New Issue Rating Report

FTA PYMES SANTANDER 11

SME CLOs / Structured Finance

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RATINGS

Class	Rating	Notional (EURm)	Notional (% assets)	CE (% assets)	Coupon	Final maturity
Series A	A_{SF}	2,681.3	75.0	30.0	3M-Euribor + 25bp	25 August 2059
Series B	$B\text{-}_{SF}$	893.7	25.0	5.0	3M-Euribor + 50bp	25 August 2059
Series C	C_{SF}	178.8	5.0	0.0	3M-Euribor + 65bp	25 August 2059
Total notes (excluding Series C)		**3,575.0**				

The transaction closed on 22 May 2015. The ratings are based on the preliminary portfolio dated 14 April 2015, provided by the originator. Scope's Structured Finance Ratings constitute an opinion about relative credit risks and reflect the expected loss associated with the payments contractually promised by an instrument on a particular payment date or by its legal maturity.

See Scope's website for the SF Rating Definitions.

Rated issuer

Purpose	Liquidity/funding
Issuer	Fondo de Titulización de Activos PYMES SANTANDER 11
Originator	Banco Santander S.A. (A+/S-1/Stable Outlook)
Asset class	SME CLO
Assets	EUR 3,575.0m
Notes	EUR 3,753.8m
ISIN Series A	ES0305070007
ISIN Series B	ES0305070015
ISIN Series C	ES0305070023
Closing date	22 May 2015
Legal final maturity	25 August 2059
Payment frequency	Quarterly
Payment dates	25 Feb, 25 May, 25 Aug, 25 Nov

Transaction profile

FTA PYMES SANTANDER 11 (PYMES 11) is a true sale securitisation of a EUR 3,575m portfolio of mortgage-secured loans (9%), unsecured loans (51%) and credit lines (40%) (jointly, the assets) granted to small- and medium-sized enterprises (SMEs) by Banco Santander to finance diverse business-related needs. The assets are originated by Santander and Banesto, a banking franchise fully integrated in Santander.

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Rating rationale (Summary)

The ratings reflect the legal and financial structure of the transaction, the quality of the underlying collateral in the context of the Spanish macroeconomic environment, the capability of Santander as the servicer, the counterparty risk exposure to Santander as the account bank, paying agent and liquidity provider, and the management ability of Santander de Titulización SGFT SA.

Spanish economy. Scope believes the Spanish economy continues to improve. This recovery will benefit class A notes in the short term, while the impact on class B notes is less certain due to the fragile recovery.

Stressed performance references. Scope calibrated the assumptions of its portfolio modelling base case with vintage data from 2007 to 2014, a period of high stress for Spanish SMEs: high defaults and relatively low recoveries, particularly for mortgages, as the recovery from Spanish real estate collateral has been slow due to the disrupted property market.

Lower quality obligors. The obligors in this portfolio are on weighted average weaker than those in the PYMES 10 portfolio, according to Santander's internal probabilities of default (WA PD of 5.6% vs. 3.2%). This is despite the better quality of credit line obligors (WA PD of 2.2% vs. 3.5%) which amortise faster and leave the transaction exposed to non-credit line obligors that have a WA PD one-and-a-half times higher than those in PYMES 10 (WA PD of 7.8% vs. 3.2%). However, Scope has modelled a lower mean lifetime 90dpd default rate (DR) of 13.9% (vs. 17.8% for PYMES 10) which reflects the shorter weighted average life (WAL) of this transaction, 1.9 years (vs. 2.8 years for PYMES 10).

High default volatility risk. Under a stress scenario, we believe the performance of the asset portfolio could deviate significantly from the base case. This is mainly because of the larger share of credit lines and unsecured loans, and the relatively lower quality of obligors of unsecured loans and mortgages compared to PYMES 10. Scope has considered