% of this has a mortgage guarantee.

Lending to households to acquire a home*

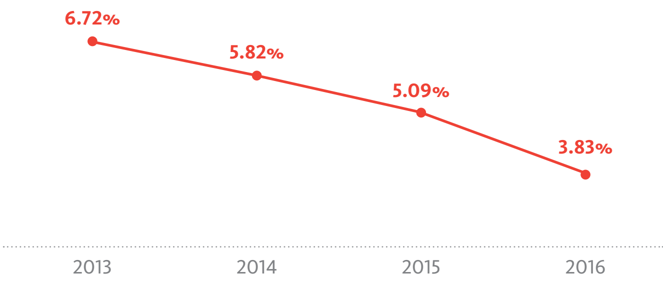
Million euros

	2016	2015	2014
Gross amount	**46,864**	**48,404**	**50,388**
Without mortgage guarantee	645	480	496
With mortgage guarantee	46,219	47,924	49,894
of which non-performing loans	**1,796**	**2,477**	**2,964**
Without mortgage guarantee	27	40	61
With mortgage guarantee	1,769	2,437	2,903

* Does not include the Santander Consumer España mortgage portfolio (EUR 2,192 million, with EUR 97 million of non-performing loans).

The NPL ratio of mortgages to households to acquire a home was 3.83%, 126 bp less than in 2015. The fall in lending (which increases the NPL ratio by 19 bp), which is due to repayments being higher than the new growth in loans, is offset with the fall in delinquency (NPL ratio down 145 bp), underpinned by further reduction in gross NPL entries while the pace of recoveries remains at 2015 levels.

NPL rate, household mortgages, Spain

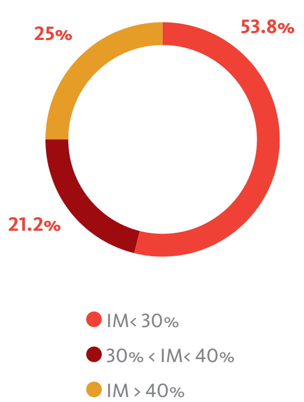


The portfolio of mortgages for homes in Spain kept its medium-low profile with limited expectations of further deterioration:

- All mortgages repay principle right from the start.
- Early amortization is usual and so the average life of the operation is well below that in the contract.
- High quality of collateral concentrated almost exclusively in financing the first home.
- Average affordability rate of close to 28%.
- Some 74% of the portfolio has a loan-to-value of less than 80% (total risk/latest available valuation of the home).

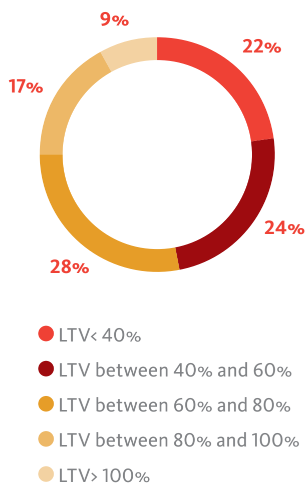
Income multiple

%



Loan to value

%

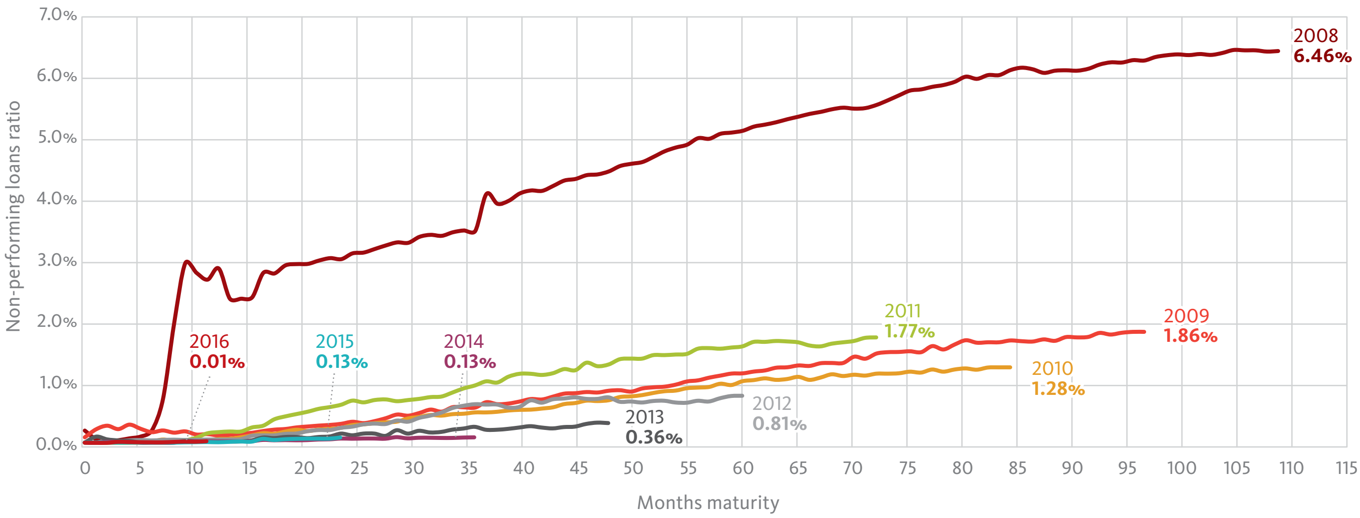


Loan to value: percentage indicating the total risk/latest available valuation of the home.

Income multiple: relation between the annual instalments and the customer's net income.

The evolution of vintages in 2016 continued to be very positive, backed by the quality of the admission measures applied since 2008 and a refocusing of demand towards better profiles, resulting in a decreasing rate of NPL entries.

Maturity of vintages



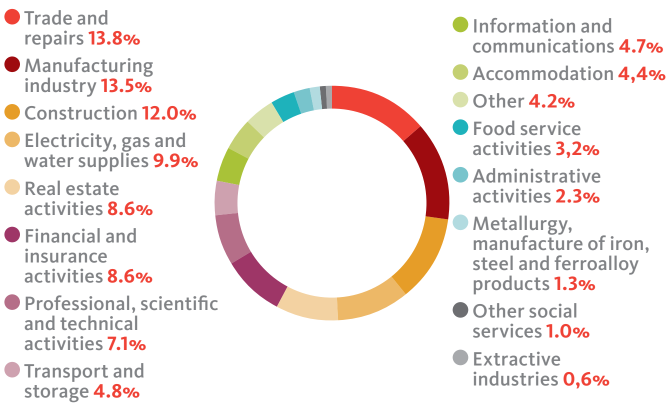
1.3.2.3. Business portfolio

Credit risk assumed directly with SMEs and companies (EUR 96,081 million) is the main lending segment in Spain (56% of the total).

Most of the portfolio (93%) corresponds to customers who have been assigned an analyst to monitor them continuously throughout the risk cycle.

It is a highly diversified portfolio, with over 199,561 active customers and without significant concentrations in any one particular business segment.

Business portfolio distribution



The NPL ratio of this portfolio was 5.79% at the end of 2016, 185 bp lower than 2015. This fall is the result of the growth in lending (which reduces the NPL ratio by 16 bp) and the fall in delinquency (NPL ratio down by 169 bp), with gross NPL entries 33% lower than the previous year and a rate of recoveries at similar levels.

1.3.2.4. Real estate activity in Spain

The Group manages real estate activity in Spain through a separate unit, which includes loans to customers mainly for real estate promotion, and has a specialised management model, with stakes in companies in the real estate sector[12] and foreclosed assets.

The Group's strategy in the last few years has been to reduce the volume of these assets, which at the end of 2016 stood at EUR 5,937 million in net terms (around 2% of loans in Spain and less than 1% of the Group's loans). The portfolio's composition is as follows:

- Net loans of EUR 1,874 million, EUR 722 million less than at December 2015, with coverage of 54%.
- Net foreclosed assets at year end were EUR 3,403 million, with coverage of 58%.
- The net value of stakes in real estate companies was EUR 660 million.

The gross exposure in loans and foreclosures continued the downward trend of previous years and fell 65% between 2008 and 2016.

12. As of December 2014, the stake in Metrovacesa was consolidated by the full equity method.

The changes over time and the classification of the credit and foreclosed assets portfolios are shown in the table below:

Credits and foreclosed assets portfolio
Million euros

	2016			2015		
	Gross balance	% cover.	Net balance	Gross balance	% cover.	Net balance
1. Lending	4,069	54%	1,874	5,959	56%	2,596
a. Performing	228	5%	217	435	27%	318
b. Non-performing loans	3,841	57%	1,657	5,524	59%	2,278
2. Foreclosed	8,061	58%	3,403	8,253	55%	3,707
Total 1+2	**12,130**	**56%**	**5,277**	**14,212**	**56%**	**6,303**

Net exposure under the management scope of the real estate unit fell by 16% in 2016.

By type of real estate that guarantees the loans and foreclosed assets, the coverage levels are as follows:

Coverage by guarantee type
Million euros

	Real estate lending		Foreclosed real estate assets		Total	
	Expos.	Cover.	Expos.	Cover.	Expos.	Cover.
Completed buildings	2,120	47%	2,178	49%	4,298	48%
Developments under construction	97	26%	839	46%	936	44%
Land	1,517	62%	5,044	63%	6,561	63%
Other guarantees	335	72%	0	-	335	72%
TOTAL	**4,069**	**54%**	**8,061**	**58%**	**12,130**	**56%**

D. 1.3.3. United States

The credit risk of Santander's US subsidiary stood at EUR 91,709[13] million at year-end 2016. This subsidiary comprises the following business units, after their integration under Santander Holdings USA in July:

- **Santander Bank N.A.**: With total loans, including off-balance sheet exposure, of EUR 54,040 million (59% of Santander US total). Its lending activity is focused on retail and commercial banking, of which 33% is with individuals and approximately 67% with companies. One of the main strategic goals for this unit is its transformation plan. This focuses on compliance with all regulatory programs, together with the development of the retail and commercial banking model towards a comprehensive solution for its customers.

- **Santander Consumer USA (SC USA)**: Focused on Automobile financing with lending of EUR 28,590 million (31% of the total for the USA), and a vehicle leasing portfolio amounting to EUR 9,120 million. This activity is mainly based on its relationship with the Fiat Chrysler Automobiles (FCA) group, which dates back to 2013. Through this agreement, SC USA became the preferred lender 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 3,843 million at year-end 2016, 4% of total lending in the USA. Santander Investment Securities (SIS), Nueva York, is dedicated to wholesale banking, with total lending at year-end 2016 of EUR 1,459 million (2% of the USA total). Finally, Banco Santander International (BSI), Miami, focuses mainly on private banking. Its lending stood at EUR 3,760 million at year-end 2016, 4% of total lending in the USA.

At an aggregate level, Santander US´s lending increased by 1.1% compared to year-end 2015. Non-performing loans and cost of credit remained stable. This was due to the improved performance of SC US´s Auto portfolios, following the implementation of new risk policies in the first quarter to improve the profile of new originations, and adjustments to the Oil & Gas sector in Santander Bank, in line with the industry. The NPL ratio stood at 2.28% (+15 bp) at year end, with a cost of credit of 3.68% (+2 bp). Details of the performance of Santander US's main units are set out below.

Great progress has been made in projects related to existing regulatory commitments, particularly with regard to stress testing and CCAR (Comprehensive Capital Adequacy and Review) exercises, reducing the number of outstanding recommendations by 66%.

1.3.3.1. Santander Bank N.A. performance

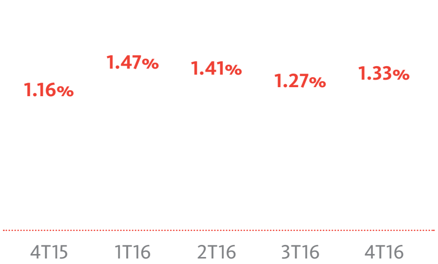
Most of the lending of Santander Bank is secured - around 60% of the total - mainly in the form of mortgages to individuals and also in companies lending. This explains its low NPL ratio and cost of credit. Lending remained broadly stable in 2016.

The NPL ratio remains very low, as shown in the charts below, standing at 1.33% at 31 December. The increase is explained by NPL classifications carried out in the first quarter for the Oil & Gas sector, which were offset by significant improvements throughout the rest of the year due to active portfolio management and favourable movements in oil prices. The cost of credit stood at 0.23%, up 10 bp compared to year-end 2015, due mainly to increased coverage for customers in this sector.

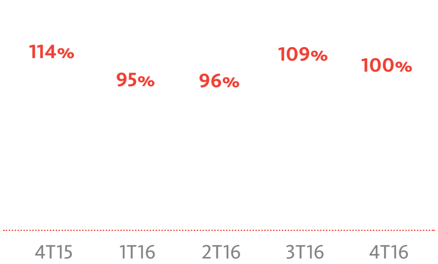
13. Includes EUR 17 million of lending under the holding company.

The coverage ratio, therefore, remains at comfortable levels ending the year at 100%.

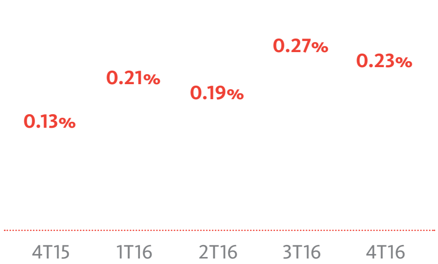
Non-performing loans ratio



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.

1.3.3.2. SC USA Performance

The risk indicators for Santander Consumer 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 leases. 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. This means that the costs of credit are higher than those in other Group units, but these are compensated 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, admission, 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.

The lending of Santander Consumer USA also include the personal lending portfolio, which is considered non-strategic. In early 2016 the Lending Club business was sold for EUR 824 million.

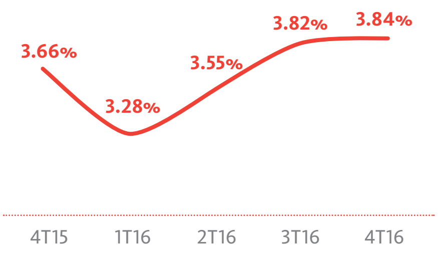
The NPL ratio remains moderate at 3.84% (up 18 bp compared to the previous year), thanks to preventive delinquency management accordingly to the type of business involved. The cost of credit improved to 10.72%, from 10.97% at year-end 2015. This was due to new risk policies implemented in the first quarter, with more demanding criteria resulting in a higher quality mix of new lending, and lower volumes of new vehicle lending.

The leasing portfolio - business carried out exclusively under the FCA agreement and focused on customers with high quality credit profiles - grew by 30.9% in the year, to EUR 9,120 million. 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 book value of the vehicles at the time of underwriting of the leasing agreement, and their potential value at maturity. These mitigating actions are carried out in accordance with the prudent risk appetite framework, through the definition of limits, and through management of the business, with rapid and efficient sales of the vehicles when the agreements end. The unit is currently evaluating "share-agreement" structures and sales agreements with third parties.

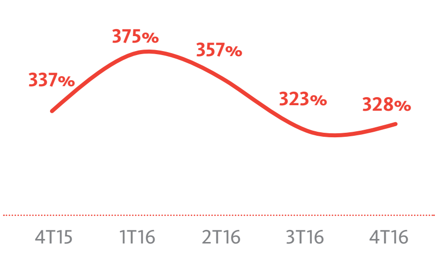
The growth in this portfolio has maintained profitability at adequate levels, with revenues performing favourably. This is reflected in the positive results for leases that matured during the year, and the mark-to-market valuation of vehicles in the portfolio compared to their book value, amounting to EUR 67 million at year-end 2016.

The coverage ratio remains high, at 328% compared to 337% in the previous year.

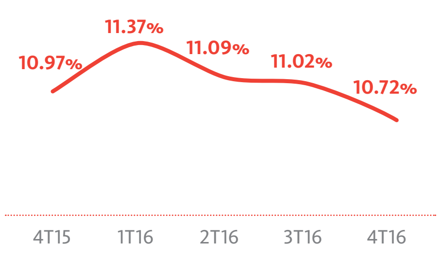
Non-performing loans ratio



Coverage ratio



Cost of credit



SC USA is benefitting from increasing access to third party funding, with a 7.5% increase in funding obtained throughout the year.

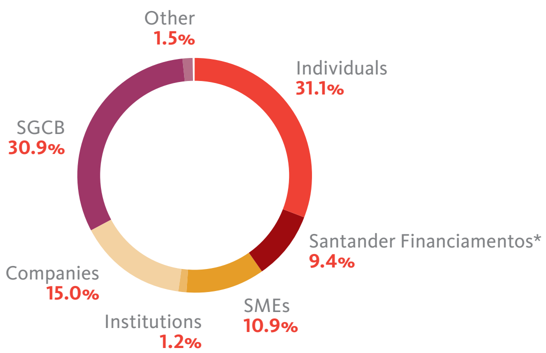
The main strategic focus is on continuing to improve the portfolio mix and its profitability, which has started to be achieved in 2016, and continuing to improve control and monitoring processes in relation to regulatory compliance and practices with customers.

D. 1.3.4. Brazil

Credit risk in Brazil amounts to EUR 89,572 million, up 24.1% against 2015 and largely due to the strengthening of the Brazilian currency. Santander Brasil thus accounts for 10.5% of all Grupo Santander lending. It is adequately diversified and with a mainly retail profile (51.4% individuals, consumer finance and SMEs).

Portfolio mix

%



* Santander Financiamentos: unit specialising in consumer finance (mainly auto finance).

As of December 2016, there was a decrease of around 1.5% in local currency terms, in line with the other private banks in the country.

This was mainly due to a lack of solvent demand, maturities of wholesale transactions (partially offset in the last quarter with the signing of confirming transactions) and the strengthening of the Brazilian real against the US dollar.

The strategy focused on changing the mix used in recent years continued during 2016. Stronger growth was obtained in segments with a more conservative profile, fostering customer loyalty and digitalisation at the same time. The individuals segment was marked by growth in the mortgage portfolio and the portfolio of payroll discount loans (marketed under the brand name *Olé Consignado*), commercial efforts aimed at the select segment, and by marketing campaigns to increase card exposure in the third quarter.

Turning to SMEs, unsecured products - such as the special cheque - also lost ground to less risky forms of funding, such as *Adquirência*. Finally, the companies and GCB portfolios (with large dollar positions in both cases) were both hit by the appreciation of the real against the US dollar, and the strategy of reducing exposure to some commodity sectors (mainly oil and gas and electricity), whilst the agricultural and foreign trade segments were boosted.

The following table shows the levels of lending and growth in the main segments at current exchange rates.

Lending: segmentation

Million euros. Exchange rate fixed at 31 December 2016

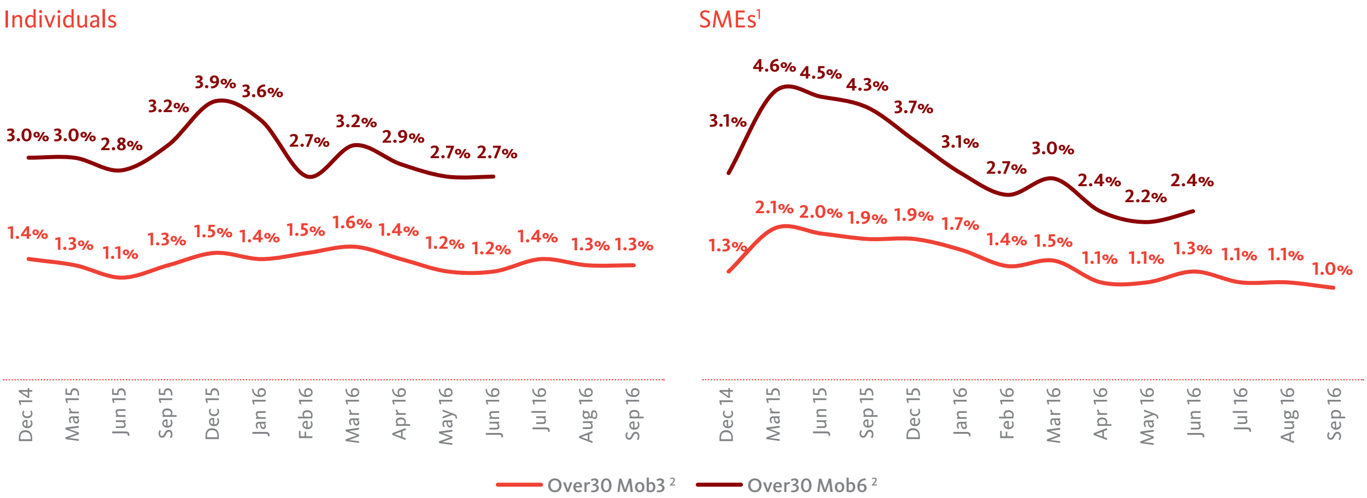
	2016	2015	2014	16 / 15	15 / 14
Individuals	**29,200**	**23,838**	**23,131**	**22%**	**3%**
Mortgages	8,069	7,677	6,321	5%	21%
Consumer	11,687	8,810	9,814	33%	(10%)
Cards	5,973	5,535	5,313	8%	4%
Other	3,472	1,816	1,683	91%	8%
Santander financiamentos	**8,420**	**7,592**	**8,207**	**11%**	**(7%)**
SMEs and large companies	**51,952**	**56,365**	**51,707**	**(8%)**	**9%**
SMEs	10,838	10,609	11,131	2%	(5%)
Companies	13,436	15,033	13,507	(11%)	11%
Corporate	27,678	30,723	27,069	(10%)	13%

The leading indicators for the credit profile of new loans (vintages) are continuously tracked. These are shown below, confirming the entity's resilience to this macroeconomic climate.

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 (Defence Plans), if any deviations from expected scenarios are detected. As we can see, these vintages were kept at comfortable levels through proactive risk management.

Vintages. Performance of the *Over 30** ratio at three and six months from each vintage admission

As a percentage



* 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

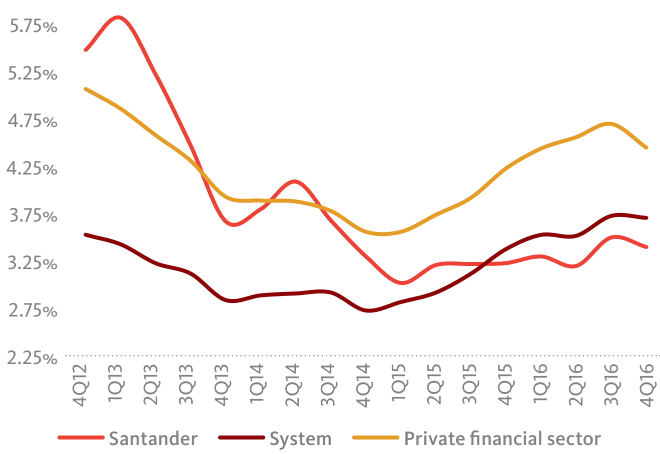
The NPL ratio stood at 5.90% at the end of 2016 (-8 bp compared to the previous year). Despite the economic situation, the outlook in Brazil is increasingly optimistic, as shown by the increase in confidence indicators and also inflation, which is converging towards the government's target range. As a result, the official interest rate (SELIC) has been reduced at recent meetings of the Monetary Policy Committee, after a period of increases. Nonetheless, the recovery could prove to be slower in terms of GDP and in employment, with direct impact on NPL entries/exists.

Given this situation, Santander Brasil has continued to beef up its risk management to anticipate any portfolio impairment through its **Defence Plan**. This Plan was implemented in the previous year, and is continuing to yield satisfactory results. These results include the performance of the retail portfolio, in terms of budget compliance and the evolution of the over 90 index (the local NPL ratio published for the Brazilian financial industry). The defensive measures in the Plan include:

- Preventive management of delinquency, extended through the payroll discount model ("consignado").
- Implementation of specific renegotiation products for different segments and products (Santander Financiamentos and real estate lending).
- Reduction of limits for high risk products and customers, and implementation of maximum indebtedness limits.
- Migration from revolving products to instalment repayment products.
- Increased collateralisation of the portfolio.
- Improved admission models, which are more accurate and predictive, and collection channels.
- More tailored treatment of the largest SMEs.
- Management of risk appetite by sectors, and restrictions on powers in the most critical sectors.

This proactive risk management - based on knowledge of our customers, strict policies and control mechanisms - is enabling Santander Brasil to enhance its position during the current economic cycle. As already mentioned, this is demonstrated by the evolution of the impairment rate for the loan portfolio (known locally as "over 90" rate). This stood at 3.40% at the end of 2016, below the average for private Brazilian banks, which stood at 4.52%.

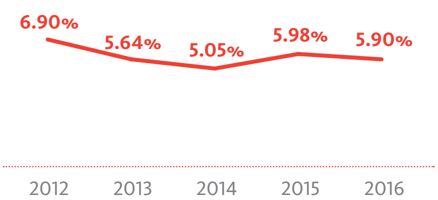
Over90 total



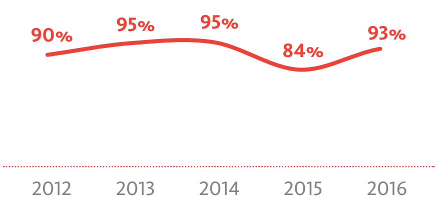
There has been an upward trend in the cost of credit, from 4.50% in 2015 to 4.89% in 2016. This is mainly due to increased coverage for specific economic groups in the Companies and GCB portfolios (generalised impact in the local financial system) and the general economic backdrop. However, the third quarter of 2016 is expected to be a turning point, after which the cost of credit should gradually correct over the following quarters in response to the efforts made previously.

The coverage ratio in the fourth quarter of 2016 stood at 93.1%, an increase of 9.4 pp compared to year-end 2015, due to increased coverage in companies.

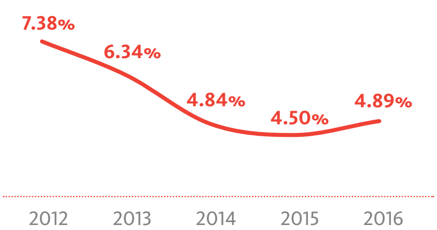
Non-performing loans ratio



Coverage ratio



Cost of credit



» D.1.4. Other credit risk optics

D. 1.4.1. Credit risk by activity in the financial markets

This section covers credit risk generated in treasury activities with customers, mainly with credit institutions. This is developed through financing products in the money market with different financial institutions, as well as products with counterparty risk to provide services to Group customers.

According to chapter six of the CRR (EU regulation 575/2013), the credit risk of the counterparty is the risk that the customer in an operation could enter into non-payment before the definitive settlement of the cash flows of this operation. This includes the following types of operations: derivative instruments, operations with repurchase commitments, stock and commodities lending, operations with deferred settlement and financing of guarantees.

There are two methodologies for measuring this exposure: the mark to market (MtM) methodology (replacement value of derivatives or amount available in committed credit lines); and calculation of exposure by Montecarlo simulation, which was introduced in the middle of 2014 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 done through an integrated system and in real time, enabling the exposure limit available with any counterparty, product and maturity and in any Group unit to be known at each moment.

Exposures in counterparty risk: over the counter (OTC) operations and organised markets (OM)

As of December 2016 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 16,834 million (net exposure of EUR 44,554 million) and was concentrated in high credit quality counterparties (85.79% of counterparty risk has a rating of A or higher).

As of December 2016, there were also CVA (Credit Valuation Adjustments) of EUR 643.9 million (-24.3% compared to 2015) and DVA (Debt Valuation Adjustments) of EUR 390.2 million (-26.4%). These reductions were mainly due to improved methodologies for calculating exposure and a general narrowing of credit spreads[14].

Around 93% of the counterparty risk operations in nominal terms were with financial institutions and central counterparties (CCPs), with whom we operate almost entirely under netting and collateral agreements. Other operations with customers that are not financial institutions are, in general, operations for hedging purposes. Operations are occasionally conducted for purposes other than hedging, but always with specialised customers.

Distribution of counterparty risk by customer rating (in nominal terms)*

AAA	0.88%
AA	7.61%
A	77.30%
BBB	11.05%
BB	3.14%
B	0.02%
RESTO	0.003%

* Ratings based on equivalences between internal ratings and credit agency ratings.

14. The definition and methodology for calculating the CVA and DVA are set out in D.2.2.2.6. Credit Valuation Adjustment (CVA) and Debt Valuation Adjustment (DVA.

Counterparty risk: distribution by nominal risk and gross market value (*)

Million euros

	2016			2015			2014		
		Market value			Market value			Market value	
	Nominal	Positive	Negative	Nominal	Positive	Negative	Nominal	Positive	Negative
CDS protection bought**	23,323	83	(384)	32,350	80	(529)	38,094	60	(769)
CDS protection sold	19,032	339	(33)	26,195	428	(52)	31,565	658	(48)
Total credit derivatives	**42,355**	**422**	**(416)**	**58,545**	**508**	**(581)**	**69,659**	**717**	**(817)**
Equity forwards	134	48	(0)	980	5	(6)	1,055	117	(17)
Equity options	15,154	448	(426)	23,564	959	(1,383)	36,616	1,403	(2,192)
Spot equities	234	0	(0)	20,643	794	-	19,947	421	-
Equity swaps	15,388	631	(461)	28	-	(1,210)	472	-	(701)
Equities - ETF	36,512	-	-	6,480	-	-	8,616	-	-
Total equity derivatives	**67,421**	**1,127**	**(888)**	**51,695**	**1,758**	**(2,598)**	**66,705**	**1,941**	**(2,910)**
Fixed income forwards	6,357	37	(83)	11,340	39	(66)	3,905	3	(124)
Fixed income options	483	5	(2)	789	8	-	423	4	0
Spot fixed income	5,159	5	(2)	3,351	-	-	5,055	-	-
Fixed income - ETF	349	-	-	831	-	-	1,636	-	-
Total fixed income derivatives	**12,348**	**48**	**(88)**	**16,311**	**47**	**(66)**	**11,018**	**8**	**(124)**
Spot and term exchange rates	150,095	3,250	(6,588)	148,537	5,520	(3,315)	151,172	3,633	(2,828)
Exchange rate options	31,362	479	(624)	32,421	403	(644)	44,105	530	(790)
Other exchange rate derivatives	606	7	(27)	189	1	(4)	354	3	(6)
Exchange rate swaps	510,405	25,753	(24,175)	522,287	20,096	(21,753)	458,555	14,771	(15,549)
Exchange rate - organised markets	824	-	-	-	-	-	-	-	-
Total exchange rate derivatives	**693,292**	**29,489**	**(31,413)**	**703,434**	**26,019**	**(25,716)**	**654,187**	**18,936**	**(19,173)**
Asset swaps	22,948	1,178	(758)	22,532	950	(1,500)	22,617	999	(1,749)
Call money swaps	223,005	2,006	(1,581)	190,328	2,460	(1,792)	264,723	1,228	(1,150)
Interest rate structures	7,406	2,321	(593)	8,969	2,314	(3,031)	23,491	2,215	(2,940)
Forward rate agreements - FRAs	370,433	41	(106)	178,428	19	(78)	171,207	13	(63)
IRS	3,182,305	92,268	(92,873)	3,013,490	85,047	(85,196)	2,899,760	95,654	(94,624)
Other interest rate derivatives	210,061	3,762	(2,985)	194,111	3,838	(3,208)	218,167	4,357	(3,728)
Interest rate - ETF	117,080	-	-	26,660	-	-	38,989	-	-
Total interest rate derivatives	**4,133,238**	**101,576**	**(98,896)**	**3,634,518**	**94,628**	**(94,806)**	**3,638,955**	**104,466**	**(104,253)**
Commodities	539	108	(5)	468	130	(40)	1,020	243	(112)
Commodities - ETF	47	-	-	59	-	-	208	-	-
Total commodity derivatives	**586**	**108**	**(5)**	**526**	**130**	**(40)**	**1,228**	**243**	**(112)**
Total OTC derivatives	**4,794,429**	**132,770**	**(131,706)**	**4,431,000**	**123,089**	**(123,805)**	**4,392,303**	**126,312**	**(127,389)**
Total derivatives organised markets* **	**154,812**			**34,028**			**49,449**		
Repos	**122,035**	**2,374**	**(2,435)**	**128,765**	**3,608**	**(3,309)**	**166,047**	**3,871**	**(5,524)**
Securities lending	**33,547**	**9,449**	**(4,124)**	**30,115**	**10,361**	**(1,045)**	**27,963**	**3,432**	**(628)**
Total counterparty risk	**5,104,823**	**144,593**	**(138,265)**	**4,623,908**	**137,058**	**(128,159)**	**4,635,762**	**133,615**	**(133,541)**

* 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.

Counterparty risk: exposure in terms of market value and credit risk equivalent, including mitigation effect[1]

Million euros

	2016	2015	2014
Market value, netting effect[2]	34,998	34,210	28,544
Collateral received	18,164	15,450	11,284
Market value with netting effect and collateral [3]	16,834	18,761	17,260
Net CRE[4]	44,554	52,148	50,077

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 3.1 million in December 2016, EUR 41 million in December 2015 and EUR 71 million in 2014).

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
CDS protection bought**	9,113	13,413	79	717	23,323
CDS protection sold	7,020	11,681	54	277	19,032
Total credit derivatives	**16,133**	**25,094**	**134**	**994**	**42,355**
Equity forwards	134	0			134
Equity options	5,400	7,520	2,111	122	15,154
Spot equities	234				234
Equity swaps	12,503	2,885			15,388
Equities - ETF	10,490	24,678	1,343	0	36,512
Total equity derivatives	**28,761**	**35,084**	**3,455**	**122**	**67,421**
Fixed income forwards	6,333	24			6,357
Fixed income options	483				483
Spot fixed income	4,156	952	36	15	5,159
Fixed income - ETF	349	0	0	0	349
Total fixed income derivatives	**11,321**	**976**	**36**	**15**	**12,348**
Spot and term exchange rates	132,349	16,994	702	51	150,095
Exchange rate options	25,462	5,900			31,362
Other exchange rate derivatives	560	46			606
Exchange rate swaps	186,913	178,562	106,320	38,611	510,405
Exchange rate - organised markets	824	0	0	0	824
Total exchange rate derivatives	**346,107**	**201,501**	**107,022**	**38,662**	**693,292**
Asset swaps	200	1,121	1,584	20,043	22,948
Call money swaps	133,823	77,070	11,026	1,086	223,005
Interest rate structures	1,428	2,859	1,394	1,726	7,406
Forward rate agreements - FRAs	355,486	14,947			370,433
IRS	495,424	1,433,620	859,276	393,985	3,182,305
Other interest rate derivatives	38,011	107,215	50,262	14,573	210,061
Interest rate - ETF	60,906	55,241	881	53	117,080
Total interest rate derivatives	**1,085,277**	**1,692,073**	**924,423**	**431,465**	**4,133,238**
Commodities	308	1		229	539
Commodities - ETF	47	0	0	0	47
Total commodity derivatives	**355**	**1**	**0**	**229**	**586**
Total OTC derivatives	**1,415,338**	**1,874,811**	**1,032,845**	**471,434**	**4,794,429**
Total derivatives organised markets***	**72,616**	**79,919**	**2,224**	**53**	**154,812**
Repos	**113,687**	**7,716**	**632**	**0**	**122,035**
Securities lending	**26,017**	**2,751**	**95**	**4,685**	**33,547**
Total counterparty risk	**1,625,289**	**1,965,196**	**1,035,797**	**476,172**	**5,104,823**

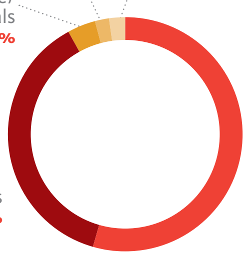
* Figures with management criteria.

** 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.

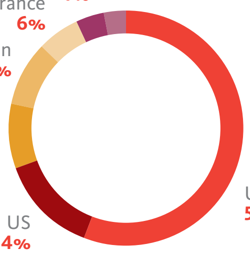
The distribution of risk in notional derivatives by type of counterparty was 38% with financial institutions and 55% with clearing houses.

Counterparty risk by customer type



As regards geographic distribution, 58% of notional derivatives are with UK counterparties (the weight of which within the total is due to the increasing use of clearing houses), 14% with North American counterparties and 7% with Spanish counterparties.

Counterparty risk by geography



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 required by the new rules through clearing houses, and to foster internal use of electronic execution systems.

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[15].

The following tables show the importance of transactions cleared through a clearing house as a share of total counterparty risk at year-end 2016, and the significant evolution of operations settled by clearing houses since 2014.

Distribution of counterparty risk by settlement channel and product type*

Nominal in EUR million

	Bilateral		CCP**		Organised markets ***		
	Nominal	%	Nominal	%	Nominal	%	Total
Credit derivatives	38,440	90.8%	3,916	9.2%	-	0.0%	**42,355**
Equity derivatives	30,853	46%	56	0.1%	36,512	54.2%	**67,421**
Fixed income derivatives	11,999	97.2%	-	0.0%	349	2.8%	**12,348**
Exchange rate derivatives	691,874	99.8%	595	0.1%	823.8	0.1%	**693,292**
Interest rate derivatives	1,401,135	33.9%	2,615,023	63.3%	117,080.1	2.8%	**4,133,238**
Commodity derivatives	539	92.0%	-	0.0%	46.8	8.0%	**586**
Repos	92,272	75.6%	29,763	24.4%	-	0.0%	**122,035**
Securities lending	33,543	100%	4	0.0%	-	0.0%	**33,547**
General total	**2,300,653**		**2,649,358**		**154,812**	**3.0%**	**5,104,823**

* 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.

15. 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

	2016	2015	2014
Credit derivatives	3,916	1,778	1,764
Equity derivatives	36,568	6,522	8,686
Fixed income derivatives	349	896	1,651
Exchange rate derivatives	1,419	11,755	484
Interest rate derivatives	2,732,103	2,069,802	1,778,261
Commodity derivatives	47	59	208
Repos	29,763	44,679	57,894
Securities lending	4	-	-
General total	**2,804,170**	**2,135,489**	**1,848,948**

* Figures with management criteria.

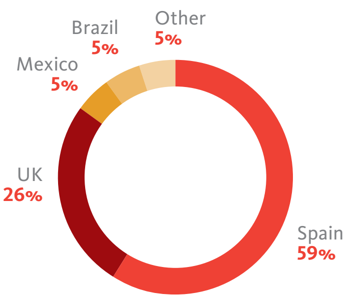
The Group actively manages operations not settled through clearing houses and seeks to optimise their volume, given the spread and capital requirements imposed by new regulations.

In general, transactions with financial institutions are done 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 ones with some exceptions, mainly with multilateral institutions and securitisation funds.

The collateral received under the different types of collateral agreements (CSA, OSLA, ISMA, GMRA, etc) signed by the Group amounted to EUR 18,164 million (of which EUR 12,870 million corresponded to collateral received for derivatives), being mostly cash (77.4%), with other types of collateral being subject to strict quality policies for the type of issuer and its rating, debt seniority and any haircuts applied.

The chart below shows the geographic distribution:

Collateral received. Geographic distribution



Off-balance sheet credit risk

The off-balance sheet risk corresponding to funding and guarantee commitments with wholesale customers was EUR 93,279 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*	11,860	14,772	32,848	3,168	**62,648**
Technical guarantees	4,976	8,379	952	431	**14,738**
Financial and commercial guarantees	4,311	4,636	3,416	2,907	**15,271**
Foreign trade**	344	254	25	0	**622**
General total	**21,492**	**28,041**	**37,241**	**6,505**	**93,279**

(*) Mainly including committed bilateral and syndicated credit lines.

(**) Mainly including stand-by letters of credit.

Activity in credit derivatives

Grupo Santander uses credit derivatives to cover loans, customer business in financial markets and trading operations. The volume of this activity is small compared to that of our peers and, moreover, is subject to a solid environment of internal controls and minimising operational risk.

The risk of these activities is controlled via a broad series of limits, such as 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, geographic area, sector and liquidity.

In notional terms, the CDS position incorporates EUR 19,984[17] million of protection acquired and EUR 19,029 million of protection sold.

At 31 December 2016, the sensitivity of lending to increases in spreads of one basis point was EUR -4.1 million, whilst the average VaR at year-end 2016 was EUR 1.7 million, lower than the 2015 figure (EUR 2.4 million).

D. 1.4.2. Concentration risk

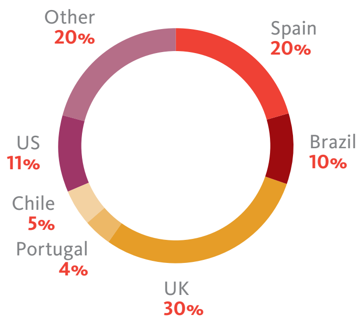
Control of concentration risk is a vital part of management. The Group continuously tracks the degree of concentration of its credit risk portfolios using various criteria: geographic areas and countries, economic sectors, products and groups of customers.

16. The definition and calculation methodology for VaR is set out in section D.2.2.2.1. Value at Risk (VaR).
17. This figure excludes CDSs with a value of around EUR 2,389 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.

The board, via the risk appetite, determines the maximum levels of concentration, as detailed in section B.3.1. Risk appetite and structure of limits. In line with the risk appetite, the Executive Risk Committee establishes the risk policies and reviews the exposure levels appropriate for adequate management of the degree of concentration of credit risk portfolios.

In geographic terms, credit risk with customers is diversified in the main markets in which the Group operates, as shown in the chart below.

Credit risk with customers



Some 56% of the Group's credit risk corresponds to individual customers, who, due to their inherent nature, are highly diverse. In addition, the portfolio is also well distributed by sectors, with no significant concentrations in specific sectors. The following chart shows the distribution at the end of the year.

Sector diversification

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 it equates to 10% or more 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.

The regulatory credit exposure with the 20 largest groups within the sphere of large risks represented 4.7% of outstanding credit risk with clients (lending plus balance sheet risks).

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.

D. 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 2016, the provisionable exposure to country-risk was EUR 181 million (EUR 193 million in December 2015). At the end of December 2016, total provisions stood at EUR 29 million, compared to EUR 25 million at the end of the previous year. It should be noted that Argentina was reclassified from Group 4 to Group 5 in the Bank of Spain classification in 2016[18] .

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.

D. 1.4.4. Sovereign risk and vis-á-vis the rest of public administrations

As a general criterion, sovereign risk is that contracted in transactions with a central bank (including the regulatory cash reserve requirement), the issuer risk of the Treasury or similar entity (portfolio of public debt) and that arising from operations with public institutions with the following features: their funds only come from the state's budgeted income and the activities are of a non-commercial nature.

This criterion, historically used by Grupo Santander, differs in some respects from that requested by the European Banking Authority (EBA) for its regular stress exercises. The main differences are that the EBA's criterion does not include risk 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.

18. The typology of countries for each risk group is defined in Bank of Spain circular 4/2004.

Exposure to sovereign risk (according to the criteria applied in the Group) mainly emanates from the obligations to which our subsidiary banks are subject regarding the establishment of certain deposits in central banks, the establishment of deposits with excess liquidity 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 one of the country of issuance is not very significant (EUR 14,477 million, 6.5% of total sovereign risk), and exposure to non-local sovereign issuers involving cross-border risk is even less significant (EUR 2,028 million, 0.90% of total sovereign risk).

In general, total exposure to sovereign risk has rem¬ained 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[19].

Exposure by rating

%

	31 Dec. 2016	31 Dec. 2015	31 Dec. 2014
AAA	16%	34%	29%
AA	17%	4%	4%
A	29%	22%	28%
BBB	8%	33%	32%
Lower than BBB	30%	7%	7%

The sovereign risk distribution by rating level has been affected by many rating reviews for the sovereign issuers of the countries where the Group operates over the last few years (Brazil, the UK, etc.).

On the basis of the EBA criteria already mentioned, the exposure to public administrations at the end of each of the last three years was as follows (figures in million euros)[20].

Exposure is moderate and remained on an upward path in 2016. The sovereign risk exposure to Spain (where the Group has its headquarters) is not high in terms of total assets (3.5% at the end of December 2016), compared to its Spanish peers.

Exposure to sovereign risk (EBA criterion)

Million euros

31 Dec 2016	Portfolio				
	Trading and other at fair value	Available for sale	Lending	Held-to-maturity portfolio	Total net direct exposure
Spain	9,415	23,415	11,085	1,978	**45,893**
Portugal	(58)	5,982	1,143	4	**7,072**
Italy	1,453	492	7	0	**1,952**
Greece	0	0	0	0	**0**
Ireland	0	0	0	0	**0**
Rest Eurozone	(1,171)	751	79	0	**(341)**
UK	475	1,938	7,463	7,764	**17,639**
Poland	287	5,973	30	0	**6,290**
Rest of Europe	0	502	289	0	**791**
US	1,174	3,819	720	0	**5,713**
Brazil	4,044	16,098	1,190	2,954	**24,286**
Mexico	2,216	5,072	3,173	0	**10,461**
Chile	428	2,768	330	0	**3,525**
Rest of America	134	497	541	0	**1,172**
Rest of the world	1,903	889	683	0	**3,475**
Total	**20,300**	**68,197**	**26,732**	**12,701**	**127,930**

31 Dec 2015	Portfolio				
	Trading and other at fair value	Available for sale	Lending	Held-to-maturity portfolio	Total net direct exposure
Spain	8,954	26,443	11,272	2,025	**48,694**
Portugal	104	7,916	1,987	0	**10,007**
Italy	2,717	0	0	0	**2,717**
Greece	0	0	0	0	**0**
Ireland	0	0	0	0	**0**
Rest Eurozone	(211)	143	69	0	**1**
UK	(786)	5,808	141	0	**5,163**
Poland	13	5,346	42	0	**5,401**
Rest of Europe	120	312	238	0	**670**
US	280	4,338	475	0	**5,093**
Brazil	7,274	13,522	947	2,186	**23,929**
Mexico	6,617	3,630	272	0	**10,519**
Chile	193	1,601	3,568	0	**5,362**
Rest of America	155	1,204	443	0	**1,802**
Rest of the world	3,657	1,687	546	0	**5,890**
Total	**29,087**	**71,950**	**20,000**	**4,211**	**125,248**

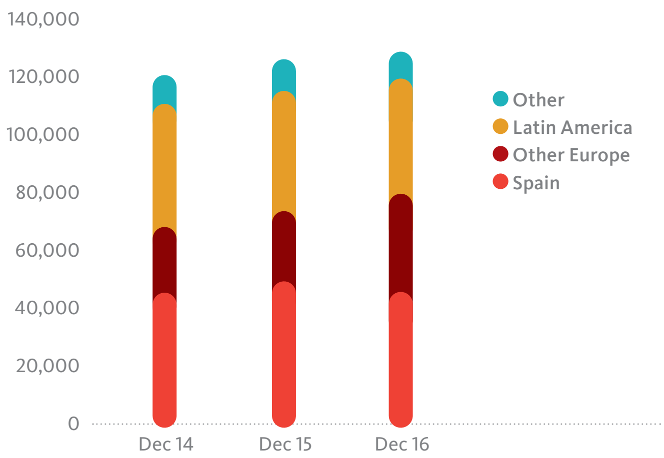
19. Internal ratings used.

20. In addition at 31 December 2016, the Group had direct net exposures to derivatives with a fair value of EUR 2,505 million, as well as indirect net exposure to derivatives with a fair value of EUR 2 million.

Sovereign exposure in Latin America is almost all 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



31 Dec 2014

	Portfolio			
	Trading and others at FV	Available for sale	Lending	Total net direct exposure
Spain	5,778	23,893	15,098	**44,769**
Portugal	104	7,811	589	**8,504**
Italy	1,725	0	0	**1,725**
Greece	0	0	0	**0**
Ireland	0	0	0	**0**
Rest Eurozone	(1.070)	3	1	**(1.066)**
UK	(613)	6,669	144	**6,200**
Poland	5	5,831	30	**5,866**
Rest of Europe	1,165	444	46	**1,655**
US	88	2,897	664	**3,649**
Brazil	11,144	17,685	783	**29,612**
Mexico	2,344	2,467	3,464	**8,275**
Chile	593	1,340	248	**2,181**
Other America	181	1,248	520	**1,949**
Rest of the world	4,840	906	618	**6,364**
Total	**26,284**	**71,194**	**22,205**	**119,683**

D. 1.4.5. Social and environmental responsibility

Banco Santander fosters the protection, conservation and recovery of the environment and the fight against climate change. To do so, Santander analyses the social and environmental risks of its funding transactions in the framework of its sustainability policies. These policies were updated in late 2015 after a painstaking review process in which the best international practices and standards were taken into account.

During 2016, the Group went to great lengths to communicate and disseminate the new versions, coordination between the different teams was stepped up, and internal processes were improved to apply the new requirements of the social and environmental policies. Supporting documentation was developed for the business and risks teams, and a training course was given by external experts designed for the areas which take part in implementing the policies i sensitive sectors such as energy and soft commodities (related to the primary sector), and in other sectors such as mining-metals and chemicals. A total of 440 pupils from across the geographical spectrum in which the Group operates took part in the course.

Policies were implemented throughout the Group by creating social-environmental risk task forces in the main geographies where Banco Santander operates, chaired by the Chief Compliance Officer. These groups were created using the same format as the corporate task force chaired by the Group Chief Compliance Officer, which includes all the functions which take part in the origination, review and decision making so as to have a common understanding and opinion about the transactions and customers affected by policies.

In addition to the above, Grupo Santander has also applied the Equator Principles (EP) since 2009, to Project Finance and corporate funding for a known purpose, including bridge loans before project finance is granted and corporate lending arrangements for building or remodelling a specific project.

» D.1.5. Credit risk cycle

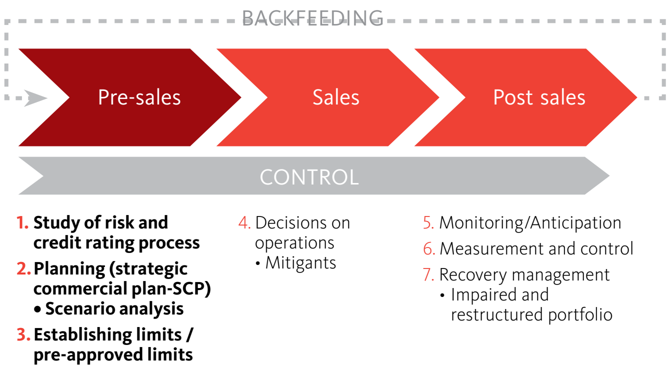
The process of credit risk management consists of identifying, analysing, controlling and deciding on the risks incurred by the Group's operations. The business areas, senior management and the risk areas are all involved.

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 approved 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 credit risk oversight and control of Grupo Santander. 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 Group's level of risk appetite approved by the board of directors, which includes identifying and monitoring current and emerging credit risk and its impact on the Group's risk profile.

The risk cycle has three phases: pre-sale, sale and post-sale. The process is constantly revised, incorporating the results and conclusions of the post-sale phase to the study of risk and presale planning.

Each of these phases is associated with different decision models, understood as the manifestations of business objectives and the lending policy that underpins them in a logical sequence associated with a decision event, with the objective that all decisions should respect the lending policies defined by the entity.



D. 1.5.1. Study of 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, risk operations, solvency and profitability on the basis of the risk assumed.

With this objective, the Group has used customer credit classification models since 1993. These models are applied to the SGCB segment (Santander Global Corporate Banking - sovereign, financial entities, corporate companies), companies and institutions, and SMEs and individuals.

These are known as rating models in the case of SGCB customers, companies and SMEs with individualised treatment, and scoring models for SMEs with standardised treatment and individuals.

The rating results 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 judgment.

The ratings given to customers are regularly reviewed, incorporating the latest available financial information and experience in the development of banking relations. The regularity of the reviews increases in the case of customers who reach certain previously determined levels in the automatic warning systems and who are classified as special watch. The rating tools are also reviewed in order to adjust the accuracy of the rating granted.

Scoring is an automatic assessment system for loan applications. It automatically assigns an individual assessment to the customer for subsequent decision making on the loan, as explained in the 'Decisions on operations' section.

D. 1.5.2. Planning (strategic commercial plan)

The purpose of this phase is to limit the risk levels assumed by the Group, efficiently and comprehensively.

The credit risk planning process serves to set the budgets and limits at portfolio level. Planning is carried out through the Strategic Commercial Plan (SCP), created as a joint initiative between the sales and risk areas.

The SCP is a management model that sets out the planning and control of the Group's lending portfolios. It has developed into an integrated and coordinated working procedure, involving all areas with a stake in the management of loan portfolios (risk, business, management control, capital and financial management). This working model makes it possible to plan and integrate sales strategies and lending policies based on the risk appetite, and to verify the availability of the resources needed to achieve the budget of each business.

The highest Executive Risk Committee of each entity is responsible for authorising and monitoring the plan. It is validated and monitored at corporate level.

SCPs are used to arrange the map of all the Group's lending portfolios.

Analysis of scenarios

As described in section B.3.3. Analysis of scenarios, credit risk scenario analysis enables senior management to 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 provisions and capital in 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** for the central or most likely (baseline scenario) and more stressed scenarios, which are less likely, but still possible (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 Grupo Santander 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 Grupo Santander'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 the default and loss histories of the portfolios 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 performance of risk factors in the face of changes in macroeconomic variables.

  These stress test models follow the same development, validation and governance cycles as the Group's other internal models. They are subject to regular backtesting and recalibration to ensure they correctly capture the relationship between macroeconomic variables and the risk parameters.

- Estimation of the **expected loss** associated with each of the scenarios put forward and the other **important credit risk metrics** deriving from the parameters obtained (NPLs, provisions, ratios, etc.).

- **Analysis and rationale for the evolution of the credit risk profile** at the portfolio, segment, unit and Group levels, in the face of different scenarios and compared to previous years.

- A series of controls and comparisons are run to ensure that the **controls and back-testing** 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 and in their decision making.

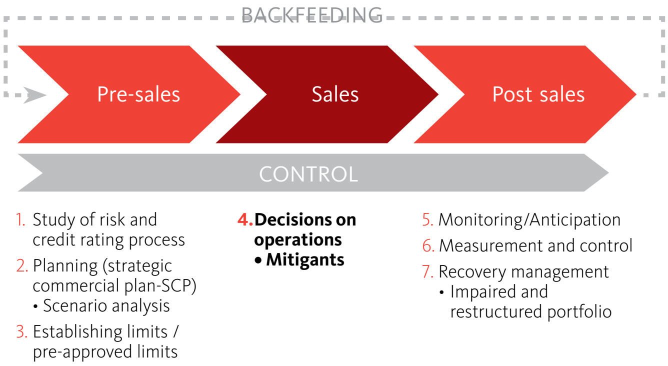
D. 1.5.3. Establishment of limits, pre-classifications and pre-approvals

Limits are planned and established using documents agreed between the business and risk areas and approved by the Executive Risk Committee or committees delegated by it, in which the expected business results, in terms of risk and return, are set out, together with the limits to which this activity is subject and management of the associated risks by group or customer.

Meanwhile, analysis is conducted at the customer level in the wholesale sphere and for other companies and institutions. When certain circumstances occur, the customer is assigned an individual limit (pre-approved limit).

In this way, 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 of maturity. A more streamlined version of pre-approved limits is used for those companies which meet certain requirements (high knowledge, rating, etc).

When individuals and SMEs display certain characteristics, limits are established with a customer-centric vision. The objective is to determine pre-approved transactions for customers, and pre-granted transactions for potential customers, for marketing campaigns and policies to foster use of the limit. For example, sales of specific products, offers to increase operational limits, sales of consumer credit tailored to each customer, etc.



D. 1.5.4. Decisions on operations

The sales phase consists of the decision-making process, which analyses and resolves operations. Approval by the risk area is a prior requirement before the contracting of any risk operation. This process must take into account the policies defined for approving operations and both the risk appetite and those elements of the operation that are relevant in the search for the right balance between risk and profitability.

In the sphere of individual customers, businesses 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. Lending is classified consistently into homogeneous risk groups, on the basis of the information on the features of the operation and of its owner.

As previously mentioned, the admission model makes a decision on the transaction based on the pre-approved limits and pre-sale models, checking against additional and more up-to-date information, such as internal and external information files. If there is no pre-approved limit, the transaction is analysed directly using the non-pre-approved model.

With regard to companies and SGCB, and as already indicated, the prior phase of setting limits can follow two different paths, giving rise to different types of decisions:

- Automatic, verifying whether there is capacity for the proposed operation (in terms of amount, product, maturity and other conditions) within the limits authorised under the pre-classification framework. This process is generally applied to SGCB pre-classifications.

- Always requiring the authorisation of the analyst although the operation meets the amount, maturity and other conditions set in the pre-approved limit. This process is applied to company pre-classifications.

Credit risk mitigation techniques

Grupo Santander applies various forms of credit risk reduction on the basis, among other factors, of the type of customer and product. As we will later see, some are inherent to specific operations (for example, real estate guarantees) while others apply to a series of operations (for example, netting and collateral).

The various mitigation techniques can be grouped into the following categories:

Determination of a net balance by counterparty

The concept of netting is the possibility of determining a net balance 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.

Real guarantees

These are assets that are subject to compliance with the guaranteed obligation. These can be provided by the customer or by a third party. The real assets or rights that are the object of the guarantee can be:

- Financial: cash, deposit of securities, gold, etc.

- Non-financial: property (both homes and commercial premises, etc), other movable property, etc.

Thus guarantees can be in the form of:

- Pledges/financial asset guarantees: a transaction with collateral in which the assets received as the guarantee are debt instruments or other financial assets.

- Real estate mortgages: a transaction with an ordinary or maximum mortgage guarantee on real estate assets.

- Other real guarantees: any other type of transaction with a real guarantee.

As a general rule, repayment capacity is the most important aspect in decisions on the acceptance of risks, although this is no impediment to seeking the highest possible 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.

A very important example of a real financial guarantee is **collateral**. 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 nature of these agreements is diverse, but whatever the specific form of collateralisation, the final purpose, as in the netting technique, is to reduce the counterparty risk.

The operations subject to the collateral agreement are regularly valued (normally day to day) and, on the net balance resulting from this valuation, the parameters defined in the contract are applied so that a collateral amount is obtained (normally cash or securities), which is to be paid to or received from the counterparty.

As regards **property collaterals**, there are regular re-appraisal processes, based on real market values for the different types of property, which meet all the requirements set by the regulator.

Implementation of the mitigation techniques follows the minimum requirements established in the guarantee management policy, which consists of:

- Legal certainty. The possibility of legally requiring the settlement of guarantees must be examined and ensured 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.

- Adequate monitoring and regular control.

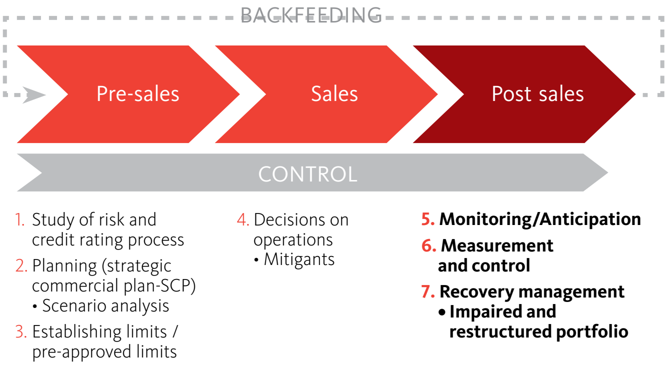
- Traceability of the goods or assets used as the guarantee.

Personal guarantees and credit derivatives

This type of guarantees corresponds to those that place a third party in a position of having to respond to obligations acquired by another to the Group. It includes, for example, sureties, guarantees, stand-by letters of credit, etc. The only ones that can be recognised, for the purposes of calculating capital, are those provided by third parties that meet the minimum requirements set by the supervisor.

Credit derivatives are financial instruments whose main objective is to cover 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, is contracted with front-line banks.

Information on mitigation techniques is set out in the “Credit risk reduction techniques of the Prudential Relevance Report (Pillar III)” section. There is also more information on credit derivatives in the section “Activity in credit derivatives” of section D.1.4.1. Credit risk by activity in financial markets.



D. 1.5.5. Monitoring/Anticipation

Monitoring is a continuous process of constant observation, which allows changes that could affect the credit quality of customers to be detected early on, in order to take measures to correct deviations with a negative impact.

Monitoring is based on customer segmentation, and is carried out by dedicated local and global risk teams, supplemented by internal audit.

In the companies and SME with assigned analyst model, the function consists, among other things, of identifying and tracking customers whose situations require closer monitoring, reviewing ratings and continuously monitoring indicators.

Four degrees are distinguished depending on the level of concern about the observed circumstances (extinguish, secure, reduce, monitor). The inclusion of a position in one of these four levels does not mean that default has occurred, but rather that it is advisable to adopt a specific policy toward that position, establishing a responsible person and time frame for it. Customers classified in this way are reviewed at least every six months, and every quarter in the most serious cases. A company can be classified in one of these levels as a result of monitoring, a decision by the officer responsible for the customer, the triggering of the system established for automatic warnings, or internal audit reviews.

Ratings are reviewed at least every year, but if weaknesses are detected, or on the basis of the rating, it is done more regularly.

Surveillance of the risks of individual customers, businesses and SMEs with a low turnover 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.

D. 1.5.6. Measurement and control

As well as monitoring customer credit quality, Santander establishes the control procedures needed to analyse the current portfolio and its evolution, through the various phases of credit risk.

The function uses a comprehensive vision of credit risk to assess risks from various complementary perspectives, with the main elements being control by countries, business areas, management models, products, etc, facilitating early detection of points for specific attention, and preparing action plans to correct any deteriorations.

Portfolio analysis permanently and systematically controls the evolution of risk with respect 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, the following metrics:

- **VMG (Change in Managed NPLs plus net write-offs)**

Unlike non-performing loans, **VMG** refers to the total impaired portfolio over a period of time, regardless of its current situation (non-performing loans and write-off). This makes the metric a main driver when it comes to establishing measures to manage the portfolio. The VMG and its components play a key role as monitoring variables.

VMG is the result of subtracting the initial balance of non-performing loans from the final balance for the period under consideration, plus the write-offs in this period, less loan loss recoveries in the same period.

It is an aggregate and forward looking measure at the portfolio level that allows a response to any observed deterioration in the evolution of NPLs.

- **Expected loss (EL) and capital**

Unlike the loss incurred, used by the Group to estimate loan-loss provisions, **expected loss** is the estimate of the economic loss which will occur during the following year in the existing portfolio at a given moment. Its forward-looking component complements the view provided by the VMG when analysing the portfolio and its evolution.

It is one more cost of activity, and must impact on the price of operations. Its calculation is mainly based on three parameters:

- Exposure at default (EAD): maximum amount that could be lost as a result of a default.

- Probability of default (PD): the probability of a customer’s default during the year.

- Loss Given Default (LGD): this reflects the percentage of exposure that could not be recovered in the event of a default. It is calculated by discounting at the time of the default the amounts recovered during the whole recovery process. This figure is then compared in percentage terms with the amount owed by the customer at that moment.

Other relevant aspects regarding the risk of operations are covered, such as quantification of off-balance sheet exposures or the expected percentage of recoveries, related to the guarantees associated with the operation, as well as other issues such as the type of product, maturity, etc.

The risk parameters also enable economic and regulatory capital to be calculated. The integration in management of capital metrics is vital for optimising their use. More detail is available in chapter D.8. Capital risk.

D. 1.5.7. 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).

The recovery areas are business areas that directly manage customers: the corporate model thus has a business focus, where sustained value creation is based on effective and efficient collection management, whether by regularisation of balances pending payment or by total recovery.

The recovery management model requires adequate co-ordination of all management areas (commercial, technology and operations, human resources and risks). It is subject to constant review and continuous improvement in the processes and management methodologies that sustain it, through applying the best practices developed in the various countries.

Recovery management is divided into four phases for adequate management: irregularity or early non-payment; recovery of non-performing loans; recovery of write-offs; and management of foreclosed assets. Indeed, the recovery function begins before the first non-payment, when the customer shows signs of impairment and ends when the debt has been paid or returned to normal. The function aims to anticipate non-compliance and is focused on preventative management.

The current macroeconomic environment directly impacts the non-performance ratio and customer delinquency. The quality of portfolios is thus fundamental for the development and growth of our businesses in different countries. Debt collection and recovery functions are given a special and continuous focus, in order to ensure that this quality always remains within expected levels.

The diverse features of our 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 component, while personalised management focuses on customers who, because of their profile, require a specific manager and more individualised management.

Recovery activity has been aligned with the socio-economic reality of our countries and different risk management mechanisms are used with adequate prudential criteria on the basis of age, guarantees and conditions, always ensuring, as a minimum, the required classification and provisions.

Particular emphasis in the recovery function is placed on management of the aforementioned early management mechanisms, in line with corporate policies, taking account of local realities and closely tracking vintages, stocks and performance. These policies are renewed and regularly adapted to reflect best management practices and regulatory changes.

As well as measures to adapt transactions to the customer's payment capacity, another important feature is recovery management, which seeks non-judicial solutions to achieve early payment of debts.

One of the ways to recover debt from customers who have suffered a severe deterioration in their repayment capacity is through repossession (judicial or deed in lieu) of the real estate assets that serve as collateral for the loans. In countries with a high exposure to real estate risk, such as Spain, 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 at a faster pace than other banks.

D.2. Trading market risk and structural risks

» Organisation of this section

We will first describe the activities subject to market risk, setting out the different types and risk factors [pag. 215-216].

Next a section is given over to each one of the market risk types according to the purpose of the risk, distinguishing between trading market risk [pag. 217-229] and structural risks [pag. 229-234], and, within the latter, structural balance sheet risks and pension and actuarial risks.

The most relevant aspects to take into account such as the principal magnitudes and their evolution are set out for each type of risk, the methodologies and metrics employed in Santander and the limits used for their control.

» D.2.1. Activities subject to market risk and types of market risk

The **scope** of activities subject to market risk includes transactions in which equity risk is borne due to changes 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.

- **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 permits 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.

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 mainly responsible for managing this risk.

b) **Structural risks**: we distinguish between balance sheet risks and pension and actuarial risks:

b.1) **Structural balance sheet risks**: market risks inherent to the balance sheet, excluding the trading portfolio. Management decisions on these risks are taken by the ALCO Committees of each country in coordination with the Group's ALCO Committee and are executed by the Financial Management 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.

b.2) **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, obliging 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.

» D.2.2. Trading market risk

D.2.2.1. Key figures and change over time

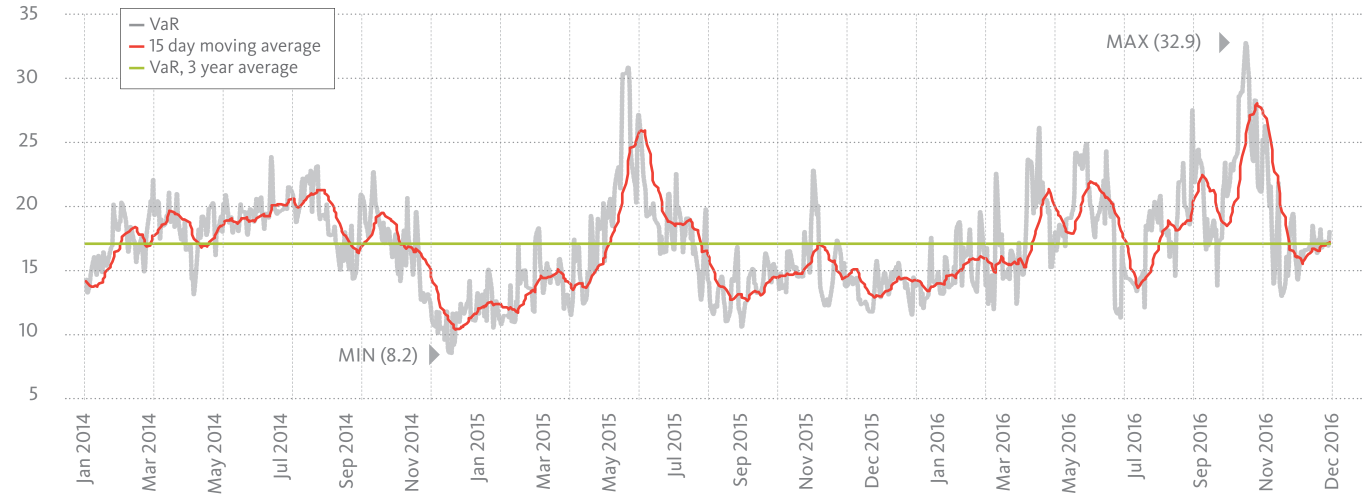
Grupo Santander's trading risk profile remained relatively low in 2016, in line with previous years, due to the fact that the Group's activity has traditionally focused on providing services to its customers, with only limited exposure to complex structured assets, as well as geographic diversification and risk factors.

D.2.2.1.1. VaR analysis[21]

In 2016, the 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 market's volatility in response to events during the year (Brexit, elections in Spain and the USA, the political and economic situation in Brazil and the constitutional referendum in Italy), grew in line with its average path over the last three years, ending 2016 at EUR 17.9 million[22].

VaR 2014-2016

Million euros. VaR at a 99% confidence interval over a one day horizon.



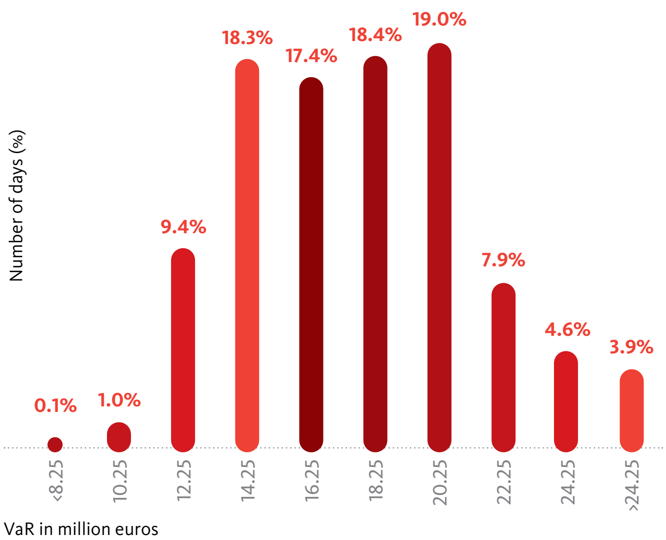
VaR during 2016 fluctuated between EUR 11.1 million and EUR 32.9 million. The most significant changes were related to changes in exchange rate and interest rate exposure and also market volatility.

The average VaR in 2016 was EUR 18.3 million, very similar to the two previous years (EUR 15.6 million in 2015 and EUR 16.9 million in 2014).

The chart below shows the distribution of risk in VaR terms from 2014 to 2016. The accumulation of days with levels of between EUR 8.25 million and EUR 24.25 million (96%) is shown. Values of higher than EUR 24.25 million (3.9%) largely occur in periods affected by temporary spikes in volatility, mainly in the Brazilian real against the dollar and also in the interest rates for both currencies.

VaR risk histogram

VaR at 99% over a one day horizon
Number of days (%) in each range



21. Value at Risk. The definition and calculation methodology for VaR is set out in section D.2.2.2.1. Value at Risk (VaR).
22. Regarding trading activity in financial markets by SGCB (Santander Global Corporate Banking). As well as the trading activity of SGCB, there are other positions catalogued for accounting purposes. The total VaR of trading of this accounting perimeter was EUR 17.8 million.

Risk per factor

The following table displays the average and latest VaR values at 99% by risk factor over the last three years, and the lowest and highest values in 2016 and the Expected Shortfall (ES) at 97.5%[23] at the close of 2016:

VaR statistics and *Expected Shortfall* by risk factor[24, 25]

Million euros. VaR at 99% and ES at 97.5% with one day time horizon.

		2016					2015		2014	
		VaR (99%)				ES (97.5%)	VaR		VaR	
		Minimum	Average	Maximum	Latest	Latest	Average	Latest	Average	Latest
Total trading	**Total**	**11.1**	**18.3**	**32.9**	**17.9**	**17.6**	**15.6**	**13.6**	**16.9**	**10.5**
	Diversification effect	(3.6)	(10.3)	(20.9)	(9.6)	(9.5)	(11.1)	(5.8)	(13.0)	(9.3)
	Interest rate	8.9	15.5	23.1	17.9	16.8	14.9	12.7	14.2	10.5
	Equities	1.0	1.9	3.3	1.4	1.7	1.9	1.1	2.7	1.8
	Exchange rate	3.3	6.9	13.3	4.8	4.9	4.5	2.6	3.5	2.9
	Credit spread	2.4	4.2	7.4	3.3	3.6	5.2	2.9	9.3	4.6
	Commodities	0.0	0.1	0.2	0.1	0.1	0.2	0.1	0.3	0.1
Europe	**Total**	**6.0**	**9.0**	**19.5**	**9.4**	**9.1**	**11.6**	**11.1**	**12.2**	**7.3**
	Diversification effect	(3.7)	(9.1)	(18.1)	(7.6)	(7.7)	(8.3)	(5.6)	(9.2)	(5.5)
	Interest rate	5.0	8.2	14.9	9.1	8.6	10.6	10.9	8.9	6.2
	Equities	0.9	1.6	2.8	1.5	1.6	1.4	1.0	1.7	1.0
	Exchange rate	1.5	4.1	13.2	3.0	3.2	3.3	1.9	2.9	1.5
	Credit spread	2.1	4.1	7.0	3.4	3.3	4.4	2.8	7.6	3.9
	Commodities	0.0	0.1	0.2	0.1	0.1	0.2	0.1	0.3	0.1
Latin America	**Total**	**5.9**	**13.7**	**26.9**	**13.5**	**14.4**	**10.6**	**9.7**	**12.3**	**9.8**
	Diversification effect	(0.6)	(3.6)	(15.1)	(2.7)	(3.0)	(4.8)	(4.4)	(3.5)	(12.2)
	Interest rate	5.4	11.4	21.6	13.0	14.1	10.7	9.3	11.8	9.8
	Equities	0.4	1.4	3.8	0.8	0.8	1.5	0.5	2.1	3.0
	Exchange rate	1.3	4.5	11.4	2.4	2.5	3.2	4.3	2.0	9.2
USA and Asia	**Total**	**0.7**	**1.3**	**4.8**	**2.7**	**2.8**	**0.9**	**0.9**	**0.7**	**0.7**
	Diversification effect	(0.2)	(0.5)	(1.2)	(0.6)	(0.2)	(0.5)	(0.4)	(0.3)	(0.2)
	Interest rate	0.7	1.3	4.9	2.7	2.8	0.8	0.8	0.7	0.7
	Equities	0.0	0.1	0.6	0.0	0.0	0.1	0.0	0.1	0.0
	Exchange rate	0.1	0.4	0.9	0.5	0.2	0.4	0.4	0.3	0.2
Global activities	**Total**	**0.3**	**0.6**	**1.9**	**0.5**	**0.8**	**1.6**	**0.4**	**2.3**	**1.9**
	Diversification effect	0.0	(0.1)	(0.3)	(0.1)	(0.1)	(0.6)	(0.2)	(0.6)	(0.6)
	Interest rate	0.0	0.1	0.2	0.1	0.1	0.5	0.1	0.6	0.4
	Credit spread	0.3	0.5	1.9	0.5	0.8	1.6	0.4	2.2	1.9
	Exchange rate	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.2

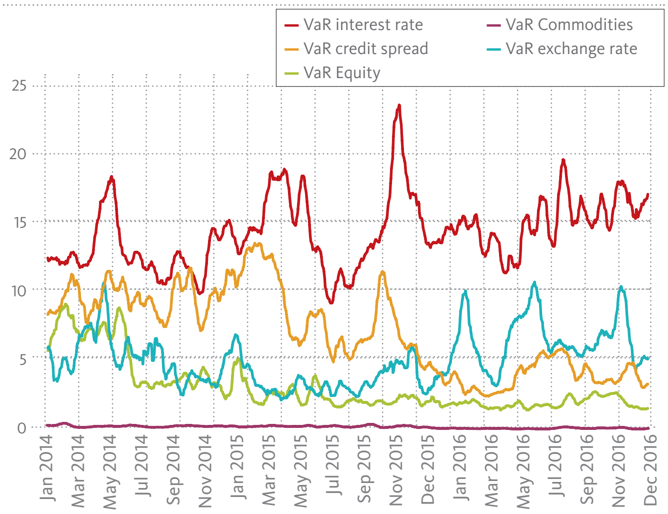
23. This metric is defined in detail in section 2.2.2.2. Following the recommendation of the Basel Committee in its Fundamental review of the trading book: a revised market risk framework (October 2013), the confidence level of 97.5% approximates a risk level similar to that captured by VaR with a 99% confidence level.
24. The VaR of global activities includes operations that are not assigned to any particular country.
25. In Latin America, the United States and Asia, VaR levels are not shown separately for credit spreads and commodities, because of their scant or zero materiality.

At the end of 2016, VaR had increased by EUR 4.3 million against 2015, increasing average VaR by EUR 2.7 million. By risk factor, average VaR increased for exchange rates, interest rate and equity risk, but fell for credit spread and commodities. By geographies, there was a slight increase in Latin America and the United States/ Asia, but 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 figures with stressed VaR figures[26] for the trading activity of the two portfolios with the highest average VaR in 2016.

Stressed VaR vs. VaR in 2016: main portfolios

Million euros. Stressed VaR and VaR at 99% with one-day time horizon.

		2016				2015	
		Mín	**Average**	**Max**	**Latest**	**Average**	**Latest**
Spain	VaR (99%)	3.1	5.7	14.1	4.7	8.9	11.2
	Stressed VaR (99%)	10.5	14.9	23.9	14.3	19.4	13.5
Brazil	VaR (99%)	4.5	12.0	26.8	10.6	9.5	9.4
	Stressed VaR (99%)	6.4	22.2	47.5	23.0	16.6	14.2

D.2.2.1.2. Gauging and backtesting measures

The real losses can differ from the forecasts by the VaR for various reasons related to the limitations of this metric. This is set out in detail later in the section on the 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 the local and global levels and in all cases with the same methodology. Backtesting consists of comparing the forecast VaR measurements, with a certain level of confidence and time frame, with the real results of losses obtained in a same time frame. 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 contrast 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 the first case and for the total portfolio, there were four exceptions for Value at Earnings (VaE)[27] at 99% in 2016 (days on which daily profit was higher than VaE) on 12 and 18 February, 13 April and 24 June. These were caused primarily by major shifts in the exchange rates of the euro and US dollar against the Brazilian real and the interest rate curves for these currencies, together witha generalised increase in volatility in the markets as a result of Brexit.

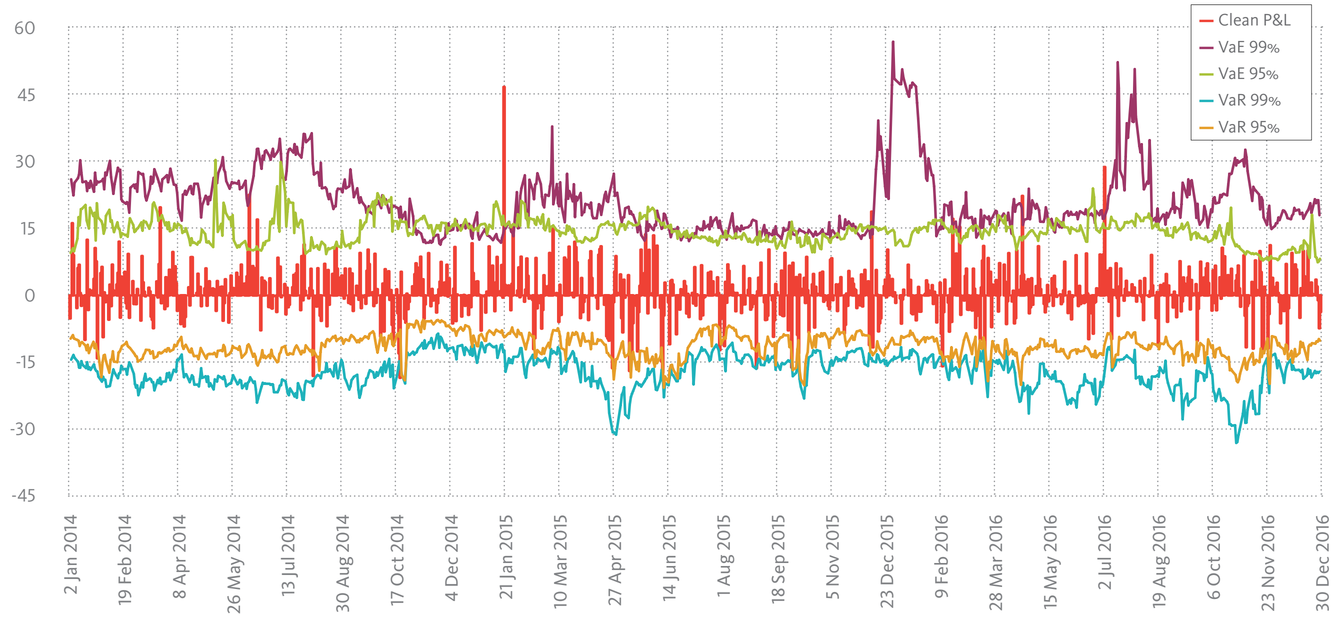
There was also an exception to VaR at 99% (days on which the daily loss was higher than the VaR) on 3 February, caused mainly, as in the above cases, by high volatility in exchange rates and interes curves, in this case for euro and Brazilian real.

The number of exceptions occurred is consistent with the assumptions specified in the VaR calculation model.

26. Description in section 2.2.2.2.
27. The definition and calculation methodology for VaE is set out in section 2.2.2.1.

Backtesting of trading portfolios: daily results vs. Value at Risk (VaR) for previous day

Million euros



D.2.2.1.3. Distribution of risks and management results[28]

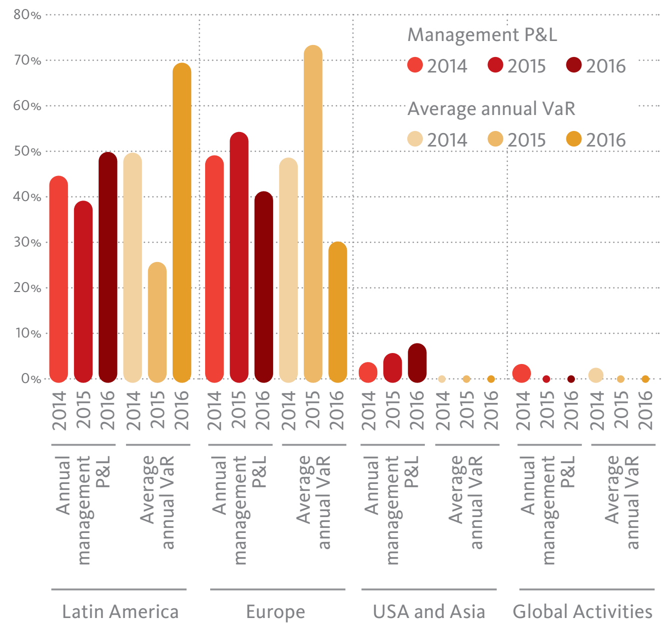
Geographic distribution

In trading activity, the average contribution of Latin America to the Group's total VaR in 2016 was 69.6% compared with a contribution of 50.1% in economic results. Europe, with 29.7% of global risk, contributed 41.9% 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 - P&L binomial: Geographic distribution

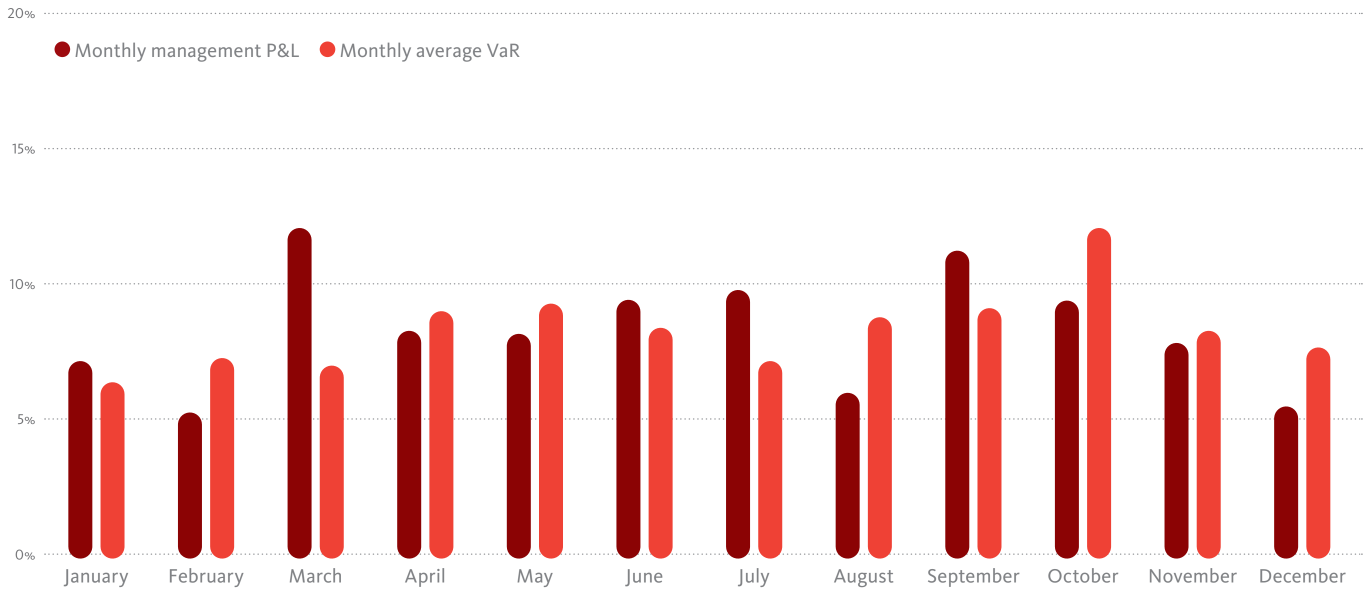
Average VaR (at 99% with a 1 day time horizon) and Annual cumulative management P&L (EUR million), % of annual totals



28. Results in terms similar to Gross Margin (excluding operating costs, the financial would be the only cost).

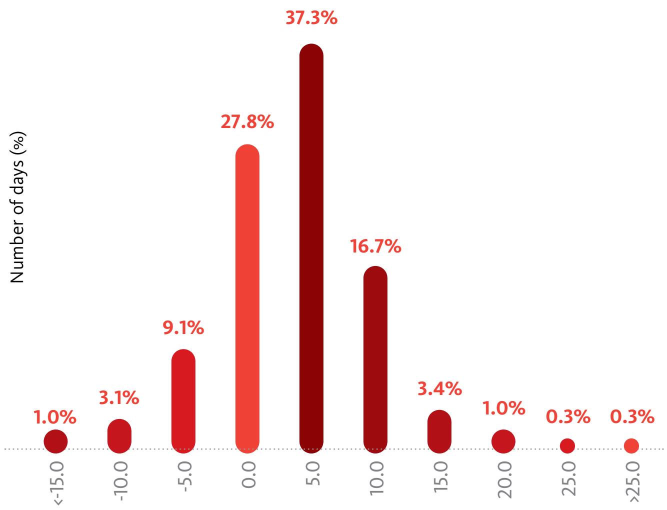
Distribution of risk by time
The next chart shows the risk assumption profile, in terms of VaR, compared to results in 2016. The average VaR remained relatively stable, albeit with higher values in the second half of the year, while results evolved in a more regular way during the same period, and were higher in the first half.

Time distribution of risks and P/L in 2016: percentages of annual totals
VaR (at 99% with a 1 day time horizon) and annual cumulative management P&L (EUR mn), % of annual totals.



The following frequency histogram shows the distribution of daily economic results on the basis of their size between 2014 and 2016. It shows that on over 95.9% of days on which the markets were open daily[29] returns were in a range of between EUR -12 and +13 million.

Daily management P&L (MtM) frequency histogram
Daily management P&L "clean" of fees and intraday operations (EUR mn). Number of days (%) in each range



D.2.2.1.4. Risk management of derivatives
Derivatives activity is mainly focused on marketing investment products and hedging risks for clients. Management is focused on ensuring that the net risk opened is the lowest possible.

These transactions include options on equities, fixed-income and exchange rates. The units where this activity mainly takes place are: Spain, Santander UK, and, to a lesser extent, Brazil and Mexico.

The chart below shows the VaR Vega[30] performance of structured derivatives business over the last three years. It fluctuated at around an average of EUR 5 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 as indicated above (Brexit, general elections in Spain and the US, political-economic situation in Brazil, constitutional referendum in Italy).

29. Yields "clean" of fees and results of intraday derivative operations.
30. Vega, a Greek term, means here the sensitivity of the value of a portfolio to changes in the price of market volatility.

Change in risk over time (VaR) of the derivatives business

Million euros. VaR vega at a 99% over a one day horizon.

As regards the VaR by risk factor, on average, the exposure was concentrated, in this order, in interest rates, equities, exchange rates and commodities. This is shown in the table below:

Financial derivatives. Risk (VaR) by risk factor.

Million euros. VaR at a 99% over a one day horizon.

	2016				2015		2014	
	Minimum	Average	Maximum	Latest	Average	Latest	Average	Latest
Total VaR Vega	**2.4**	**4.0**	**11.4**	**2.5**	**6.8**	**7.0**	**3.3**	**2.7**
Diversification effect	(1.1)	(2.4)	(7.1)	(2.3)	(2.3)	(1.7)	(2.1)	(2.6)
VaR interest rate	2.0	3.6	10.6	2.6	6.5	7.3	2.4	1.7
VaR equities	0.9	1.7	3.0	1.3	1.5	0.8	1.8	2.0
VaR exchange rate	0.5	1.1	4.8	0.9	1.1	0.6	1.2	1.6
VaR commodities	0.0	0.0	0.1	0.0	0.1	0.0	0.0	0.1

Exposure by business unit was mainly concentrated in Spain, Santander UK, Brazil and Mexico (in that order).

Financial derivatives. Risk (VaR) by unit

Million euros. VaR at a 99% over a one day horizon.

	2016				2015		2014	
	Minimum	Average	Maximum	Latest	Average	Latest	Average	Latest
Total VaR Vega	**2.4**	**4.0**	**11.4**	**2.5**	**6.8**	**7.0**	**3.3**	**2.7**
Spain	2.1	3.6	11.3	2.3	6.6	6.9	2.4	1.5
Santander UK	0.6	1.3	3.4	0.9	0.9	0.9	1.4	0.9
Brazil	0.3	0.8	2.4	0.7	0.7	0.4	0.8	0.7
Mexico	0.2	0.4	0.8	0.2	0.8	0.3	0.9	1.3

The average risk in 2016 (EUR 4 million) is lower compared to 2015 and higher than in 2014, for the reasons explained above.

Grupo Santander continues to have a very limited exposure to complex structured instruments or vehicles, showing that it maintains a culture in which prudence in risk management is particularly important. At the end of 2016, the Group had:

- Hedge funds: the total exposure is not significant (EUR 179.4 million at close of December 2016) 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. Exposure has fallen compared with the previous year.

- Monolines: the Grupo Santander's exposure to bond insurance companies (monolines) was, EUR 49.5 million as of December 2016, mainly indirect exposure, EUR 49 million by virtue of the guarantee provided by this type of entity to various financing or traditional securitisation operations. The exposure in this case is to double default, been the primary underlying assests of high credit quality. The small remaining amount is direct exposure (for example, via purchase of protection from the risk of non- payment by any of these insurance companies through a credit default swap). Exposure has fallen compared with the previous year.

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 Risks division verifies:

- The existence of an appropriate valuation model to monitor the value of each exposure: Mark-to-Market, Mark-to-Model or Mark-to-Liquidity.

- The availability in the market of observable data (inputs) needed to be able to apply this valuation model.

And provided these two points are always met:

- The availability of appropriate systems, duly adapted to calculate and monitor every day the results, positions and risks of new operations.

- The degree of liquidity of the product or underlying asset, in order to make possible their coverage when deemed appropriate.

D.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.

Million euros. Data at December 2016

	More 'long' positions (sales of protection)		More 'short' positions (purchase of protection)	
	Exposure at *default* (EAD)	% of total EAD	Exposure at *default* (EAD)	% of total EAD
1st reference	1,132.6	18.5%	(30.9)	0.7%
2nd reference	132.3	2.2%	(24.0)	0.5%
3rd reference	90.9	1.5%	(19.0)	0.4%
4th reference	87.3	1.4%	(19.0)	0.4%
5th reference	81.9	1.3%	(18.7)	0.4%
Sub-total top 5	1,525.0	24.9%	(111.6)	2.4%
Total	**6,130.0**	**100%**	**(4,748.4)**	**100%**

Note: zero recoveries are supposed (LCR=0) in the EAD calculation

D.2.2.1.6. Analysis of scenarios

Various stress scenarios were calculated and analysed regularly in 2016 (at least 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 2016 are shown in the following table.

Stress scenario: maximum volatility *(worst case)*
Million euros. Data at December 2016

	Interest rate	Equities	Exchange rate	*Credit* spread	Commodities	Total
Total trading	**(100.5)**	**(3.1)**	**(10.3)**	**(10.0)**	**(0.1)**	**(124.0)**
Europe	(14.7)	(1.2)	(2.9)	(9.2)	(0.1)	(28.1)
Latin America	(74.8)	(1.9)	(6.8)	0.0	0.0	(83.5)
US	(7.5)	0.0	(0.5)	0.0	0.0	(8.0)
Global activities	(0.1)	0.0	0.0	(0.8)	0.0	(0.9)
Asia	(3.4)	0.0	(0.1)	0.0	0.0	(3.5)

The stress test shows that the economic loss suffered by the Group in its trading portfolios, in terms of the mark to market (MtM) result, would be, if the stress movements defined in the scenario materialised in the market, EUR 124 million. This loss would be concentrated in Latin America (in the following order: interest rates, exchange rates and equity) and Europe (in the following order: interest rates, credit spread, exchange rates and equities).

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 is to capture the impact on results of the reduction in liquidity in the markets. Two time horizons were used (one day and 10 days), in both cases there are 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. This year, the new scenario has been included in the set of scenarios handled by the entity.

EBA adverse scenario: the scenario proposed by the European Banking Authority (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 this 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.

This latter scenario replaced the sovereign debt crisis scenario in November 2014. This historic scenario identified four geographic zones (the USA, Europe, Latin America and Asia) and included interest rate rises, falls in stock markets and volatilities, widening credit spreads, depreciation of the euro and Latin American currencies, and appreciation of Asian currencies, against the dollar.

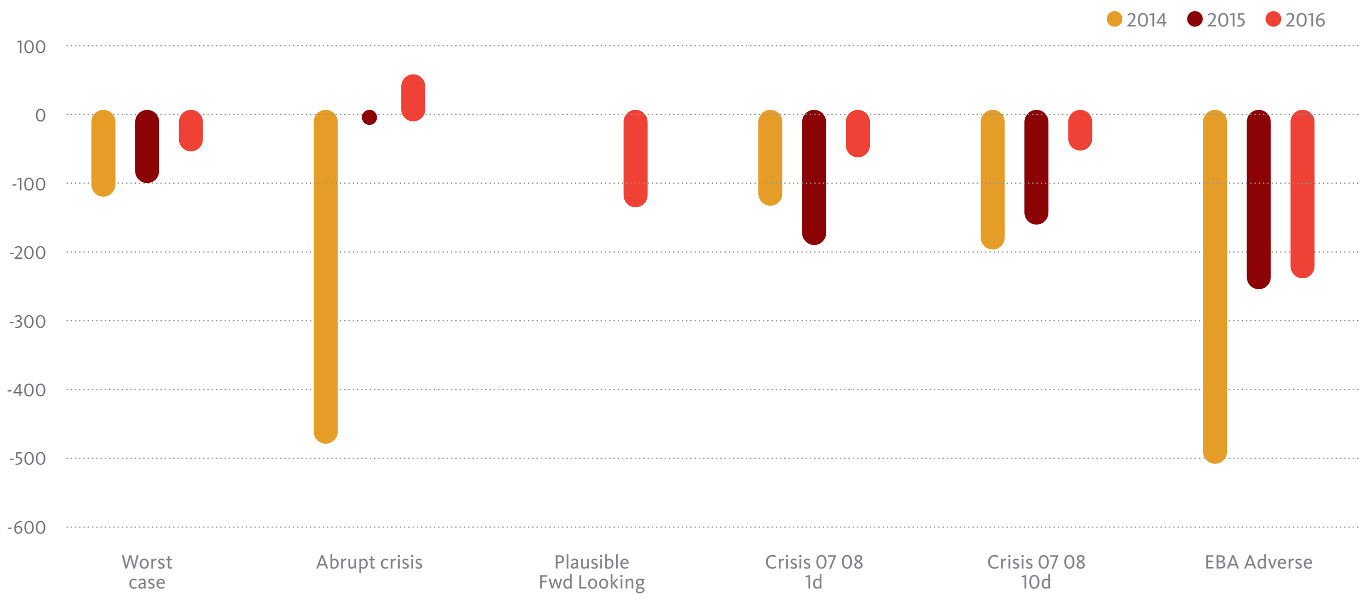
In 2016, the analysis of the Reverse Stress Tests was added. These tests are based on establishing a predefined result (unfeasibility of a business model or possible insolvency) and subsequently the risk factor scenarios and movements which could cause that situation are identified.

Every month a consolidated stress test report is drawn up 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 the 2014-2016 scenarios (annual averages)

Million euros



D.2.2.1.7. Linkage with balance sheet items. Other alternative risk measures

Below are the balance sheet items in the Group's consolidated position that are subject to market risk, distinguishing the positions whose main risk metric is 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. (December 2016)

	Balance sheet amount	Main market risk metric: VaR	Main market risk metric: Other	Main risk factor for 'Other' balance
Assets subject to market risk	**1,339,125**	**189,372**	**1,149,753**	
Cash and deposits at central banks	76,454		76,454	Interest rate
Trading portfolio	148,187	147,738	449	Interest rate, credit spread
Other financial assets at fair value	31,609	31,284	325	Interest rate, credit spread
Available-for-sale financial assets	116,774	-	116,774	Interest rate; equities
Investments	4,836	-	4,836	Equities
Hedging derivatives	10,377	10,350	27	Interest and exchange rates
Loans	854,472		854,472	Interest rate
Other assets financials[1]	35,531		35,531	Interest rate
Other non-financial assets[2]	60,885		60,885	
Liabilities subject to market risk	**1,339,125**	**157,098**	**1,182,027**	
Trading portfolio	108,765	108,696	69	Interest rate, credit spread
Other financial liabilities at fair value	40,263	40,255	8	Interest rate, credit spread
Hedging derivatives	8,156	8,147	9	Interest and exchange rates
Financial liabilities at amortised cost[3]	1,044,688		1,044,688	Interest rate
Provisions	14,459		14,459	Interest rate
Other financial liabilities	9,025		9,025	Interest rate
Equity	102,699		102,699	
Other non-financial liabilities	11,070		11,070	

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 Grupo Santander (basically derivatives linked to the home price index - HPI - in market activity in Santander UK, and interest rate and correlation derivatives for share prices in the parent bank's market activity), as well as in general for inputs 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.

D. 2.2.2. Methodologies

D.2.2.2.1. Value at Risk (VaR)

The standard methodology the 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 quickly. 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 risk of the portfolio, 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 accuracy of the VaR calculation model.

D.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[31]. Going forward, in the near term the Basel Committee has recommended replacing VaR with Expected Shortfall as the baseline metric for calculating regulatory capital for trading portfolios[32]. The 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.

D.2.2.2.3. Analysis of scenarios

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. This consists of 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.

D.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 to changes in market factors can be obtained using analytical approximations by partial derivatives or by complete revaluation of the portfolio.

In addition, the statement of income is also drawn up every day, providing an excellent indicator of risk, enabling us to identify the impact of changes in financial variables on the portfolios.

31. 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.

32. "Minimum Capital Requirements for Market Risk" (BCBS Document on banking supervision, January 2016).

D.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 basically 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.

D.2.2.2.6. Credit Valuation Adjustment (CVA) and Debt Valuation Adjustment (DVA)
Grupo Santander incorporates credit valuation adjustment (CVA) and debt valuation adjustment (DVA) when calculating the results of trading portfolios. The **CVA** is a valuation adjustment of over the-counter (OTC) derivatives, as a result of the risk associated with the credit exposure assumed by each counterparty.

The CVA is calculated by taking into account the potential exposure with each counterparty in each future maturity. The CVA for a particular counterparty is therefore the sum of the CVAs over all such future terms. The following inputs are used:

- 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.

D.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 B.3.1. Risk appetite and limits structure). This process is part of an annual limits plan drawn up 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 activity 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 transactions.

These general limits are complemented by other sub-limits to establish a sufficiently granular limits framework for effective control of the market risk factors to which the Group is exposed in its trading activities. Positions are monitored on a daily basis, at both the unit and global levels, with exhaustive control of changes to portfolios, so as to identify any incidents that might need immediate correction. Meanwhile, the daily drawing up of the income statement by the Risks area is an excellent indicator of risks, as it allows the impact that changes in financial variables have had on portfolios to be identified.

Implementation of the Volcker Rule throughout the Group in July 2015 required activities to be reorganised to ensure compliance with this new regulation, the preparation of new metrics and the definition of limits at the desk level.

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 and so as 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.

» D.2.3. Structural balance sheet risks[33]

D. 2.3.1. Key figures and change over time

The market risk profile inherent in Grupo Santander's balance sheet, in relation to its asset volumes and shareholders' funds, as well as the budgeted financial margin, remained moderate in 2016, in line with previous years.

D.2.3.1.1. Structural interest rate risk

Europe and the United States

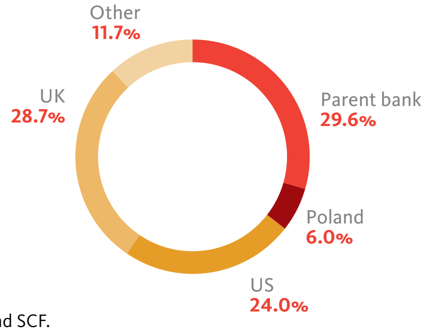
The main balance sheets, the Parent, United Kingdom and United States, in mature markets and in a low interest rate setting, usually show positive sensitivities to interest rates in economic value of equity and net interest income.

Exposure levels in all countries are moderate in relation to the annual budget and capital levels.

At the end of 2016, 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 euro yield curve, at EUR 186 million, the British pound, at EUR 166 million, the US dollar, at EUR 140 million and the Polish zloty, at EUR 32 million, all relating to risks of rate cuts.

Net interest income (NII) sensitivity[34]

% of total

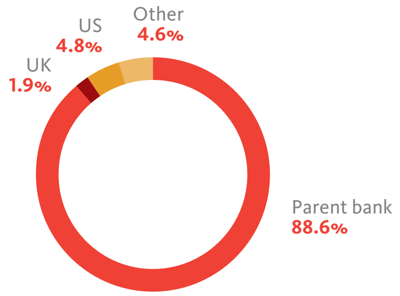


Other: Portugal and SCF.

At the same date, the main risk to the most relevant 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 3,736 million, followed by the US dollar at EUR 341 million, the British pound at EUR 59 million and the Polish zloty at EUR 45 million, all with a risk of falling interest rates, scenarios which are now very unlikely.

Economic value of equity (EVE) sensitivity[35]

% of total



Other: Poland, Portugal and SCF.

33. This includes the whole balance sheet with the exception of trading portfolios.
34. Sensitivity to the worst-case scenario between +100 and -100 basis points.
35. Sensitivity to the worst-case scenario between +100 and -100 basis points.

The tables below set out the interest-rate risk of the balance sheets of the Parent bank and Santander UK by maturity, at the end of 2016.

Parent: Interest rate repricing gap[36]

Million euros. December 2016

	Total	3 months	1 year	3 years	5 years	> 5 years	Not sensitive
Assets	365,495	112,927	67,646	21,565	15,836	27,989	119,534
Liabilities	399,667	112,551	43,856	57,518	43,329	59,929	82,484
Off balance sheet	34,172	34,174	(445)	2,477	45	(2,079)	0
***Net* gap**	**0**	**34,550**	**23,346**	**(33,477)**	**(27,448)**	**(34,020)**	**37,049**

Santander UK: Interest rate repricing gap[37]

Million euros. December 2016

	Total	3 months	1 year	3 years	5 years	> 5 years	Not sensitive
Assets	322,299	162,655	37,162	63,408	19,719	19,106	20,249
Liabilities	326,740	194,038	23,848	27,133	21,550	29,803	30,368
Off balance sheet	4,441	(18,061)	8,872	(713)	8,598	5,745	0
***Net* gap**	**0**	**(49,443)**	**22,186**	**35,562**	**6,766**	**(4,953)**	**(10,118)**

In general, the gaps by maturities are at reasonable levels in relation to the size of the balance sheet.

Latin America

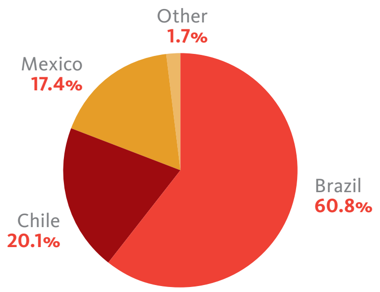
Latin American balance sheets are usually positioned for interest rate cuts for both economic value and net interest income, except for net interest income in Mexico, where excess liquidity is invested in the short term in the local currency.

In 2016, 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 112 million), Chile (EUR 37 million) and Mexico (EUR 32 million), as shown in the chart below.

Net interest income (NII) sensitivity[38]

% of total

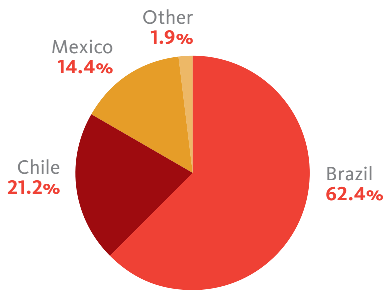


Other: Argentina and Uruguay.

Risk to the economic value of equity over one year, measured as sensitivity to parallel changes in the worst-case scenario of ±100 basis points, was also concentrated in Brazil (EUR 489 million), Chile (EUR 166 million) and Mexico (EUR 113 million).

Economic value of equity (EVE) sensitivity[39]

% of total



Other: Argentina and Uruguay.

36. Aggregate gap for all currencies on the balance sheet of the parent bank unit, in euros.
37. Aggregate gap for all currencies on the balance sheet of the Santander UK unit, in euros.
38. Sensitivity to the worst-case scenario between +100 and -100 basis points.
39. 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 2016.

Brazil: Interest rate repricing gap[40]
Million euros. December 2016

	Total	3 months	1 year	3 years	5 years	> 5 years	Not sensitive
Assets	205,668	102,488	21,710	20,601	8,911	16,078	35,880
Liabilities	205,668	141,865	7,188	7,322	3,734	7,027	38,533
Off balance sheet	0	15,059	2,506	2,572	(140)	2,384	(22,382)
***Net* gap**	**0**	**(24,317)**	**17,028**	**15,852**	**5,037**	**11,435**	**(25,035)**

Balance sheet structural interest rate VaR
In addition to sensitivities to interest rate movements (in which, assessments of ±100 bp movements are supplemented 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.

	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.

	2014			
	Minimum	Average	Maximum	Latest
Structural interest rate VaR*	**411.3**	**539.0**	**698.0**	**493.6**
Diversification effect	(109.2)	(160.4)	(236.2)	(148.7)
Europe and USA	412.9	523.0	704.9	412.9
Latin America	107.6	176.4	229.4	229.4

* Includes credit spread VaR on ALCO portfolios.

Structural interest rate risk, measured in terms of VaR at one-day and at 99%, averaged EUR 340.6 million in 2016. It is important to note the high level of diversification between the Europe and United States balance sheets and those of Latin America.

D.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[41]. In 2016, hedging levels of the core capital ratio for exchange rate risk were maintained at around 100%.

At the end of 2016, the largest exposures of permanent investments (with their potential impact on equity) were, in order, in Brazilian reais, pounds sterling, US dollars, Chilean pesos, Mexican pesos and Polish zlotys. The Group hedges some of these positions of a permanent nature with exchange-rate derivatives.

In addition, the Financial Management 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.

D.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 2016 was diversified in securities in various countries, mainly Spain, China, the USA, Brazil and the Netherlands. Most of the portfolio is invested in the financial and insurance sectors. Other sectors, to a lesser extent, are public administrations (stake in Sareb), professional, scientific and technical activities, the transport and storage sector and manufacturing industry.

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 2016, the VaR at 99% with a one day time frame was EUR 323 million (EUR 208.1 and EUR 208.5 million at the end of 2015 and 2014, respectively).

40. Aggregate gap for all currencies on the balance sheet of the Brazil unit, in euros.
41. In early 2015, the criteria for coverage of the core capital ratio was changed from phase-in to fully loaded.

D.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 rate 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.

	2016				2015		2014	
	Minimum	Average	Maximum	Latest	Average	Latest	Average	Latest
Structural VaR	**717.8**	**869.3**	**990.6**	**922.1**	**698.5**	**710.2**	**718.6**	**809.8**
Diversification effect	(288.0)	(323.4)	(399.5)	(316.6)	(509.3)	(419.2)	(364.1)	(426.1)
VaR interest rate*	242.5	340.6	405.8	327.2	350.0	264.2	539.0	493.6
VaR exchange rate	564.1	603.4	652.7	588.5	634.7	657.1	315.3	533.8
VaR equities	199.3	248.7	331.5	323.0	223.2	208.1	228.4	208.5

* Includes credit spread VaR on ALCO portfolios.

D. 2.3.2. Methodologies

D.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.

Assets and liabilities interest rate gap

This is the basic concept for identifying the entity's interest-rate risk profile and measuring 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 (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. This separation between stable and unstable balances is obtained from a model that is based on the relation between balances and their own moving averages.

From this simplified model, the monthly cash flows are obtained and used to calculate 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 the fixed rate on the mortgage and the market rate at which it could be refinanced, net of cancellation and opening costs.

- **Seasoning**: pre-payment trends downward at the start of the instrument's life cycle (signing of the contract) and upwards, 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: defines as more stable those loans that have already overcome various waves of interest rate falls. In other words, when a portfolio of loans has passed one or more cycles of downward rates and thus high levels of pre-payment, the "surviving" loans have a significantly lower pre-payment probability.

  c) Others: geographic mobility, demographic, social 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, which come into force in 2018.

D.2.3.2.2. Structural exchange-rate risk/hedging of results

These activities are monitored via position measurements, VaR and results, on a daily basis.

D.2.3.2.3. Structural equity risk

These activities are monitored via position measurements, VaR and results, on a monthly basis.

D.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 ones 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 relevant risk management executives must explain the reasons and facilitate the measures to correct it.

» D.2.4. Pension and actuarial risk

D. 2.4.1. 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.

D.2.4.2. Actuarial risk

Actuarial risk is produced by biometric changes in the life expectancy of those with life assurance, 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.

D.3. Liquidity risk and funding

» Organisation of this section

First, we present the Group's **Liquidity management**, which includes 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 to the **evolution of liquidity in 2016**. For the last year, we examine changes in the liquidity management ratios and the business and market trends that gave rise to these [pag. 236-241].

The section ends with a qualitative description of the **outlook** for funding in the following year for the Group and its main countries [pag. 242].

» D.3.1. Liquidity management in Grupo Santander

Management of structural liquidity aims to fund the Group's recurring activity in optimum conditions of maturity and cost, avoiding the assumption of undesired liquidity risks.

Santander's **liquidity management** is based on the **following principles**:

- Decentralised liquidity model.
- Needs derived from medium- and long-term activity must be financed 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 terms.
- Limited recourse to wholesale short-term funding.
- Availability of sufficient liquidity reserves, including the discounting capacity in central banks to be used in adverse situations.
- Compliance with regulatory liquidity requirements required at Group and subsidiary level, as a new conditioning factor in management.

The effective application of these principles by all the institutions that comprise 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 senior management of subsidiaries 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 ALM corporate 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 optimum levels of liquidity to cover its short and long-term needs with stable funding sources, optimising the impact of its cost on the income statement, both under ordinary circumstances and under stress.

  Accordingly, risk appetite metrics have been set up with specific levels, both for the different ratios and for the minimum liquidity horizons under the different stress scenarios. Generally, the following scenarios are defined for all Group units in their reporting to the senior management, without overlooking the local development of ad hoc scenarios:

  a. Idiosyncratic crisis: Only affects the entity but not its environment.

  b. Local systemic crisis: A loss of trust by international financial markets in the country where the unit is located.

c. Global crisis: The global economy deteriorates, mainly in the United States and in Europe, and this effect spreads to the leading emerging countries (BRIC).

- **Management adapted** in practice to the **liquidity needs of each business**. Every year, based on business needs, a liquidity plan is developed which will ensure 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 use of balance sheet assets, as well as complying with both regulatory metrics and other metrics included in each entity's risk appetite statement. Over the course of the year, all the dimensions of the plan are monitored.

The Group applies **ILAAP** (internal liquidity adequacy assessment process), an internal self-assessment process of the adequacy of liquidity 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 input for the SREP (Supervisory Review and Evaluation Process). The ILAAP shares the stress scenarios described above, with the Grupo Santander recording sound liquidity ratios in all of these.

» D.3.2. Funding strategy and evolution of liquidity in 2016

D.3.2.1. 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 of 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 stress in the markets.

- 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 2016, Santander continued to improve in specific aspects based on a very comfortable liquidity position at the level of the Group and in the subsidiaries, with no significant changes in liquidity management or funding policies or practices. All of this enables us to face 2017 from a good starting point, with no restrictions on growth.

In general terms, **the approaches** to funding strategies and liquidity management implemented by Santander subsidiaries **are being maintained**:

- Maintaining adequate and stable medium and long-term wholesale funding levels.

- Ensuring a sufficient volume of assets which can be discounted in central banks as part of the liquidity reserve.

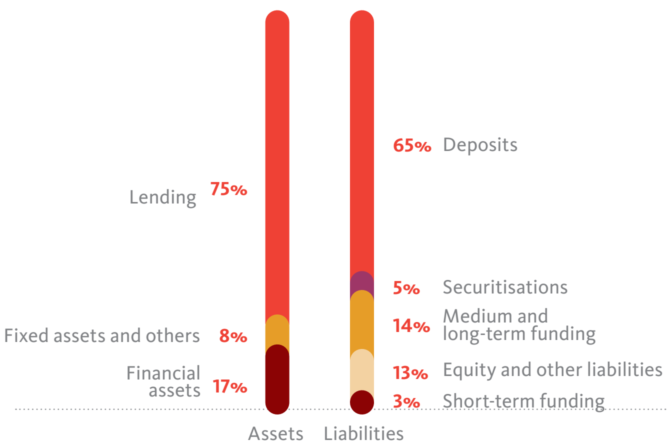
- Strong liquidity generation from the commercial business through lower credit growth and increased emphasis on attracting customer deposits.

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 in a retail banking balance sheet**. Customer deposits are the main source of the Group's funding, representing around two-thirds of the Group's net liabilities (i.e. of the liquidity balance) and 87% of net loans at the end of 2016.

  They are also very stable funds given their origin mainly in business with retail customers (89% of the Group's deposits come from retail and private banking, whilst the remaining 11% come from large corporate and institutional clients).

Grupo Santander liquidity balance sheet
%. December 2016

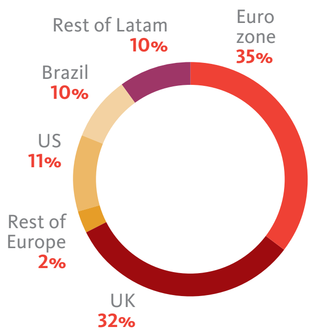


- **Diversified wholesale funding focused on the medium and long term, with a very small relative short-term component** . Medium and long term wholesale funding accounts for 20%% of the Group's net funding and comfortably covers the lending not financed by customer deposits (commercial gap).

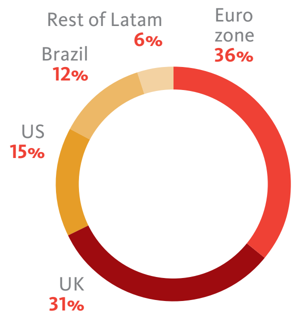
  This funding is well balanced by instruments (approximately 40% senior debt, 30% securitisations and structured products with guarantees, 20% covered bonds, and the rest preferred shares and subordinated debt) and also by markets so that those with the highest weight in issues are those where investor activity is the strongest.

The following charts show the **geographic distribution** of customer loans in the Group, and its medium and long-term wholesale funding, so that their similarity can be appreciated.

Net customer loans
December 2016



M/LT wholesale funding
December 2016



The bulk of medium and long-term wholesale funding consists of debt issues. Their outstanding balance at the end of 2016 was 149.578 million in nominal terms, with an adequate maturity profile and average maturity of 4.3 years).

The distribution of this by instrument, evolution over the last three years and maturity profile was as follows:

Medium and long-term debt issue. Grupo Santander
Million euros

	Change in outstanding balance at nominal value		
	Dec-16	Dec-15	Dec-14
Preferred	8,515	8,491	7,340
Subordinated	11,981	12,262	8,360
Senior debt	89,568	83,630	68,457
Covered bonds	39,513	45,010	56,189
Total	**149,578**	**149,393**	**140,346**

Distribution by contractual maturity. December 2016*

	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	-	-	-	-	-	-	-	8,515	8,515
Subordinated	61	-	-	-	215	601	580	10,524	11,981
Senior debt	2,035	7,331	4,438	6,892	8,018	15,374	32,310	13,170	89,568
Covered bonds	3,112	749	3,284	-	4,850	1,073	11,629	14,816	39,513
Total*	**5,208**	**8,079**	**7,722**	**6,892**	**13,083**	**17,048**	**44,520**	**47,025**	**149,578**

* In the case of issues with put option in favour of the holder, the maturity of the put option is considered instead of the contractual maturity. Note: there are no additional guarantees for any of the senior debt issued by the Group's subsidiaries.

In addition to debt issues, medium and long-term wholesale funding is completed by securitised bonds placed on the market, and collateralised and other specialist financing amounting in total to EUR 57.012 million, with a maturity of 1.7 years.

The wholesale funding of short-term issuance programmes is a residual part of the Group's financial structure, accounting for around 3% of net funding, which is related to treasury activities and is comfortably covered by liquid financial assets.

The outstanding balance at the end of 2016 was EUR 27.250 million, distributed as follows: various certificate of deposit and commercial paper programmes in the UK, 36%; European commercial paper and US commercial paper and the domestic programmes of the parent bank, 25%, and programmes in other units, 39%.

D.3.2.2. Evolution of liquidity in 2016

The main aspects of liquidity in 2016 can be summarised as follows:

i. Basic liquidity ratios were maintained at comfortable levels.

ii. We are continuing to achieve regulatory ratios ahead of schedule.

iii. Our large liquidity reserves are continuing to increase.

iv. Moderate use of encumbered assets in funding operations.

i. Basic liquidity ratios at comfortable levels

The table shows the evolution of the basic metrics for monitoring liquidity at the Group level over the last few years:

Grupo Santander Monitoring metrics

	2016	2015	2014
Net loans/net assets	75%	75%	74%
Net loan-to-deposit ratio (LTD ratio)	114%	116%	113%
Customer deposits and medium and long-term funding/net loans	114%	114%	116%
Short-term wholesale funding/net liabilities	3%	2%	2%
Structural liquidity surplus (% net liabilities)	14%	14%	15%

At the end of 2016, and compared to the previous year, Grupo Santander recorded:

- A stable ratio of credits over net assets (total assets minus trading derivatives and inter-bank balances) of 75%, similar to the level in 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 ratio) at 114%, within a very comfortable 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 held at 114% in the year.

- Reduced recourse to short-term wholesale funding. The ratio was around 3%, in line with previous years.

- Lastly, the Group's structural surplus (i.e. the excess of structural funding resources - deposits, medium and long-term funding and capital - over structural liquidity needs - fixed assets and loans) rose in 2016, to an average of EUR 151,227 million, unchanged on the end of the previous year.

At 31 December 2016, the consolidated structural surplus stood at EUR 150,105 million. This consists of fixed-income assets (EUR 169,931 million) and equities (EUR 17,139 million), partly offset by short-term wholesale funding (EUR -27,250 million) and net interbank and central bank deposits (EUR -9,716 million). In relative terms, the total volume was equivalent to 14% of the Group's net liabilities, a similar level to December 2015.

The table below sets out the most frequently used liquidity ratios for Santander's main units at the end of December 2016:

Main units and liquidity metrics

%. December 2016

	LTD Ratio	Deposits + M&LT funding/Net lending
Spain	86%	148%
Portugal	91%	124%
Santander Consumer Finance	243%	66%
Poland	88%	116%
UK	118%	109%
Brazil	104%	129%
Mexico	94%	115%
Chile	138%	99%
Argentina	72%	141%
US	132%	113%
Group total	**114%**	**114%**

Generally speaking, there were **two drivers** behind the evolution of the Group's liquidity and that of its subsidiaries in **2016** (stripping out the forex effect):

1. Good performance in deposits in the main geographies where the Group operates, particularly in Spain and the UK. This performance has helped to narrow the commercial gap, which has more than made up for the increased lending.

2. The firm momentum in debt issuance has been maintained, particularly by European units, although a more selective approach has been adopted in its execution due to the lower banking book requirements and the greater funding facilities implemented by central banks, in particular the Bank of England's Term Funding Scheme, following the UK's referendum on EU membership.

In 2016, the Group as a whole attracted EUR 45,995 million in medium and long-term funding.

In terms of **instruments**, the biggest fall was in issuances of medium and long-term fixed-income (senior debt, covered bonds, subordinated debt and preferred shares), down 25% to EUR 32,851 million, mainly due to the decrease in senior bonds. Spain and the UK were the largest issuers, followed by Santander Consumer Finance, accounting jointly for 73% of issuances. Securitisations and structured financing activities amounted to EUR 13,144 million, 9% lower than in 2015.

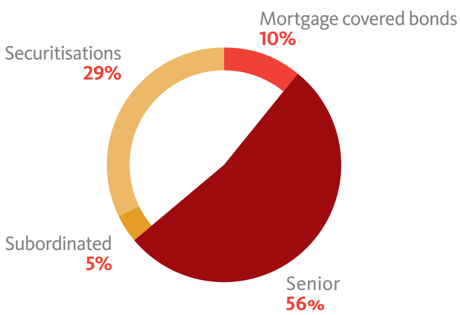
By **geography**, the biggest falls were in Brazil and the UK. In Brazil, this was mainly due to lower funding requirements, as a result of the performance of assets. In the UK, this was due to a more positive than expected performance by deposits.

Santander Consumer Finance achieved a securitisation volume of around EUR 4,868 million, significantly higher than in 2015, due to the new incorporations.

The chart below sets out in greater detail their distribution by **instruments and geographic areas**:

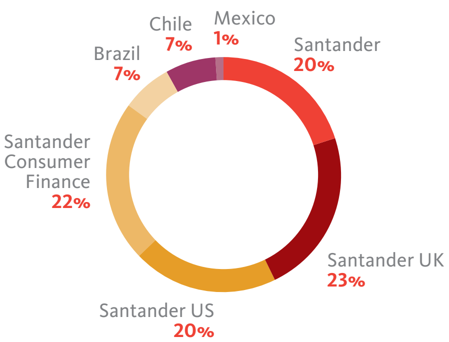
Distribution by instrument

Issued in 2016 (%)



Distribution by geography

Issued in 2016 (%)



In summary, Grupo Santander maintained comfortable access to the markets in which it operates, strengthened by the incorporation of new issuing units. It was involved in issuances and securitisations in 13 currencies in 2016, in which 23 issuers from 16 countries participated, with an average maturity of around 4 years, similar to the previous year.

ii. Compliance ahead of schedule with regulatory ratios

Under its liquidity management model, over the last few years Grupo Santander has been managing the implementation, monitoring and compliance - ahead of schedule - with the new liquidity requirements established under international financial regulations.

LCR (Liquidity Coverage Ratio)

Implementation was delayed until October 2015, although the initial compliance level of 60% was maintained. This percentage will be gradually increased to 100% in 2018.

The Group's strong short-term liquidity starting position, combined with autonomous management of the ratio 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 of December 2016, the Group's LCR ratio stood at 146%, comfortably exceeding regulatory requirements**. Although this requirement has only been set at the Group level, the other subsidiaries also comfortably exceed this minimum ratio: Spain 134%, the UK 139%, Brazil 165%.

NSFR (Net Stable Funding Ratio)

The final definition of the net stable funding ratio was approved by the Basel Committee in October 2014, and will come into force on 1 January 2018.

As regards 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 enabled Santander to maintain a balanced liquidity structure, with a high NSFR. This ratio stood at over 100% at the Group level and in most subsidiaries at al year-end 2016, even though this is not required until 2018.

In short, the liquidity models and management of the Group and its main subsidiaries have enabled them to meet both regulatory metrics ahead of schedule.

iii. High liquidity reserve

This is the third major aspect reflecting the Group's comfortable liquidity position during 2016.

The liquidity reserve is the total volume of highly liquid assets for the Group and its subsidiaries. This serves as a last resort recourse at times of maximum stress in the markets, when it is impossible to obtain funding with adequate maturities and prices.

As a result, this reserve includes deposits in central banks and cash, unencumbered sovereign debt, discounting capacity with central banks, assets eligible as collateral and undrawn credit lines in official institutions (e.g. Federal Home Loans Banks in the US).

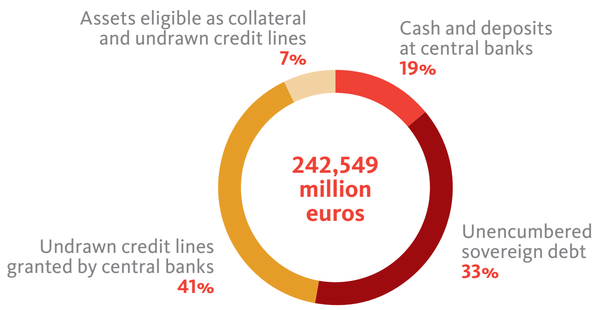
All of this reinforces the solid liquidity position that Santander's business model (diversified, retail banking focus, autonomous subsidiaries, etc.) confers on the Group and its subsidiaries.

At 31 December 2016, Grupo Santander's liquidity reserve amounted to EUR 265,913 million, 3% higher than at year-end 2015 and 10% above the average for the year. The structure of this volume by asset type according to cash value (net of haircuts) was as follows:

Liquidity reserve
Cash value (net of haircuts) in million euros

	2016	2016 average	2015
Cash and deposits at central banks	52,380	45,620	48,051
Unencumbered sovereign debt	89,135	81,040	85,454
Undrawn credit lines granted by central banks	105,702	100,531	110,033
Assets eligible as collateral and undrawn credit lines	18,696	15,358	14,202
Liquidity reserve	**265,913**	**242,549**	**257,740**

Liquidity reserve
Net of haircuts



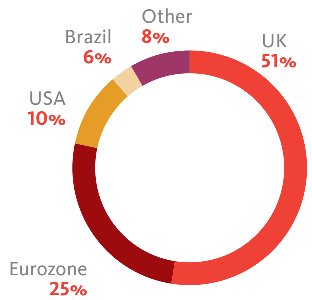
This increase was accompanied by a qualitative rise in the Group's liquidity reserve, deriving from the varied evolution of its assets. The first two categories (cash and deposits in central banks + unencumbered sovereign debt), the most liquid (or high quality liquidity assets in Basel's terminology, as first line of liquidity), increased by more than the average. They rose by EUR 8,010 million, increasing their share of total reserves at the end of the year to 53% (52% in 2015).

Under the autonomy conferred by the funding model, each subsidiary maintains a suitable composition of assets in its liquidity reserve for its business and market conditions (for example, capacity to mobilise their assets and recourse to additional discounting lines, such as in the US).

Most of the assets are denominated in the currency of the country, and so there are no restrictions on their use. There are however regulatory restrictions in most countries limiting activity between related parties.

Geographically, the liquidity reserve is distributed 51% in the UK, 25% in the Eurozone, 10% in the USA, 6% in Brazil and 8% in the other geographies.

Location of liquidity reserves
Million euros



iv. Asset encumbrance

Lastly, it is worth pointing out 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 assets on the balance sheet contributed as collateral in operations to obtain liquidity as well as those off-balance sheet assets received and re-used for a similar purpose, as well as other assets associated with liabilities for different funding reasons.

The report on the Grupo Santander information required by the EBA at the end of 2016 is given below.

Grupo Santander
Asset encumbrance

Billion euros	Carrying value of encumbered assets	Fair value of encumbered assets	Carrying value of unencumbered assets	Fair value of unencumbered assets
Assets	**303.2**		**1,035.9**	
Credit and loans	210.2		725.0	
Equities	10.9	10.9	9.7	9.7
Debt instruments	62.6	62.4	128.8	128.9
Other assets	19.5		172.5	

Grupo Santander
Encumbered received collateral

Billion euros	Fair value of encumbered collateral received and or of debt issued by the encumbered entity	Fair value of collateral received or of the debt issued by the entity available to be encumbered
Collateral received	**54.6**	**43.6**
Credit and loans	0.0	0.0
Equities	1.9	3.1
Debt instruments	50.5	35.5
Other collateral received	2.2	5.1
Debt instruments issued by the entity other than covered loans and securitisations	**0.0**	**4.1**

Grupo Santander
Encumbered assets and collateral received. and related liabilities

Billion euros	Liabilities. contingent liabilities or securities loan associated with the encumbered assets	Encumbered assets and collateral received. including debt instruments issued by the entity other than covered or securitised bonds encumbered
Total sources of encumbrances (carrying value)	**279.4**	**357.8**

On-balance sheet asset encumbrance amounted to EUR 303,200 million, over two-thirds of which is accounted for by loans (mortgages, corporate, etc.). Off-balance sheet asset encumbrance stood at EUR 54,600 million, mainly relating to debt securities received as collateral in operations to acquire assets which were re-used. The total for the two categories was EUR 357,800 million of encumbered assets, giving rise to a volume of associated liabilities of EUR 279,400 million.

At the end of 2016, total asset encumbrance in funding operations represented 25% of the Group's extended balance sheet under EBA criteria (total assets plus guarantees received: EUR 1,437 million as of December 2016). The ratio of encumbered assets in funding transactions stands at 25%, compared to 26% last year. The Group's request to the TLTRO in 2016 was more than offset by maturities of secured debt (mainly mortgage bonds).

Lastly, a distinction needs to be made between the different natures of the sources of encumbrance within these, as well as their role in funding the Group:

- 47% of total asset encumbrance corresponds to collateral contributed in medium and long-term funding operations (with a residual maturity of more than 1 year) to finance the commercial activity on the balance sheet. This puts the level of asset encumbrance understood as "structural" at 12% of the extended balance sheet, using EBA criteria.
- The other 53% corresponds to market transactions with a residual maturity of less than one year or collateral contributed in operations with derivatives the purpose of which is not to finance the ordinary activity of businesses but efficient short-term liquidity management.

» D.3.3. Funding outlook for 2017

Grupo Santander starts 2017 with a comfortable liquidity position and a good outlook for financing over the coming year. However, some risks to stability remain, such as volatility in financial markets and geopolitical risks.

With maturities which can be assumed in the coming quarters, due to the reduced weight of short-term maturities and a dynamic of medium and long-term issues similar to that in recent years, the Group will manage each geography separately to maintain a robust balance sheet structure in its units and the Group as a whole.

Low commercial requirements are envisaged over the Group as a whole, due, in most cases, to the increase in lending being balanced by increased customer deposits. The greatest liquidity requirements will arise in Santander Consumer Finance units and the UK.

Without prejudice to this, at Group level, Santander is continuing its long-term plan to issue liabilities eligible as capital. This plan seeks to enhance the Group´s current regulatory ratios efficiently, and also takes into account future regulatory requirements. Specifically, this includes fulfilment of TLAC (total loss-absorbing capacity) requirements, which come into effect in 2019 for systemically-important financial institutions. Although this is currently just an international agreement and awaits transposition into European regulations, the Group is already incorporating it into its issuance plans to meet potential requirements. The issue of such instruments therefore does not relate so much to larger volumes of issuances as the need to focus on specific unsecured instruments. As a result, it is likely that the level of assets committed in long-term funding operations will be even more limited over the coming quarters.

Within this general picture, the Group's various units took advantage of favourable market conditions at the beginning of 2017 to make issues, capturing more than EUR 5,000 million in January.

D.4. Operational risk

» Organisation of this section

We first introduce the concept of operational risk and then describe the operational-risk management and control model [pag. 243-248].

We then detail the performance of the main metrics associated with this risk factor [pag. 248-250]. We then set out the Group's mitigation measures for the main sources of this risk and describe its Business Continuity Plan [pag. 250-252].

Finally, we discuss other aspects of the monitoring and control of operational risk [pag. 252-253].

» D.4.1. Definition and objectives

Following the Basel framework, Grupo Santander defines operational risk (OR) as the risk of losses from defects or failures in its internal processes, employees 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 (for example, section D.5. Compliance and conduct risk).

The Group's objective in controlling and managing operational risk is to identify, measure, evaluate, monitor, control, mitigate and communicate this risk.

The Group's priority is thus 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 2016, 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.

The Bank has received a major boost through the completion of all the organisation of the risk identification and assessment exercise, in inherent and residual terms, and its control environment, and also the roll-out of the new Heracles application[42].

Grupo Santander has been calculating regulatory capital by operational risk using the standardised approach set forth in the European Capital Directive. The AORM programme helps Grupo Santander develop capital estimation models in its main geographic areas, both for economic capital and stress testing, and for potential application as regulatory capital. During 2016, operational losses under stress estimation methodology have been forecast using the guidelines provided by the EBA in the EU-Wide stress test (conduct risk and other operational risks) methodological note published in 2016.

The Prudential Relevance Report (Pillar III) includes information on the calculation of capital requirements for operational risk.

» D.4.2. Operational risk management and control model

D.4.2.1. Operational risk management cycle

In Grupo Santander, operational risk is managed in accordance with the following elements:

42. Heracles is a GRC (Governance, Risk & Compliance) application for enterprise-wide risk management.

The various phases of the operational risk management and control model are:

- 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.
- Promote the involvement of all employees in the operational risk culture, through adequate training in all spheres and at all levels.
- Measure and assess operational risk objectively, continuously and consistently with regulatory standards (BCBS, European Banking Authority, Single Supervisory mechanism, Bank of Spain) and the sector.
- Continuously monitor operational risk exposure, and implement control procedures, improve the internal control environment and mitigate losses.
- Establish mitigation measures that eliminate or minimise the risk.
- Produce 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.

The advantages of Grupo 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 sets out common tools, taxonomies and metrics for the entire organisation.
- 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 facilitates the establishment of operational risk appetite limits.
- It prioritises risks and the associated mitigation measures for decision making.

Grupo Santander 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 the collegiate body responsible for oversight of the identification, mitigation, monitoring and reporting of operational risk in the Group. It ensures compliance with the operational risk framework, 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 is a transverse committee, which involves all corporate divisions in the management and control of operational risk.

The Group has also set up a number of specialist 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 D.5 Compliance and conduct risk), the suppliers and cyber-security committees, and the fraud management, damage to physical assets, employment practices and cyber-security 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.

D.4.2.2. Risk identification, measurement and assessment model

A series of quantitative and qualitative corporate techniques and tools has been defined 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 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:

- An **internal database of events**, which is designed to record all of the Group's operational risk events. The capture of operational risk events 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.

- **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 produces 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 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 in 2016, are set out in greater detail in section D.5 Compliance and conduct risk.

- An **external database of events**, as Grupo Santander participates in international consortiums, such as the Operational Risk Exchange (ORX). 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, and the scenario analysis exercises described below have been adequately prepared.

- **Analysis of OR scenarios**. An expert opinion is obtained from the business lines and from risk and control managers to identify potential events with a very low probability of occurrence, but which could result in a very high loss for an institution. The possible effects of these are assessed and extra controls and mitigating measures are identified to reduce the likelihood of high economic impact.

- **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 2016, the Group 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 spheres 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.

- **Capital calculation through the standardised approach** (see the corresponding section in the Prudential Relevance Report/ Pillar III).

- **Internal data model and stress tests**: concerns the application of statistical models to measure expected and unexpected loss, mainly based on the information included in the internal loss database. In 2016, the Group has made headway in carrying out modelling exercises. The main application in this exercise has been the estimation of operational risk losses in the EBA stress tests.

- **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 D.5.3. Governance and organisational model.

- **Other specific instruments** that enable more detailed analysis of technology risk, such as control of critical system incidents and cyber-security events.

- **Specific assessment of risks** related to technological infrastructure management processes, the acquisition and development of solutions, control of information security and IT governance.

The appetite for non-financial risks is structured as follows:

- A general statement setting out that Grupo Santander 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. These include measures relating to the volume of losses compared to the gross margin, stressed losses, the relevant events ratio, the loss multiplier and expired 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: fraud, technological, cyber, legal, anti-money laundering, commercialisation of products, regulatory compliance and supplier management risk.

D.4.2.3. Implementation of the model and initiatives

Almost all the Group's units are now incorporated into the model with a high degree of uniformity. However, the different pace of implementation and historical depth of the respective databases means that the degree of progress varies from country to country.

As set out in section D.4.1. Definition and objectives, the Group accelerated its transformation to an advanced operational risk management (AORM) approach in 2016. The programme has a twofold objective: on the one hand, to consolidate the current operational risk framework, 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: most of them, covering the ten main geographic areas, have been completed in 2016. 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). It has been implemented for the main operational risk management instruments in 2016 in all Group geographies, in addition to the transformation plan.

The main activities and global initiatives adopted to ensure effective operational risk management are:

- Consolidation of the operational risk framework, policies and procedures, both at the corporate level and in the geographic areas. An important development here has been the approval of the new fraud model, and also the review of the documentary structure and promotion of the operational risk policies in the first lines of defence. This is independent of the new conduct framework discussed in section D.5. Compliance and conduct risk.

- The reinforcement of governance and the operational risk instruments in the first lines of defence, leading to a greater degree of involvement and integration in businesses and support functions, through the following:

  - Clear definition of roles and responsibilities for risk management and mitigation.

  - Involvement of first lines in the risk instruments (self-assessment, database, event escalation, indicators, etc.).

  - New operational risk appetite approach broken down for the most significant business units.

- Addition of further risk appetite metrics relating to the volume of relevant losses over total losses (losses multiplier) and controlling supplier management, and for the management and control of money laundering, conduct and regulatory compliance (As set out in section D.5.8. Risk assessment model of compliance and risk appetite).

- Improvement in the process of assurance, certification and oversight of control model and inclusion of control activities in the risks self-assessment process.

- Deployment of more robust cross-checking processes between different operational risk instruments, to ensure a better understanding of the relevant risks of the organisation.

- A training programme at all levels of the organisation (from the board to the employees most exposed to risk in the first business lines) and initiatives for the sharing of experiences (best practice sessions, launch of a monthly newsletter, etc.).

- Fostering of mitigation plans for aspects of particular relevance (information security and cyber-security in the widest sense, control of suppliers, etc.): monitoring of the implementation of corrective measures and projects under development.

- Improvements to the quality and granularity of the information on such risks analysed and presented to the main decision making forums.

- Improvements to contingency, business-continuity and, in general, crisis-management plans (this initiative is linked to the recovery and resolution plans).

- Fostering the control of risk associated with technology (application development and maintenance, design, implementation and maintenance or technological platforms, output of IT processes, etc.).

- Development of the model and governance of the compliance and conduct function, as described in section D.5. Compliance and conduct risk.

For the control of suppliers referred to above, in 2016 the corporate framework and model of reference were reviewed, covering the new requirements issued by the regulator in this field and aligning them with the best practices in the sector. We have also made progress in defining and deploying procedures and tools in the Group entities so as to adapt current processes to the model's principles and requirements. In 2016, our 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 risks carries out the control procedure to check that the model's principles are fulfilled.

- Evolving the corporate supplier management system to cover the new model requirements, particularly regarding:

  - Adding a decision making tool which can be used to discriminate services by their relevance and level of associated risk, so that the most appropriate controls for each can be set up in other phases of the service life cycle.

  - Defining specific questionnaires which are 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 to monitor and decision making for all matters concerning relevant services and suppliers and review of procedures and escalation criteria.

- Definition and monitoring of indicators and dashboard concerning the model implementation. Including specific suppliers metrics in the Group risk appetite report.

- Review and enhancing quality of data of inventories of relevant services and associated suppliers.

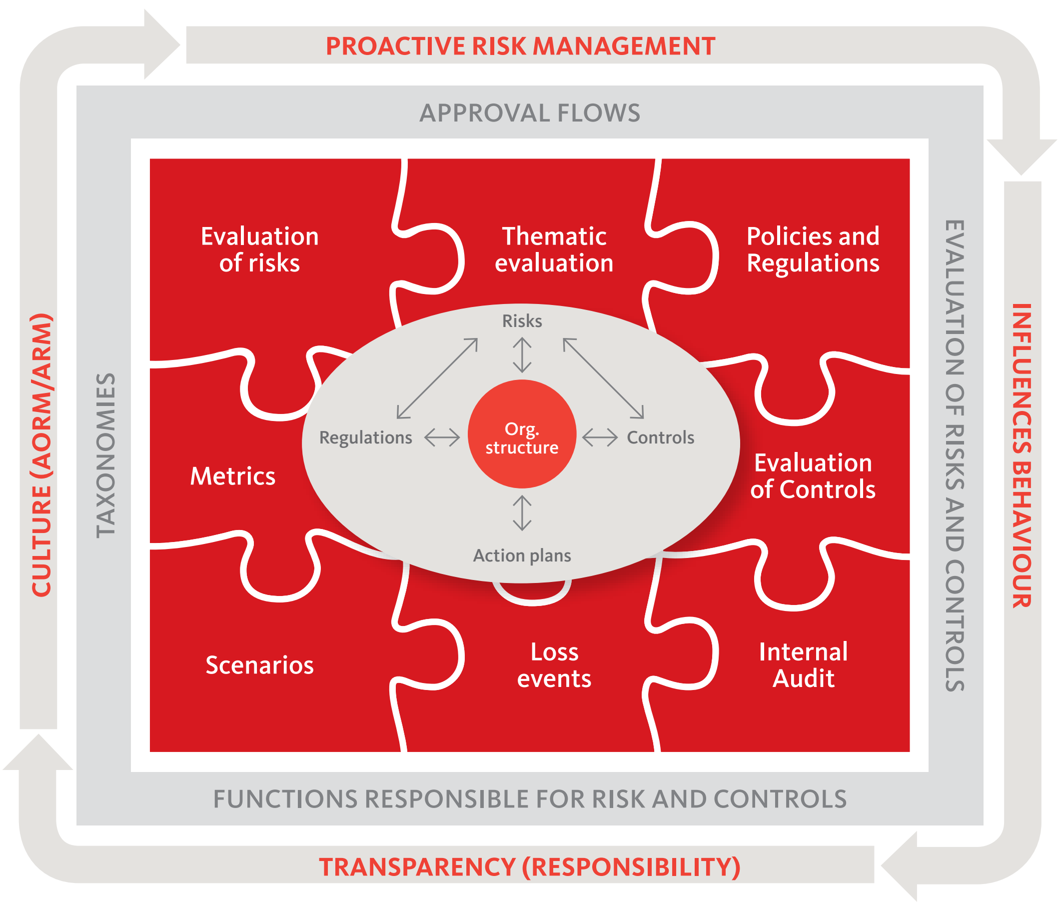
- Training and awareness raising of risks associated with suppliers and other third parties.

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.

D.4.2.4. Operational risk information system

The Group's corporate information system supports operational risk management tools, providing information for reporting functions and needs at both local/corporate levels.

As part of the implementation of the advanced operational risk management approach, and taking into account the synergies that will be produced in the control sphere (the operational risk control functions, broadly defined, its special features in the field of compliance and conduct, and internal control model control documentation and certification, are all integrated in the same tool), the Group is in the process of installing a new GRC (Governance, Risk and Compliance) tool based on the SAP system, known as Heracles. The objective of Heracles is to improve decision making for operational risk 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, but subject to their specific needs or limited to a particular sphere. However, it is always draws on a single source of information for all of the functions involved.

At year-end 2016, Heracles had been implemented globally throughout the Group, providing integrated risk and control information for units that generate and control risks.

The risk self-assessment and certification of controls were completed in this tool during the year, together with the migration of the internal events database and operational risk indicators. Development of operational-risk scenario functionality is pending implementation this year.

In 2016, the Group also worked on uploading data in OR management systems, and on improving reporting capabilities in the context of the project to comply with regulations on effective aggregation and reporting principles (Risk Data Aggregation/Risk Reporting Framework - RDA/RRF).

In order to achieve the objectives for this project, 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.

Within the framework for the implementation of RDA standards, the progress made this year has been along the lines of extending the scope, through defining new metrics in the dictionary, as far as RIA and risk appetite tools are concerned.

Further work has also been done in automating the supply of data from entities' local systems.

D.4.2.5. 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 2016, a number of different training sessions were conducted using the e-learning format, and which addressed general knowledge of OR and specifically, cybersecurity. The courses are designed for all Group employees, although specific courses for directors have also been designed.

The compliance and conduct function has prepared and launched a number of training actions, as described in section D.5.9. Transversal corporate projects.

A number of other new training initiatives were implemented in 2016, including specific disclosure and on-site sessions. This also included the creation of the Higher Operational Risk programme, providing in-depth knowledge for the employees most involved in this area. A number of specific courses were also held throughout the year for each of the modules of the new corporate Heracles tool.

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.

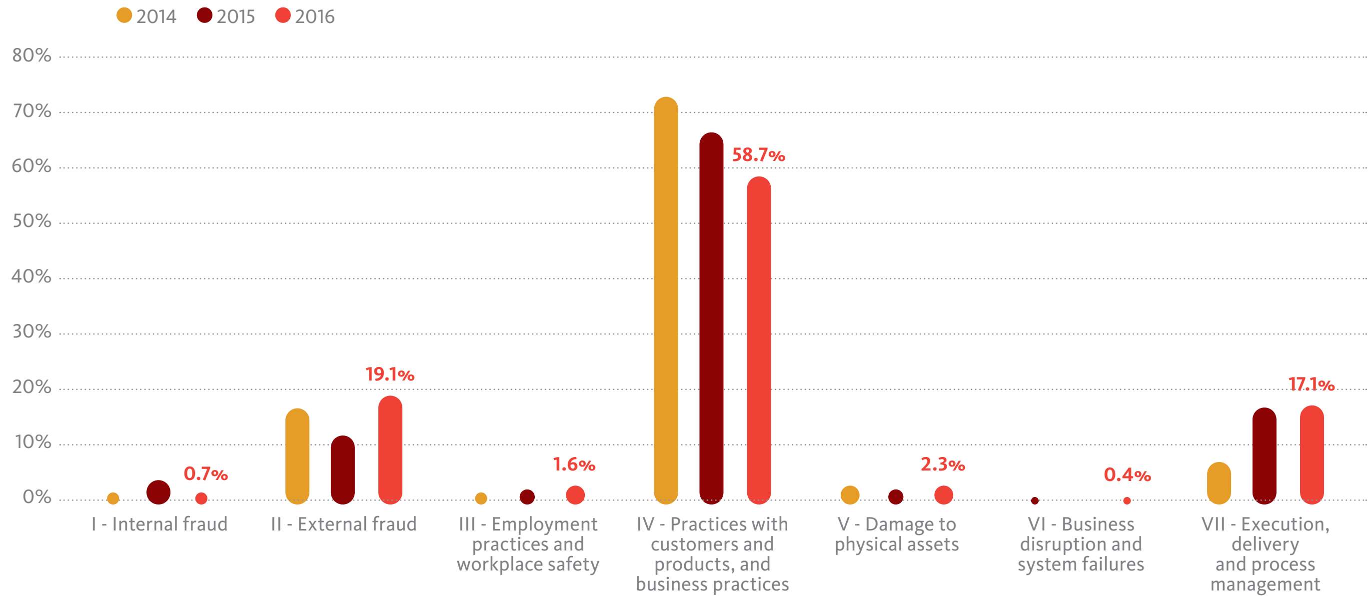
» D.4.3. Evolution of the main metrics

Regarding the databases of events, and after consolidating the information received, the evolution of net losses (including both incurred loss and net provisions) by Basel[43] risk category over the last three years is set out in the chart below:

43. The Basel categories include the risks set out in chapter D.5. Compliance and conduct risk.

Distribution of net losses by operational risk category[44]

% total



The evolution of losses by category shows a large reduction in relative terms for practices with clients, products and business, although it continues to be the largest item.

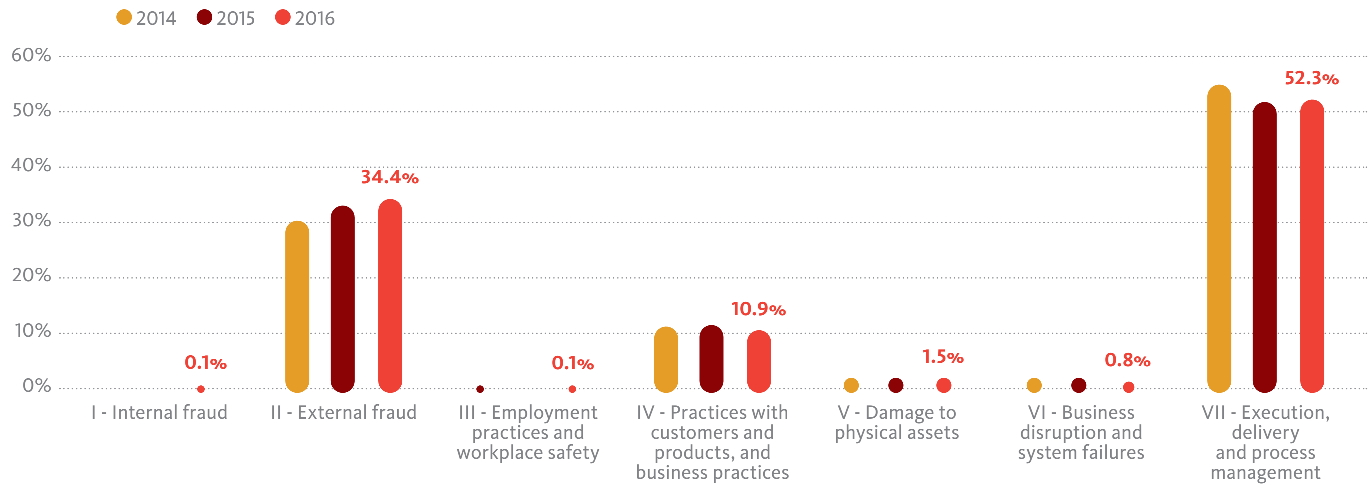
In the 2016 year, the most significant losses by type and geography are due to legal proceedings in Brazil. Here the Bank maintains a set of measures to improve customer service (as set down in the comprehensive mitigation plan described in section 4.4 Mitigation measures), enabling it to reduce the volume of losses due to legal proceedings. In 2016, the volume of losses fell in the UK, owing to provisions allocated the previous year, primarily to cover future claims for the sale of Payment Protection Insurance (PPI).

The main risk concentrations in external fraud still concern the fraudulent use of debit and credit cards, card not present and 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 categories[45]

% total



44. 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.
45. 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 2015, the Group established a new procedure for escalation of relevant events (in terms of both financial impact and number of customers affected), enabling us to implement corrective measures more efficiently. This process has been updated in 2016, including more details in terms of impacts on customer data security. The concentration of relevant events compared to total events remained at very low levels, and was lower than in the previous year.

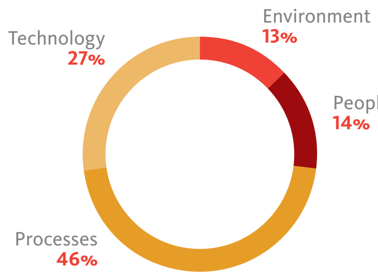
» D.4.4. Mitigation measures

The Group uses the model to monitor the mitigation measures for the main risk sources which have been identified through the tools (internal event database, indicators, self-assessment, scenarios, audit recommendations, etc.) used in OR management, and the preventive implementation of operational risk management and control policies and procedures.

Active mitigation management became even more important in 2016. A new governance model has been introduced, 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.

A significant volume of measures have been identified in the self-assessment exercise, and are distributed in accordance with the root cause of the risk, in the following way:

Mitigation 2016 - by root cause of risk



The most significant mitigation measures have been centred on improving the security of customers in their usual operations, the 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:
- Deployment of chip cards (EMV) in all the Group's geographic areas in line with the time frame set down by the payment channels industry and applying additional security measures:
  - Replacement of vulnerable cards with new cards based on CDA technology, reducing the risk of cloning through more robust and complete encryption algorithms.
  - Robust (Full Grade) validation of card transactions, including more checks, always carried out online.
- Implementation of the secure e-commerce standard (3DSecure) for internet purchases and requiring additional security codes for transactions, including the use of one-time passwords (OTP-SMS).
- Gradual roll-out in Brazil of a new 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.
- Incorporation of anti-skimming detectors and passive elements in ATMs to stop card cloning.
- Review of card limits based on the product and customer segment, to adjust these for risk levels.
- Application of specific fraud monitoring rules and detection tools to block suspicious transactions abroad.

Electronic fraud:
- Implementation of specific protection measures for mobile banking, such as identification and registration of customer devices (Device Id).
- An improved Internet banking authentication system, with additional checks depending on the risk level for the customer or transaction.
- Checks 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).

Cyber-security and data security plans:

The Santander Cyber-Security Program has been developed to foster and complement actions in progress, setting out:
- management based on the three lines of defence;
- an approach based on cyber-resilience, including prevention, identification, detection, protection and response actions;
- aspects of cyber-security that affect training, access control and segregation of functions, and secure software development;
- organisational enhancement initiatives.

Throughout 2016, 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 denial of service attacks.

The Group has evolved its internal cyber-security model to reflect international standards (including, the US NIST - National Institute of Standards and Technology - framework), incorporating concepts which can be used to assess the degree of maturity in deployment. Based on this new assessment model, individual in-situ analyses have been carried out in the main geographies to identify deficiencies and include them in the cyber-security Master Plans.

The Group's organisational and governance structure for the management and control of this risk has also been beefed up. Specific committees have been set up and cyber-security metrics have been included in the Group's risk appetite.

The Group's intelligence and analysis function has also been reinforced, by contracting bank threat monitoring services.

Progress has also been made in the incident registration, notification and escalation mechanisms for internal reporting and reporting to supervisors.

Another good practice which has been continued is that local units take part in different coordinated cyber-exercises in the different countries with public bodies, and also carrying out internal cyber-security scenarios such as risk assessment mechanisms, and response capacity tests when faced with these kinds of events.

In addition, observation and analytical assessment of the events in the sector and in other industries enables us to update and adapt our models for emerging threats.

Other relevant mitigating measures:
The Group has set up mitigation measures to optimise process management according to our customers' needs. Plans in the UK in retail and commercial banking, and aimed at improving transaction banking and customer account management, are considered to be particularly important.

With regard to mitigation measures relating to customer practices, products and business, Grupo Santander 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. Detailed information on these areas can be found in section D.5.2. Compliance risk control and supervision.

The Working Well (Trabalhar Bem) project in Brazil is also relevant to this category of operational risk, seeking to provide the Bank's customers with a better service, with fewer incidents and complaints, by improving internal processes and the products offered. This project includes various lines of action to improve selling practices and customer protection, including: influencing design decisions for products and services, analysis and solution of the root causes of customer complaints, development of a complaints management and monitoring structure, and improvement of protection networks at contact points.

» D.4.5. Business continuity plan

The Group has a business continuity management system (BCMS), which ensures that the business processes of our 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, Grupo Santander.

- Meet the Group's obligations to its employees, customers, shareholders and other stakeholders.

During 2016, the Group continued to advance in implementing and continuously improving its business continuity management system. The methodology has been reviewed to include the definition of scenarios and plans to cope with emergency risks (such as cyber-risks), the reference policy for preparing IT contingency plans has been updated, and a control dashboard has been designed and deployed for monitoring the status of continuity plans in all geographies in which the Bank operates.

The Group has also updated the corporate application which is used to register and store the Group's continuity plans, improving the functionalities (continuity scenarios and strategies, control dashboard with monitoring metrics, etc.) so as to enhance the daily management of the plans' monitoring and maintenance.

Furthermore, and based on the improvements made to the Group's Recovery and resolution plans, a new comprehensive model for the management of special situations (crises) has been defined (for more details see section B.3.4. Recovery and resolution plans). This model helps to deal with potential non-financial stress situations (e.g. operational or reputational, etc.) by reinforcing the escalation and governance process protocols specifically established for crisis situations, in addition to those applied in normal situations.

The Group has rolled out this new model in the corporate centre and main geographies in 2016, adapting the current business continuity committees to the governance and the escalation procedures outlined in the new model.

» D.4.6. 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. During 2016, therefore, the control model of this business has been steadily improved, with special emphasis on preparing a framework on unauthorised trading, and also on drawing up an assessment methodology to measure the robustness of that environment in each geography. Further efforts have also been made in reinforcing the following points:

- Analysis of individual transactions of each Treasury trader in order to detect anomalous behaviour not aligned with the specific limits for each desk.

- Improvement of the "*Speachminer*" tool, which enhances control over recordings and enables compliance with new record keeping requirements for monitoring communication channels, adapted to the requirements of new regulations.

- Strengthening of controls on cancelling and modifying operations and calculation of the actual cost thereof, where these are due to operational errors.

- Reinforcement of additional controls to detect and prevent irregular transactions (such as controls on triangular sales).

- Formalisation of IT procedures, tools and systems for cyber-security protection, prevention and training.

- Review of specific procedure for control and governance of trading in remote books used in some geographies and applying the procedure to the rest.

- Development of the *Keeping in B* project. This involves a range of inter-disciplinary teams seeking to reinforce aspects relating to corporate governance, compliance with money laundering and credit risk controls and procedures, the architecture of financial and operational architecture, technological platforms, regulatory and organisational aspects and sufficiency of resources.

For more information on issues relating to regulatory compliance in markets, refer to section D.5.4. Regulatory compliance.

Lastly, it is important to note that the business is also undertaking a global transformation and evolution of its operational risk management model. This 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 operational risk function has an operational risk management information system that provides data on the Group's main elements of risk. The information available for each country and unit in the operational risk sphere 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 Grupo Santander's countries and 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 drawn up:

- Grupo Santander's operational risk management model and the Group's main units and countries.

- The scope of operational risk management.

- Monitoring of risk appetite metrics.

- The risk profile by country and risk category, and the main operational risk concentrations.

- Operational risk regulatory capital.
- The action plans associated with each risk source.
- Distribution of losses by geographic area and risk category.
- Evolution of losses (accumulated annual, deviation on previous year and against budget) and provisions by detection and accounting dates.
- Analysis of the database of relevant internal and external events.
- Analysis of the most relevant risks detected from different information sources, such as the 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 Board Risk Committee, the Operational Risk Committee, senior management, regulators, rating agencies, etc.

Insurance in the management of operational risk

Grupo Santander regards insurance as a key element in the management of operational risk. In 2016, 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 analysis of losses and loss 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 award of contracts in 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 mitigation of operational risk.
- Active involvement of both areas in the global insurance sourcing unit, the Group's highest technical body for defining coverage strategies and contracting insurance, the forum for monitoring the risk insured (created specifically 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.

D.5. Compliance and conduct risk

Organisation of this section

We first introduce the compliance and conduct function and describe how it is governed, its organisational model and the functions involved in monitoring and controlling risks in this area [pag. 254-257].

We then detail the transversal functions and those that control and monitor specialist risks: regulatory compliance, product governance and consumer protection, prevention of money laundering and terrorist financing, and reputational risk [pag. 257-261].

Finally, we describe the annual risk assessment exercise, and how the risk appetite proposed by compliance and conduct to the board in 2016 was prepared [pag. 261-262].

» D.5.1. Scope, aim, definitions and objective

The compliance and conduct function fosters the adherence of Grupo Santander 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 at large.

This function addresses all matters related to regulatory compliance, prevention of money laundering and terrorism financing, product governance and consumer protection and reputational risk.

Under the current corporate configuration of the three lines of defence in Grupo Santander, compliance and conduct was consolidated in 2016 as an independent second-line control function reporting directly and regularly to the board of directors and the committees thereof, through the GCCO (Group Chief Compliance Officer), who acts independently. The compliance and conduct function reports to the Chief Executive Officer (CEO). This configuration is aligned with the requirements of banking regulation and with the expectations of supervisors.

The following compliance risks have been defined:

- **Compliance risk**: risk of not complying with the legal framework, internal rules or the requirements of regulators and supervisors.
- **Conduct risk**: risk arising from the actions of people or the Bank as a whole that might have poor consequences for customers or the markets.
- **Reputational risk**: risk of damage to the Bank's image among the public, customers, investors and other stakeholders.

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.

5.2. Compliance and conduct risk control and oversight

According to the configuration of lines of defence in the Grupo Santander and in particular, within this function, the first lines of defence have primary responsibility for managing this function's risks, jointly with the business units that directly originate such risks and 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. A number of different initiatives have been launched along these lines in 2016 throughout the Group, and they have been monitored and controlled.

The GCCO is responsible for reporting to Grupo Santander's governance and management bodies, and must also advise and inform, as well as promote the development of the function, in accordance with the annual plan. This is independently of the vice chairman of risks' and the GCRO's other reporting to the governance and management bodies of all Group risks, which also includes compliance and conduct risks.

In 2016, the new compliance and conduct model was rolled out at the corporate level and started to be developed in the main Group units and countries, providing the basic components for these risks to be managed (frameworks and policies for prevention of money laundering and terrorism financing, governance of products and services and consumer protection, regulatory compliance, reputational risk, etc.) and ensuring that other risks are duly covered by the appropriate units (codes of conduct, responsible financing policies, etc.). The pertinent governance, control and oversight systems are established for this purpose.

Furthermore, Internal Audit - as part of its 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.

The corporate frameworks of the compliance and conduct function are as follows:

- General compliance and conduct framework.
- Commercialisation of products and services and consumer protection framework.
- Anti-money laundering and terrorist financing framework.

These corporate frameworks are developed in the Grupo Santander's internal governance and are consistent with the parent-subsidiary relationship model. The existing frameworks for marketing products and services and consumer protection were brought together in a single document in 2016, to improve the integration of these areas and simplify their management.

The General Code of Conduct enshrines the ethical principles and rules of conduct that govern the actions of all Grupo Santander's employees. It is supplemented in certain matters by the rules found in other codes and their internal rules and regulations.

In addition to the frameworks mentioned, the General Code of Conduct also establishes:

- Compliance functions and responsibilities in this field.
- 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 Board Risk Committee (BRC), 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.

» D.5.3. Governance and the organisational model

A global transformation process - TOM - was carried out in 2016, in accordance with the mandate entrusted to the compliance and conduct function by the board. The scope and targets of this model were defined in the first phase. In 2016, the model was deployed in the corporation, and the Group also launched an assessment and development process in the main Group units, seeking to ensure that the compliance and conduct function is in line with the best standards in the financial sector by the end of 2018.

It is also important to note the coordination with the risk function and in particular, with the operational risk function, which, through risk governance, fosters a global overview of all the Group's risks. It also reports to the board and its committees.

D.5.3.1. Governance

The following corporate committees - each of which has a corresponding local replica - are collegiate bodies with compliance competencies:

The **Regulatory Compliance Committee** is the collegiate body for regulatory compliance matters. It has the following key functions:

(i) Controlling for regulatory compliance matters and overseeing regulatory compliance risk in the Group, as a second line of defence.

(ii) Defining the regulatory compliance risk control model in the Group and validating the annual work plans of the different local units.

(iii) Assessing proposed regulatory compliance programmes, or modifying them, for presentation to the Compliance Committee and subsequently, the board of directors for approval.

In 2016, the Regulatory Compliance Committee held 4 meetings.

The **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 risk appetite to the Compliance Committee.

(iii) Establishing interpretation criteria and approving the refence models to develop the corporate product and service and consumer protection framework and its rules of commercialisation, and also to validate the local adaptations of those models.

(iv) Assessing and deciding which significant commercialisation 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 Commercialization Committee met 15 times in 2016 and analysed 128 new products/services, having validated all of them.

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 commercialisation 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 commercialization and consumer protection in a transversal way across the Group.

The Monitoring And Consumer Protection Committee met 24 times in 2016.

The **Anti-money Laundering/Terrorism Financing Committee** is the collegiate body in this field. It has the following key functions:

(i) Controlling and overseeing anti-money laundering/terrorism financing (AML/TF) risk in the Group, as a second line of defence.

(ii) Defining the AML/TFC risk control model in Grupo Santander.

(iii) Considering corporate AML/TF framework proposals for escalation to the Compliance Committee, and updates of that framework.

(iv) Considering and analysing local adaptations and validating them, as the case may be.

It met on 4 times in 2016.

The **Compliance Committee**. In 2016, in order to reinforce function governance, the functions and objectives of these committees have been aligned, to bring them in line with the Group governance model, including its actions in the Compliance Committee, which is the higher-level collegiate body of the compliance and conduct function and which combines the objectives of these committees.

It has the following key functions:

(i) Monitoring and assessing compliance and conduct risk which could impact on Grupo Santander, 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 Compliance Committee met eight times in 2016.

D.5.3.2. Organisational model

Derived from the aforementioned transformation programme (TOM) 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 has been consolidated and reinforced during the 2016 year, helping the Group's purpose in this field:

Transversal functions

Governance, planning and consolidation

a) **Governance**. Governance and management of 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, and acting with staff from the GCCO.

b) **Planning**. Planning and fostering the definition of the compliance and conduct strategy and its annual plan and reporting on this to senior management. Maintaining the compliance and conduct regulatory map and policies. Managing and coordinating the function's internal organisational and human resource processes.

c) **Consolidation**. Consolidating compliance risks and conduct at a global level through an annual risk assessment exercise in the various Group units, in coordination with risks. Supervising the application of the mitigation measures and risk assessment plans defined and monitoring responses to, and the implementation of, requests from regulators. Proposing risk appetites for compliance and conduct, by collating proposals from local levels into the Group's risk appetite.

d) **Regulatory radar**. Developing and coordinating the creation and administration of the global repository of rules and regulations applicable to all units, through a multidisciplinary process involving various functions.

Coordination with units

Coordinating interactions with Group units, providing a global outlook on compliance risks and the models in these units.

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 rules and ensuring compliance by units.

Governance of products and consumer protection

Management, control and supervision of governance of products and services in the Group and risks relating to conduct with customers, consumer protection and fiduciary and custody risk for financial instruments, developing specific policies and regulations in this regard.

Anti-money laundering/ terrorist financing

Management, control and supervision of the application of the anti-money laundering and terrorist 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, consolidating the global vision of these risks in the Group and global trends.

Reputational risk

Development of the control and supervision model for reputational risk, through early detection and prevention of events and mitigation of any potential impact on the Group's reputation for employees, customers, shareholders, investors and society in general.

» D.5.4. 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.

- Collaboration with Internal Audit on its regular audits of the General Code of Conduct and other codes and their implementing regulations, and other issues subject to direct review.

- Assessment and detection of risks not covered by specific regulations, and preparing and modifying compliance programmes for presentation to the Regulatory Compliance Committee and, as applicable, subsequent approval by the board of directors or its committees.

- Regularly report to the RSRCC and the board of directors on the development of the framework and the implementation of the compliance programme.

- Assess changes that need to be introduced into the compliance programme, particularly in the event of detecting unregulated risk situations and procedures which could be improved, proposing any changes required to the Regulatory Compliance Committee or the RSRCC.

- Receive and handle the accusations made by employees or third parties via the whistle blowing channel.

- Direct and coordinate investigations into possible acts of 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.

- Supervise mandatory training activity on Compliance programme.

The compliance TOM guides the focus of the regulatory compliance function in the following areas:

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 of minimising the impact of the criminal responsibility of legal persons for any crimes committed on account of and for the benefit of them administrators, or representatives and by employees as a result of a lack of control.

In 2016, the Group rolled out a corporate defence model which focuses on the Group's main units, with the view of developing initiatives to raise awareness of the main criminal risks in the organisation. This model is structured in each country with the formal recognition of this function by each compliance function, with the appointment of a subject matter expert responsible for management of the model at the local level and coordinating with the corporate centre and disseminating corporate policies and tools in the local unit.

The system of managing risks for the prevention of criminal offences obtained AENOR certification in 2014. It was audited in 2016, with favourable results.

A key element in this system is the whistleblowing channel. The Group has 5 main whistleblower channels and in total, they received 450 complaints in 2016.

In 2016, a whistleblowing channel was set up for suppliers, through which any supplier of services to Banco Santander, S.A. or its subsidiaries in Spain can inform compliance and conduct of inappropriate conduct by Group employees in the contractual relationship between the supplier and the Group.

Organisational aspects
One of the main developments in 2016 was the launch of the new General Data Protection Regulation (GDPR), as a result of which the corporate centre has developed guidelines with uniform criteria to help Group countries adapt to the regulation. During the 2017 year and until May 2018, when compliance with the regulation will be compulsory, the approach will be to monitor the redesign of the impacted processes and to increase the degree of awareness about the importance of complying with this regulation.

There are two areas of work in relation to the automatic exchange of fiscal information between FATCA and CRS statements: support for implementation and the second line of compliance with the regulation in the Group.

Market regulations
In 2016, 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 law or its European counterpart, EMIR (European Market Infrastructure Regulation).

Regulatory compliance is responsible for disclosing relevant information on the Group to the markets. Banco Santander made public 57 relevant facts in 2016, which are available on the Group's web site and that of the National Securities Market Commission (CNMV).

Code of Conduct in Securities Markets (CCSM)
The Code of Conduct in Securities Markets (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.

- Resolve doubts on the CCSM.

In 2016, the corporate centre worked hard on deploying new IT tools to detect possible market abuse scenarios, to review procedures to adapt them to the European market abuse regulation and the training programmes which have been launched to inform people of the new developments in this new system.

» D.5.5. Product governance and consumer protection

The product governance and consumer protection function defines the key elements needed for adequate management and control of commercialization and consumer protection risks, which are defined as risks arising from inadequate practices in customer relations, the service and products offered to customers and their adequacy for each specific customer.

This function promotes an appropriate culture in Grupo Santander, 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 on the basis of 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 commercialization of products and services and consumer protection defines the key items for adequate management and control of risks arising from commercialisation, distribution, encompassing all phases (design, sale and post-sale).

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 Commercialization 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 commercialization risk throughout the entire life cycle and of complaints, with a twofold purpose: possible impact on customers and over the Group. Identify and follow up on actions taken to mitigate the detected risks.

- Identify and disclose the best practices for commercialization marketing and consumer protection.

The main activities carried out by this function in 2016 were as follows:

- Update of the products and services commercialization and consumer protection framework (including the previous corporate complaint management framework) and processing for its approval by the governing bodies.

- Updating the regulations of the committees associated with the function, integrating the fiduciary risks subcommittee into the function and adapting their responsibilities for the new organisational structure, functions and governance of the corporate compliance and conduct function.

- Development and dissemination within the Group of the procedure to control training for sale of products and services, which defines the set of activities which need to be performed to ensure correct training/qualification of the sales force and thereby, minimise risks arising from inadequate commercialization and of infringements of the applicable laws.

- Update of the new corporate procedure which regulates the processes for the approval and monitoring of own and/or customers assets custody.

- Preparation of the risk alerts report, in collaboration with the corporate credit risk function and distribution to units.

- Taking part, in coordination with the Group's human resources function, in defining the variable remuneration corporate policies associated with the sales force.

- In addition to the 128 products and services submitted to the Commercialisation Committee, the products and consumer protection governance function also analysed:

    - 32 products or services considered to be not new.

    - 37 structured notes issued by Santander International Products Plc. (subsidiary fully owned by Banco Santander), for which the compliance with applicable agreement is reviewed.

    - 172 consultations from different areas and countries for resolution.

- Preserve internal consumer protection, with the objective of improving relations with the Group, effectively promoting their rights, facilitating a solution to any controversies, in accordance with best practices through any channel and fostering financial knowledge. The objective is to contribute to lasting relationships with customers.

- Identify, analyse and control fiduciary risk generated by private banking, asset management, insurance and outsourced activity of custody services for customers' financial instruments. Fiduciary risks are considered to be risks incurred when acting as the trustee or manager of third party assets. Improper management or administration of assets could cause losses for the customer, and the trustee may be held responsible for such losses, and will face the ensuing economic or reputational impact.

  Fiduciary risk management includes the admission and monitoring of products, and the exposure and performance of the assets of customers managed by Grupo Santander 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.

- Establish and maintain methodologies to assess marketing risks and follow up on such assessments.

- Analysis and processing for corporate validation in the fiduciary risks subcommittee of:

  - 519 requests for the launch, renewal or modification of product characteristics (314 collective investment vehicles and profile discretionary management portfolios, 46 saving insurance/investment, 134 products distributed by Private Banking and 25 structured notes/deposits).

  - 69 requests relating to policies, fund and ETF distribution focus lists and requests for opinion from other areas.

- Analyse and consolidate complaint information and management thereof from 25 local units and 36 business units and 10 branch offices of SGCB.

Corporate projects

- Definition of the commercialization conduct risks taxonomy, which has been used to carry out the first self-assessment exercise with a scope of 19 entities in 16 different geographies.

- Creation of the insurance conduct forum in seven countries to identify, assess and manage commercialization risks, so as to centralise the information and controls which are currently carried out locally on insurance business, thus providing a global overview and simplifying reporting lines.

- Launch of compulsory online training on commercialization conduct risk in the corporation and dissemination thereof to Group subsidiaries for implementation.

» D.5.6. Anti-money laundering and terrorist financing

One of Grupo Sanatnder strategic objectives is to maintain an advanced and efficient anti-money laundering and terrorist financing system, constantly adapted to the latest international regulations, with the capacity to confront the development of new techniques by criminal organisations.

- This is based on a corporate framework setting out the basic principles and guidelines for action, establishing mandatory minimum standards for Grupo Santander units. These are formulated based on the principles set out in Financial Action Task Force (FATF), recommendations and obligations in EU directives to prevent the use of the financial system for money laundering and terrorist financing.

- Local units are responsible for managing and coordinating anti-money laundering and counter terrorist financing systems and procedures in the countries where Santander 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.

- Corporate systems and processes have been put in place in all units, based on decentralised exploitation of technological systems. These provide local management information and data for active and preventive management, enabling the analysis, identification and monitoring of suspicious activities that might involve money laundering or terrorist financing. These systems enable reporting to the corporate function responsible for oversight and control.

- Grupo Sanatnder 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 prevention organisation covers 169 different Group units established in 31 countries. Over one thousand Group professionals currently carry out the anti-money laundering/financing of terrorism function.

The main activity data in 2016 are as follows:

- Subsidiaries reviewed: 169
- Investigations: 118,453
- Disclosure to authorities: 32,036
- Employee training: 139,246

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 combating terrorism financing.

» D.5.7. Reputational risk

Due to the transformation of the compliance function through the development of the TOM model, very significant progress has been made in spelling out the details of the reputational risk model.

The specific characteristics of reputational risk are: there are a vast number of sources and a widely varying understanding of the concept among stakeholders. This means it requires a unique approach and control model, separate from other risks.

The reputational risk model uses a primarily preventive approach, but it also takes part in efficient crisis management processes.

The aim is for reputational risk to be integrated into both business and support activities, and internal processes, allowing the risk control and oversight functions to include it in their activities.

The reputational risk model also implies a comprehensive understanding not only of the bank's activities and processes in carrying out its business activity, but also of how it is perceived by stakeholders (employees, customers, shareholders and investors and the wide society), in its different settings. This approach requires the management, support and control functions to be closely coordinated with different stakeholders.

Reputational risk governance is thus included in the governance of compliance and conduct, as described. This function reports to senior management on reputational risk questions, once data on the sources of this risk has been consolidated.

» D.5.8. Risk assessment model of compliance 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 in a homogeneous way in units, by establishing a common taxonomy, which consists of setting a series of compliance risk indicators and assessment matrices which are prepared for each local unit.

As in previous years, the compliance and conduct function carried out a regulatory risk assessment exercise in 2016 focused on the Group's main units. This exercise is performed every year, using a bottom-up process. The first lines of the local units identify the inherent risk of all rules and regulations applicable to them and once they have assessed how consistent controls upon them are, they determine the residual risk of each entity and set up, as the case may be, the appropriate action plans. Actions plans have been designed to offset the risks identified in this risk assessment. These are monitored on a quarterly basis, unit by unit.

In accordance with the new TOM, the different indicators of the different compliance and conduct risks have been reviewed in 2016. Furthermore, a convergence plan has been established, with the assistance of the risk function to integrate the global overview of non-financial risks into a common tool called Heracles.

With this purpose, compliance and conduct proposed the risk appetite to the board of directors in July 2016, through its governance bodies and those of risks. The board of directors approved the proposal, and that risk appetite is currently being developed and implemented in the Group's units.

Also as part of the TOM development, the taxonomy of the different types of compliance and conduct risks have been reviewed, in coordination with the risk function, so that such risks can be clearly identified.

» D.5.9. 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 - the first year in which these transversal functions have been running - a great progression has been made in the three areas:

- Development of the organisation structure of the function and of the resources needed for it to function and monitoring its impact.
- 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 our processes.
- Organisational development and monitoring TOM's degree of maturity in units.

During 2016, 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.

This methodology is currently in the testing phase and the idea is that it will be deployed in mid 2017.

A project has been launched with the aim of ensuring compliance with the mandatory training activities within the Group. The project, organised in conjunction with the Human Resources function, will determine the minimum guidelines to be followed by units, and also define the reporting metrics required for this type of training. At the same time, the vertical functions have prepared and launched various e-learning initiatives in 2016, such as the General Code of Conduct and Corporate Defence, prevention of market abuse, conduct risk in marketing, the Volcker Rule and others which have also been shared with units.

Following the best practices already applied in other Group units, significant efforts have been made to identify and document all processes of the corporate compliance and conduct function. Once details of the activities have been gathered and the main operational risks and controls are identified, the next phase to be developed in 2017 is to implement continuous improvement dynamics. Here it is important to note the project already launched to automate and digitalise the main processes.

The systems map and strategy for information systems have been set up in conjunction with the technology and operations function. Efforts are also being made to develop solutions to enable data to be exchanged between compliance units, to monitor TOM's degree of deployment, the effective application of regulatory management and Risk Assessment methodologies and the execution of control models linked with the second line function. For example, during 2016 work has been done on the following systems: Opera (products governance), Fiduciary Catalogue (Group fiduciary risks consolidated data repository), Codcon (code of conduct in securities market), Apama (market abuse scenarios), FIT (financial intelligence unit cases management), Regulatory Radar (end-to-and management of the process to assess and deploy new regulations), etc.

Lastly, the following progress has been made in management data: according to the mandate and objectives set out in the TOM for risk types, the management metrics have been reviewed, the most relevant ones have been identified and special attention paid to the coverage of risk appetite. In addition, management reports are being improved for each risk type, to provide adequate support for decisions by governance bodies. This process of adapting our management data has been coordinated with the Chief Data Officer (CDO), ensuring that all compliance metrics and reports comply with data governance standards in the Group.

D.6. Model risk

Grupo Santander 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 cases. By simplifying in this way, we can focus our attention on the specific aspects which are considered to be most important to apply a certain model.

Using models implies model risk, which is defined as the potential negative consequences arising from decisions based on the results of incorrect, inadequate models or models used in an inappropriate way.

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.

Grupo Santander 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.

The function is deployed at the corporation and also at each of the Group's main entities. This function is governed by the model risk framework, a common control framework throughout the Group with details concerning questions such as organisation, governance, model management and model validation, According to internal regulations in force, the Models Committee is largely responsible for authorising the use of models.

The Models Committee is the collegiate body responsible for supervision and control of the risk model in Grupo Santander. The committee is established as set down in the model risk, credit risk and market risk admission and control, and structural and liquidity frameworks, in accordance with the powers delegated by the Executive Risk Committee.

The aim of the committee is to effectively control model risk, with the functions involved, 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 Senior management of Grupo Santander, in the various units and also at the Corporation itself, 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.

Management and control of Model Risk is based on the life cycle of a model as defined by Grupo Santander, shown below:

1	2	3	4	5	6	7
Identification	Planning	Development	Validation	Approval	Implementation and use	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.

Grupo Santander 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. 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 figures 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 validated by the corporation.

3. Development

This is the model's construction phase, based on the needs set out in the Models Plan and the information furnished to this end by the specialists.

Most of the models used by the Grupo Santander 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 Grupo Santander's model risk.

Hence, a specialist unit is in place which is totally independently 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 Grupo Santander 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 (first line of defence), internal validation units (second line of defence) and internal audit (third line of defence) 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. Implementation 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 framework and related internal regulations.

D.7. Strategic risk

For Grupo Santander, strategic risk is one the risks considered to be transversal, and there is a **strategic risk control and management model** which is used as a reference for Group subsidiaries. This model includes the definition of the risk, the principles and key processes for management and control, as well as functional and governance aspects.

Strategic risk is the risk which is associated with strategic decisions and with changes in the entity's general conditions, which have an important impact on its business model in both the mid and long term.

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 each year and for the next three years at least.

There are three categories or types of strategic risk:

- **Business model risk**: the risk associated with the entity's business model. This includes the risk of the business model being obsolescent, of it being irrelevant, and/or losing value, and so not being able to deliver the expected results. 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 expected results. It is also important to consider the cost of opportunity of designing another more adequate strategy or the lack of action through not designing it.

- **Strategy execution risk**: The risk associated with executing long-term strategic plans and three-year 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.

Lastly, in addition to the three components above, strategic risk management and control also takes into account other risks which may not be of a strategic origin (credit, market, operational, compliance risks, etc.) but which could cause a significant impact or affect the entity's strategy and business model. These risks are identified, assessed and managed through the corporate Risk Identification & Assessment exercise (see details in section B.3.2). jointly by the business areas and the risks areas of the bank. This identifies the "top risks", which are regularly reported to the bank's senior management in a manner that enables them to be adequately monitored and mitigated.

D.8. Capital risk

» Organisation of this section

First we shall introduce the concept of capital management and adequacy and the **solvency levels at the close of 2016**, and then next describe the main capital items [page. 266-267].

After which the **regulatory framework** with regards to capital is described [pag. 268-268].

Next, the **regulatory capital** and **economic capital** figures are presented [pag. 268-273].

Lastly, the **capital planning process and stress tests** in the Grupo Santander are described [pag. 273-274].

Refer to the Prudential Relevance Report (Pillar III) of Grupo Santander for further details.

» D.8.1. Introduction

Santander defines capital risk as the risk that the Group or some of its companies do not have the amount and/or quality of equity sufficient to meet the minimum regulatory requirements set for operating as a bank, to fulfil the market's expectations of its solvency and support business growth and the strategic possibilities they present, in accordance with the strategic plan.

Capital management and adequacy in the Group are conducted using an all-encompassing approach, seeking to guarantee the solvency of the entity to comply with regulatory requirements and to obtain the highest possible profitability. It is determined by the strategic targets and the risk appetite established by the board of directors. With this purpose in mind, a series of policies are defined, reflecting the Group's approach to capital management:

- Establish an adequate capital planning which can be used to cover the current needs and to provide the own funds needed to cover the needs of business plans, regulatory demands and associated short and mid term risks, maintaining the risk profile approved by the board.

- Ensure that under stress scenarios, the Group and its subsidiaries have sufficient capital to cover needs arising from the increased risks due to worsening macroeconomic conditions.

- Optimise the use of capital through an adequate capital allocation to businesses based on relative return on regulatory and economic capital, taking into account risk appetite, its growth and strategic targets.

Grupo Santander commands a sound solvency position, above the levels required by regulators and by the European Central bank, our supervisor.

At 31 December 2016, the Group's main capital ratios are as follows:

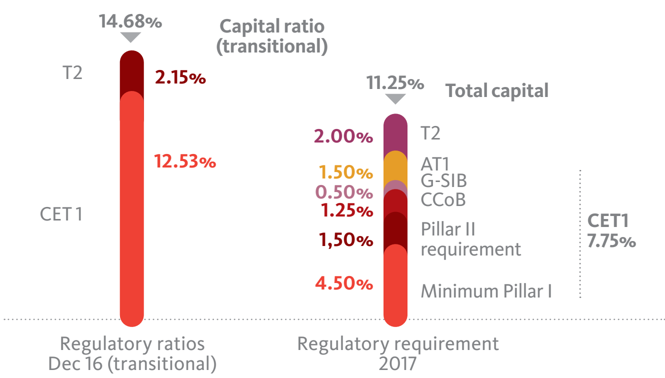
	Fully loaded	*Phase-in*
Common Equity (CET1)	10.55%	12.53%
Tier1	11.53%	12.53%
Total Ratio	13.87%	14.68%
Leverage ratio	5.00%	5.40%

Phase-in ratios are calculated applying the transitional Basel III implementation schedules, while Fully Loaded ratios are calculated using the final standard.

In late 2016, the ECB sent each entity its minimum prudential capital requirements for the following year. In 2017, at the consolidated level, Grupo Santander has to maintain a minimum capital ratio of 7.75% CET1 phase-in (4.5% for Pillar I, 1.5% for Pillar 2 requirement, 1.25% for the capital conservation buffer, and 0.50% as a Global Systemically Important Entity). Grupo Santander must also maintain a minimum Tier 1 phase-in capital ratio of 9.25%, and minimum total phase-in capital of 11.25%.

As shown in the table above, the Group's Capital is in excess of the ECB minimum requirement.

Main capital figures and solvency ratios



The Group is working towards its goal of having a CET1 fully loaded ratio higher than 11% by 2018.

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.

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.

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.

Leverage ratio

This is a regulatory metric that monitors the solidity 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 depends on the size of the balance sheet.

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.

» D.8.2. Regulatory framework

In December 2010, the Basel Committee on Banking Supervision published a new global regulatory framework for international capital requirements (Basel III). This reinforced the requirements set out in the earlier Basel I, Basel II and Basel 2.5 regulations, enhancing the quality, consistency and transparency of the capital base and improving risk coverage. The Basel III legal framework was incorporated into European regulations on 26 June 2013 through Directive 2013/36 (hereinafter, CRD IV), which repealed Directives 2006/48 and 2006/49 and Regulation 575/2013, on prudential requirements for credit institutions and investment firms (hereinafter, CRR).

CRD IV was introduced into Spanish law through Act 10/2014, on the ordering, supervision and solvency of credit institutions, and its subsequent regulatory implementation through Royal Decree Act 84/2015 and Bank of Spain Circular 2/2016, which completed the adaptation of the Spanish legislative framework. This Circular repealed most of Circular 3/2008 (which continued to apply to aspects of Circular 5/2008 on minimum own funds and mandatory information for mutual guarantee societies), on the determination and control of own funds; and a section of Circular 2/2014, on the exercise of various regulatory provisions set down in the CRR. The CRR is directly applicable in Member States from 1 January 2014 and repeals lower-ranking standards that entail additional capital requirements.

The CRR provides for a phase-in period that will allow institutions to adapt gradually to the new requirements in the European Union. The phase-in arrangements have been introduced into Spanish law through Bank of Spain Circular 2/2014. The phase-in affects both the new deductions from capital and the instruments and elements of capital that cease to be eligible as capital under the new regulations. The capital conservation buffers provided for in CRD IV will also be phased in gradually, starting in 2016 and reaching full implementation in 2019.

The Basel regulatory framework is based on three pillars: Pillar I determines minimum eligible capital, allowing the possibility of using internal models and ratings to calculate risk-weighted exposures. The idea is that regulatory requirements should be more sensitive to risks actually borne by entities when carrying out their business activities. Pillar II establishes a supervisory review system to improve internal management of risks and self-assessment of capital adequacy based on risk profile. Lastly, Pillar III defines elements relating to information and market discipline.

On 23 November 2016, the European Commission published a draft of the new CRR and CRD IV, including different standards to those used by Basel, such as the Fundamental Review of the Trading Book for market risk, the Net Stable Funding Ratio for liquidity risk and the SA-CCR for calculating EAD for counterparty risk. It also introduced changes to the treatment of central clearing counterparties, the MDA (Maximum distributable amount), Pillar II and the leverage ratio. One of the most significant developments was the implementation of the TLAC Term Sheet issued by the FSB (Financial Stability Board) for capital, such that systemic entities have to comply with TLAC requirements in Pillar I, whilst non-systemic entities only have to comply with the MREL in Pillar II, as the resolution authority decides on a case by case basis.

Refer to section 1.3.1.1. of the Prudential Relevance Report for more details of regulatory developments.

In 2016, the European Banking Authority carried out a transparency exercise, in which it published capital and solvency information and details for sovereign positions at December 2015 and June 2016 for 131 banks in 24 European countries. This exercise has been aimed at promoting transparency and knowledge about European banks' capital and solvency data, thereby enhancing market discipline and financial stability in the EU. The results demonstrate the Group's sound capital position and solvency, and show that it is ahead of its peers in many of the main metrics.

Lastly, this past year the Supervisory Board of the ECB has launched the Targeted Review of Internal Models (TRIM) exercise, which is aimed at restoring its credibility, homogenising the discrepancy in capital requirements which are not due to the risk profile of exposures, and standardising supervisory practices through better knowledge of models. This review affects 70 entities at European level and approximately 2,000 models; it is going to be developed in 2016, 2017 and 2018 with different intermediary milestones.

» D.8.3. Regulatory capital

The regulatory capital framework is based on three pillars:

- According to Pillar I, minimum regulatory capital for credit, market and operational risk, with the possibility of using internal rating based models (IRB) to calculate the exposures weighted by credit risk, internal models (VaR) for market risk, and internal models for operational risk. The goal is that regulatory requirements should be more sensitive to risks actually borne by entities when carrying out their business activities.

- Pillar II establishes a supervisory review system to improve internal management of risks and self-assessment of capital adequacy based on risk profile.

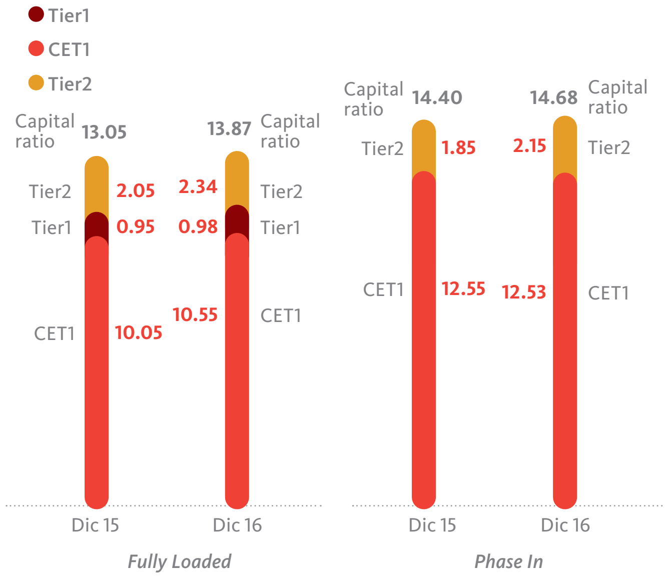
- Lastly, Pillar III defines elements referring to higher transparency in reporting and discipline.

In 2016, the solvency target set was achieved. Santander's CET1 fully loaded ratio stood at 10.55% at the close of the year, demonstrating its organic capacity to generate capital. The key regulatory capital figures are indicated below:

	Fully loaded		*Phase-in*	
	Dec 16	**Dec 15**	**Dec 16**	**Dec 15**
Common equity (CET1)	62,068	58,705	73,709	73,478
Tier1	67,834	64,209	73,709	73,478
Total capital	81,584	76,209	86,337	84,350
Risk-weighted assets	588,088	583,917	588,088	585,633
CET1 Ratio	10.55%	10.05%	12.53%	12.55%
Tier 1 ratio	11.53%	11.00%	12.53%	12.55%
Total capital ratio	13.87%	13.05%	14.68%	14.40%

Capital

%



The table below shows risk-weighted assets (RWAs) in the main geographic areas and type of risk.

Million euros

Monitoring metrics
Total FL RWAs: 588,088

Continental Europe Total: 246,349	**UK Total: 97,329**	**Latin America Total: 162,994**	**US Total: 80,626**	**Other Total: 790**
All risks: Credit: 85% Operational: 8% Market: 7%	**All risks:** Credit: 87% Operational: 9% Market: 4%	**All risks:** Credit: 84% Operational: 13% Market: 3%	**All risks:** Credit: 85% Operational: 15% Market: 0%	**All risks:** Credit: 92% Operational: 8% Market: 0%

Deployment of models

As regards credit risk, Grupo Santander continued its plan to implement Basel's advanced internal rating-based (AIRB) approach for almost all the Group's banks (up to covering more than 90% of net exposure of the credit portfolio under these models). Meeting this objective in the short term will also be conditioned by the acquisition of new entities, as well as by the need for coordination between supervisors of the validation processes of internal models.

The Group operates in countries where the legal framework among supervisors is the same, as is the case in Europe via the Capital Directive. However, in other jurisdictions, the same process is subject to the cooperation framework between the supervisor in the home country and that in the host country with different legislations. This means, in practice, adapting to different criteria and calendars in order to attain authorisation for the use of advanced models on a consolidated basis.

Grupo Santander currently has supervisory authorisation to use advanced approaches for calculating the regulatory capital requirements for credit risk of the parent bank and its main subsidiaries in Spain, the UK and Portugal, and certain portfolios in Mexico, Brazil, Chile, Scandinavia (Sweden, Finland, Norway), France and the US. The strategy of implementing Basel in the Group is focused on achieving use of advanced models in the main institutions in the Americas and Europe. During 2016, this was authorised for the portfolios of IFIC, which have been integrated into Santander Totta Portugal. We are now awaiting completion of the supervisory validation process for the institutions and sovereign portfolios in Chile, the mortgages and most of the revolving product portfolios of Santander Consumer Germany, and the consumer portfolios of PSA UK.

With regard to operational risk, Grupo Santander currently applies the standard approach to calculating regulatory capital, as set out in the European Capital Directive. In February 2016, the European Central Bank authorised the use of the alternative standard approach to calculate capital requirements at consolidated level in Banco Santander Brazil.

As for the other risks expressly considered in Basel Pillar I, in market risk this year the Group received permission to use its internal model in the treasury trading activity in the UK, in addition to those already authorised in Spain, Chile, Portugal and Mexico.

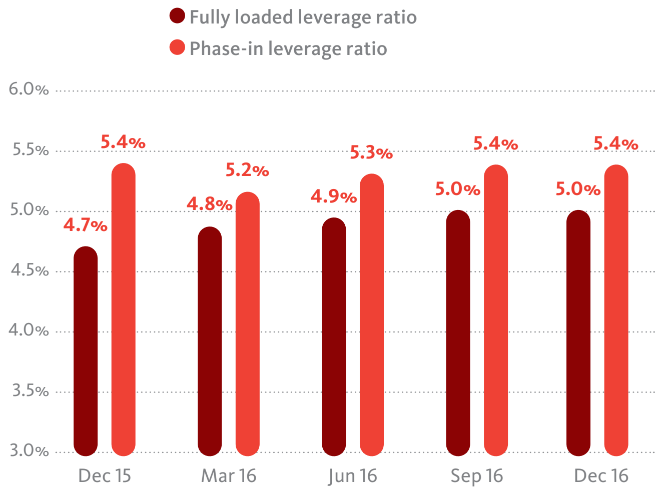
Leverage ratio

The leverage ratio has been defined within the regulatory framework of Basel III as a measure of the capital required by financial institutions not sensitive to risk. The Group performs the calculation as stipulated in CRD IV and its subsequent amendment in EU Regulation no. 573/2013 of January 17, 2015, which was aimed at harmonising calculation criteria with those specified in the BCBS Basel III leverage ratio framework and disclosure requirements document.

This ratio is calculated as the ratio between Tier 1 divided by the leverage exposure. This exposure is calculated as the sum of the following items:

- Accounting assets, without derivatives and not including items considered to be deductions in Tier 1 (for example, it includes the balance of loans but not of goodwill).
- Off-balance sheet items (guarantees, unused credit limits granted, documentary credits, in the main) weighted by the credit limits.
- Inclusion of net value of derivatives (gains and losses are netted with the same counterparty, minus collaterals if they comply with certain criteria) plus a charge for the future potential exposure.
- A charge for the potential risk of security funding transactions.
- Lastly, it includes a charge for the risk of the credit derivatives (CDS).

The ratios published by the Group since December 2015 are indicated below:



The leverage ratio is still undergoing calibration and it is not compulsory until 2018. For the time being, a reference of 3% has been set (the Bank's ratio is higher). During this period, the only obligation is to publish the data on the market. More details are available in the Prudential Relevance Report (Pillar III) which is published on the Group website.

Global systemically important banks

Grupo Santander is one of the 30 entities which have been classified as global systematically important banks (G-SIB).

The designation as a systemically important entity is based on the measurement set by regulators (the FSB and BCBS), based on 5 criteria (size, cross-jurisdictional activity, interconnectedness with other financial institutions, substitutability and complexity). This information is requested annually from banks with leverage exposure in excess of EUR 200,000 million, which are required to publish it (refer to the information at www.gruposantander.com).

According to the information published on November 21 2016 by the FSB and the BCBS, Grupo Santander is included in the group of systemic banks with a small capital buffer of 1%.

This definition means it has to fulfil certain additional requirements, which consist mainly of a capital buffer (1%), in TLAC requirements (total loss absorbing capacity), that we have to publish relevant information more frequently than other banks, greater regulatory requirements for internal control bodies, special supervision and drawing up of special reports to be submitted to supervisors.

The fact that Grupo Santander has to comply with these requirements makes it a more solid bank than its domestic rivals.

Refer to the Prudential Relevance Report (Pillar III) for more information.

» D.8.4. Economic capital

Economic capital is the capital needed, in accordance with an internally developed model, to support all the risks of business with a certain level of solvency. In the case of Santander, the solvency level is determined by the long-term rating objective of “A” (two notches above Spain’s rating), which means a confidence level of 99.95% (above the regulatory level of 99.90%) for calculating capital requirements.

The measurement of Santander’s economic capital model includes all the significant risks incurred by the Group in its operations (concentration risk, structural interest risk, business risk, pensions risk and others beyond the sphere of Pillar 1 regulatory capital). Moreover, economic capital incorporates the diversification impact, which in the case of Grupo Santander is vital, because of its multinational nature and many businesses, in order to determine the global risk profile and solvency.

Economic capital is a key tool for the 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, the Group uses, in the context of Basel Pillar II, its economic model for the internal capital adequacy assessment process (ICAAP). For this, the business evolution and capital needs are planned under a central scenario and alternative stress scenarios. By using this planning, the Group ensures that it meets its solvency targets even under adverse economic scenarios.

The economic capital metrics also enable risk-return objectives to be assessed, setting the prices of operations on the basis of risk, evaluating the economic viability of projects, units and lines of business, with the overriding objective of maximising the generation of shareholder value.

As a homogeneous measurement of risk, economic capital can be used to explain the risk distribution throughout the Group, reflecting comparable activities and different types of risk in a metric.

The economic capital requirement at the end of September 2016 was EUR 72,632 million, EUR 23,199 million above the EUR 95.831 million available economic capital.

The table below sets out the available economic capital:

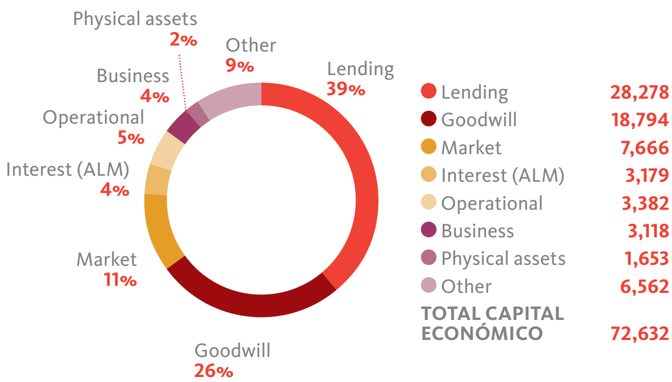
Million euros

	Dec 16	Dec 15
Net capital and issue premiums	52,196	52,004
Reserves and retained profits	52,967	49,673
Valuation adjustments	(16,116)	(15,448)
Non-controlling interests	6,784	6,148
Base economic capital available	**95,831**	**92,377**
Economic capital required	72,632	71,444
Excess capital	23,199	20,933

The main difference to regulatory CET1 comes from the treatment of goodwill, other intangible assets and deferred tax assets (DTAs), which we consider as additional capital requirements, rather than deductions from available capital.

The distribution of economic capital needs by type of risk at the end of December 2016 is shown in the following chart:

Million euros



The table below sets out Grupo Santander's distribution by types of risk and geographic area at the end of 2016:

Monitoring metrics

Total requirements: 72,632

Million euros

Corporate activities 26,561	Continental Europe 18,129	UK 7,524	Latin America 13,121	Estados Unidos 7,297
All risks:	**All risks:**	**All risks:**	**All risks:**	**All risks:**
Goodwill: 71%	Credit: 58%	Credit: 59%	Credit: 61%	Credit: 66%
Market: 18%	Market: 11%	Pensions: 22%	Interest (ALM): 11%	Operational: 8%
DTAs: 9%	Operational: 8%	Operational: 8%	Business: 9%	Tangible assets: 8%
Other: 2%	Interest (ALM): 7%	Business: 5%	Operational: 7%	Intangible assets: 7%
	Other: 16%	Other: 6%	Other: 12%	Business: 5%
				Other: 6%

The distribution of economic capital among the main business areas reflects the diversified nature of the Group's business and risk. Continental Europe represents 39% of the capital, Latin America including Brazil 28%, the UK 17% and the US 16%.

Outside the operating areas, the corporate centre assumes, principally, the risk from 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 (equivalent to geographic) as well as inter-risks, amounted to approximately 30%.

Return on risk adjusted capital (RoRAC) and value creation

Grupo Santander has been using the RoRAC methodology in its credit risk management since 1993 in order to:

- Calculate the consumption of economic capital and the return on it of the Group's business units, as well as segments, portfolios and customers, in order to facilitate optimum assigning of economic capital.
- Measurement of the Group units' management, using budgetary tracking of capital consumption and RoRAC.
- Analyse and set prices in the decision-taking process for operations (admission) and clients (monitoring).

RoRAC methodology enables one to compare, on a like-for-like basis, the return on operations, customers, portfolios and businesses, identifying those that obtain a risk-adjusted return higher than the cost of the Group's capital, aligning risk and business management with the intention of maximising the creation of value, the ultimate aim of the Group's senior management.

The Group regularly assesses the level and evolution of value creation (VC) and the risk-adjusted return (RoRAC) of its main business units. The VC is the profit generated above the cost of the economic capital (EC) employed, and is calculated as follows:

Value creation =profit – (average EC x cost of capital)

The profit used is obtained by making the necessary adjustments to the accounting profit so as to extract just the recurrent profit that each unit generates in the year of its activity.

The minimum return on capital that an operation must attain is determined by the cost of capital, which is the minimum required by shareholders. It is calculated objectively by adding to the free return of risk the premium that shareholders demand to invest in our Group. This premium depends essentially on the degree of volatility in the price of the Banco Santander share in relation to the market's performance. The Group's cost of capital for 2016 was 9.37% (vs. 9.31% the previous year).

The Group's internal management includes an annual revision of the cost of capital and also an estimated cost of capital for each business unit, taking into account the specific features of each market, under the philosophy of subsidiaries which are autonomous in capital and liquidity, in order to assess if each business is capable of generating value individually.

A positive return from an operation or portfolio means it is contributing to the Group's profits, but it is only creating shareholder value when that return exceeds the cost of capital.

The creation of value and the RoRAC for the Group's main business areas at September 2016 are shown below:

	Dec 16		Dec 15	
Main segments	**RoRAC**	**Value creation**	**RoRAC**	**Value creation**
Continental Europe	17.3%	1,426	13.9%	883
UK	20.2%	825	22.5%	1,065
Latin America	33.1%	2,879	33.8%	2,746
US	9.2%	(13)	13.4%	308
Total business units	**20.7%**	**5,117**	**20.2%**	**5,001**

» D.8.5. Capital planning and stress tests

Capital stress tests have become particularly important as a dynamic evaluation tool of the risks and solvency of banks. It is a forward-looking assessment, based on macroeconomic as well as idiosyncratic scenarios of little probability but plausible. Thus, It is necessary to have robust planning models, capable of transferring the impact defined in projected scenarios to the different elements that influence a bank's solvency.

The ultimate objective of the stress exercises is to carry out a full assessment of the risks and solvency of banks, which enables possible capital requirements to be calculated in the event that they are needed because of banks' failure to meet the capital objectives set, both regulatory and internal.

Internally, Grupo Santander has defined a process of stress and capital planning not only to respond to the various regulatory exercises, but also as a key tool integrated in the Bank's management and strategy.

The goal of the internal process of stress and capital planning is to ensure sufficient current and future capital, including when facing adverse though plausible economic scenarios. Starting from the Group's initial situation (defined by its financial statements, capital base, risk parameters and regulatory ratios), the envisaged results are estimated for different business environments (including severe recessions as well as "normal" macroeconomic situations), and the Group's solvency ratios are obtained for a period of usually three years.

This process provides a comprehensive view of the Group's¬ capital for the time frame analysed and in each of the scenarios defined. It incorporates the metrics of regulatory capital, economic capital and available capital.

The structure of the process is shown below:

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 LGC 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 recently presented structure facilitates achieving the ultimate objective which is capital planning, by turning it into an element of strategic importance for the Group which:

- Ensures the solvency of current and future capital, including in adverse economic scenarios.
- Enables comprehensive management of capital and incorporates an analysis of the specific impacts, 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 and adequacy strategy.
- Facilitates communication with the market and supervisors.

In addition, the whole process is developed with the maximum involvement of senior management and its close supervision, under a framework that ensures that the governance is the suitable one and that all elements that configure it are subject to adequate levels of challenge, review and analysis.

One of the key elements in capital planning and stress analysis exercises, due to its particular importance in forecasting the income statement under defined stress scenarios, consists of calculating the provisions needed under these scenarios, mainly those to cover losses in the credit portfolios. Specifically, to calculate credit portfolio loan loss provisions, Grupo Santander uses a methodology that ensures that at all times there is a level of provisions that covers all the projected credit losses for its internal models of expected loss, based on the parameters of exposure at default (EaD), probability of default (PD) and loss given default (LGD).

This methodology is widely accepted and it is similar to that used in the EBA stress tests of 2016 and in previous stress tests (in 2011 and 2014 or the stress test on the Spanish banking sector in 2012).

Lastly, the capital planning and stress analysis process is completed by solvency analysis under the various scenarios designed and over a defined time frame. This assesses the sufficiency of capital and ensures that the Group meets its internally defined capital objectives and all regulatory requirements.

In the event of not meeting the capital objectives set, an action plan will be prepared which envisages the measures needed to be able to attain the desired minimum capital. These measures are analysed and quantified as part of the internal exercises, even it is not necessary to put them into force as Santander exceeds the minimum capital thresholds.

This internal stress and capital planning process is conducted in a transversal way throughout Grupo Santander, not only at the consolidated level, but also locally in the Group's units, as they use the stress and capital planning process as an internal management tool and to respond to their local regulatory requirements.

Throughout the 2008 economic crisis, Grupo Santander was submitted to six stress tests which demonstrated its strength and solvency in the most extreme and severe macroeconomic scenarios. All of them, thanks mainly to the business model and geographic diversification in the Group, showed that Banco Santander will continue to generate profits for its shareholders and comply with the most demanding regulatory requirements.

Last July, the European Banking Authority (EBA) published the results of its stress tests of the 51 leading banks in the European Union. Unlike in the 2014 year, no minimum capital requirements were set for passing the test. Instead, the final results were used as a further variable by the ECB to determine the minimum capital requirements for each bank (under the Supervisory Review and Evaluation Process - SREP). Despite facing a more demanding adverse scenario than in previous yeas, and more stringent assumptions in relation to operational risk, conduct risk and market risk, Grupo Santander was the bank which destroyed the least capital of all its peers (see further details in section C. Environment and next challenges, table 1).

As already mentioned, as well as the regulatory stress tests, Grupo Santander annually conducts since 2008 internal exercises of resilience within its self-assessment process of capital (Pillar II). All of them showed, in the same way, Grupo Santander's capacity to meet the most difficult scenarios, both globally as well as in the main countries in which it operates.

Appendix: EDTF transparency

Banco Santander has traditionally maintained a clear commitment to transparency. By virtue of this transparency, it has played an active role in the Enhanced Disclosure Task Force (EDTF) promoted by the Financial Stability Board (FSB) in order to improve the quality and comparability of the risk information that banks provide to the market. Several studies have analysed the degree of adoption of the 32 recommendations formulated by the EDTF in October 2012, in which Santander stands out as one of the banks that is leading globally the practical application of this initiative.

The table below sets out where the EDTF recommendations can be found in the information published by Grupo Santander.

		EDTF Recommendations	Annual report	Audit report and annual accounts	PRR (Pillar III)
General	1	Index with risk information	Executive summary		Appendix V; Appendix VI; 1.2.4.
	2	Risk terminology and measures	B.1.; D.1.5.; D.2.1.-D.2.4.; D.3.1.	Notes 54b, 54c, 54d, 54e	Appendix IV --> Corporate website.
	3	Main and emerging risks	C		3
	4	New regulatory ratios and compliance plans	D.1.; D.3.; D.8.	Notes 54c, 54e, 54j	1; 2.1; 2.2.2.2; 7.1
Risk governance and management and business model	5	Organisation of risk management, processes and functions	B; D.3.1.	Notes 54b, 54e	3; 2.1.1; 2.1.2; 2.1.3
	6	Risk culture and internal measures	A; B.4.	Notes 54a, 54b	3
	7	Business model, management and risk appetite risks	B, D.8.	Notes 54b, 54j	3; 7.2
	8	Stress test uses and processes	B.3.1-B.3.3; D.1.5; D.2.2-D.2.3; D.3.1.; D.8.5.	Notes 54b, 54c 54d, 54e, 54j	2.3.2
Capital and risk-weighted assets	9	Minimum capital requirements (Pillar I)	D.8.	Note 54j	Executive summary; 2.2.1; 2.2.2;2.2.3
	10	Components of regulatory capital and reconciliation with balance sheet			1.2.7, 2.2.1. Appendices III.a and III.c
	11	Breakdown of changes in regulatory capital			2.2; 2.2.1; Appendix III.b; Appendix III.c
	12	Capital planning	D.8.5.	Note 54j	2.3.2
	13	Business activities and risk-weighted assets	D.8.	Note 54j	2.2.2
	14	Capital requirements by calculation method and portfolio			2.2; 2.2; 2; 3.4
	15	Credit risk by portfolios			2.2.2.1.1; 3.2-3.4
	16	Flows of risk-weighted assets			Executive summary; 2.2.2.1; 2.2.2.3; 2.2.2.4
	17	Back-testing of models (Pillar III)			3.7; 3.9; 5.2.5
Liquidity	18	Liquidity, management and liquidity reserve requirements	D.3.1.; D.3.2.	Note 54e	7.1
Financing	19	Encumbered and unencumbered assets	D.3.2.	Note 54e	7.1
	20	Contractual maturities of assets, liabilities and off-balance sheet amounts	D.3.2.	Note 54e	
	21	The entity's funding plan	D.3.2.; D.3.3.	Note 54e	7.1
Market Risk	22	Reconciliation of balance sheet with trading and non-trading positions	D.2.2.	Note 54d	
	23	Significant market risk factors	D.2.1-D.2.3.	Note 54d	5.1; 5.2
	24	Limitations of the measurement model for market risk	D.2.2.	Note 54d	5.2:5.2.6
	25	Management techniques for managing and evaluating the risk of losses	D.2.2.	Note 54d	5.2.1; 5.2.2; 5.2.3; 5.2.4; 5.2.5
Credit Risk	26	Credit risk profile and reconciliation with balance sheet items	D.1.2.	Note 54c	3.2
	27	Policies for impaired and restructured loans	D.1.2.	Note 54c	
	28	Reconciliation of impaired balance and loan-loss provisions	D.1.2.	Note 54c	3.2
	29	Counterparty risk from transactions with derivatives	D.1.4.	Note 54c	3.10
	30	Mitigation of credit risk	D.1.5.	Note 54c	3.11
Other risks	31	Other risks	D.4; D.6; D.7	Notes 54f, 54h, 54i	6; 7
	32	Discussion of risk events in the public domain	D.5.	Note 54g	7.2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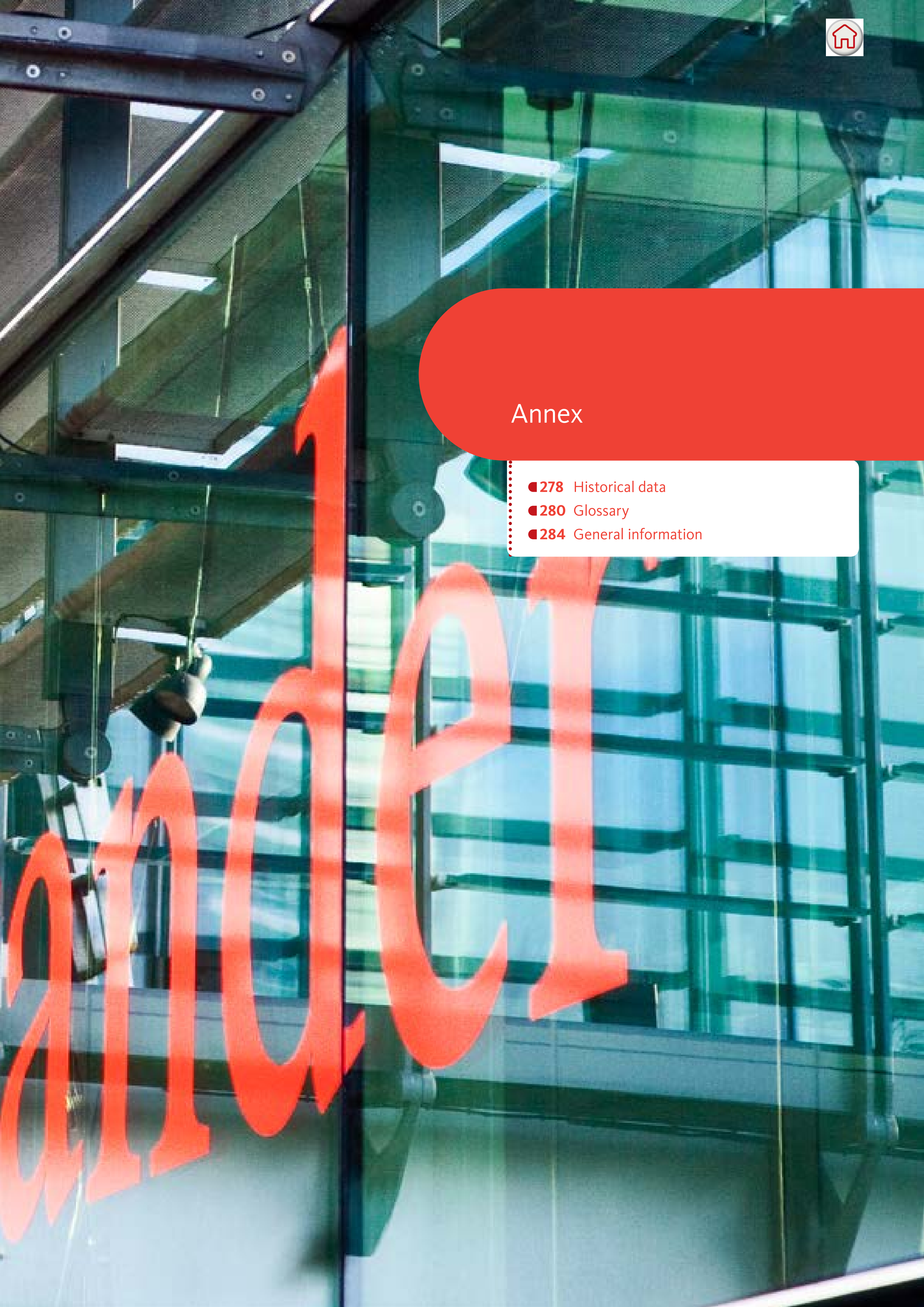

Annex

Historical data. 2006 - 2016

Balance sheet	US$Mill.	2016 € Million	2015 € Million	2014 € Million	2013 € Million	2012 € Million
Total assets	1,411,572	1,339,125	1,340,260	1,266,296	1,134,128	1,282,880
Net customer loans	833,234	790,470	790,848	734,711	684,690	731,572
Customer deposits	728,501	691,112	683,142	647,706	607,836	626,639
Customer funds under management	1,162,133	1,102,488	1,075,563	1,023,189	946,210	990,096
Total equity	108,255	102,699	98,753	89,714	80,298	81,747
Total managed funds	1,603,953	1,521,633	1,506,520	1,428,083	1,270,042	1,412,617
Income statement						
Net interest income	34,388	31,089	32,189	29,548	28,419	31,914
Gross income	48,507	43,853	45,272	42,612	41,920	44,989
Net operating income	25,182	22,766	23,702	22,574	21,762	24,753
Profit before taxes	11,911	10,768	9,547	10,679	7,378	3,565
Attributable profit to the Group	6,863	6,204	5,966	5,816	4,175	2,283

Per share data (1)	US$	2016 Euros	2015 Euros	2014 Euros	2013 Euros	2012 Euros
Attributable profit to the Group	0.45	0.41	0.40	0.48	0.39	0.23
Dividend	0.22	0.21	0.20	0.60	0.60	0.60
Share price	5.227	4.959	4.558	6.996	6.506	6.100
Market capitalisation (million)	76,226	72,314	65,792	88,041	73,735	62,959

Euro / US$ = 1.054 (balance sheet) y 1.106 (income statement).
(1) Figures adjusted to capital increase in 2008.

2011	2010	2009	2008	2007	2006
€ Million	€ Million	€ Million	€ Million	€ Million	€ Million
1,251,008	1,217,501	1,110,529	1,049,632	912,915	833,873
748,541	724,154	682,551	626,888	571,099	523,346
632,533	616,376	506,976	420,229	355,407	331,223
984,353	985,269	900,057	826,567	784,872	739,223
80,813	80,914	73,871	60,001	57,558	47,072
1,382,464	1,362,289	1,245,420	1,168,355	1,063,892	1,000,996

28,883	27,728	25,140	20,019	14,443	12,480
42,466	40,586	38,238	32,624	26,441	22,333
23,055	22,682	22,029	17,807	14,417	11,218
7,858	12,052	10,588	10,849	10,970	8,995
5,330	8,181	8,943	8,876	9,060	7,596

2011	2010	2009	2008	2007	2006
Euros	Euros	Euros	Euros	Euros	Euros
0.60	0.94	1.05	1.22	1.33	1.13
0.60	0.60	0.60	0.63	0.61	0.49
5.870	7.928	11.550	6.750	13.790	13.183
50,290	66,033	95,043	53,960	92,501	88,436

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.

Phase-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 profit before tax as a percentage of total assets.

RoE (return on equity): this measures an entity's return, calculated as attributable profit as a percentage of capital.

RoTE (return on tangible equity): this measures an entity's return, calculated as attributable profit as a percentage of tangible capital.

RoRWA (return on risk-weighted assets): this measures an entity's return, calculated as profit as a percentage of 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 valuation adjustments (excluding non-controlling interests) after deducting goodwill and 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.

General information

Banco Santander, S.A.

The parent group of Grupo Santander was established on 21 March 1857 and incorporated in its present form by a public deed executed in Santander, Spain, on 14 January 1875, recorded in the Mercantile Registry of the Finance Section of the Government of the Province of Santander, on folio 157 and following, entry number 859. The Bank's By-laws were amended to conform with current legislation regarding limited liability companies. The amendment was registered on 8 June 1992 and entered into the Mercantile Registry of Santander (volume 448, general section, folio 1, page 1,960, first inscription of adaptation).

The Bank is also recorded in the Special Registry of Banks and Bankers 0049, and its fiscal identification number is A-390000013. It is a member of the Bank Deposit Guarantee Fund.

Registered office

The Corporate By-laws and additional public information regarding the Company may be inspected at its registered office at Paseo de Pereda, numbers 9 to 12, Santander.

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This report was printed on ecologically friendly paper and has been produced using environmentally friendly processes.

Photographs:
Miguel Sánchez Moñita, Lucía M. Diz, Stephen Hyde, Javier Vázquez, Beto Adame

Production:
MRM Worldwide

Printing:
Alborada

Legal deposit:
M-7447-2017

All customers, shareholders and the general public can use Santander's official social network channels in all the countries in which the Bank operates.

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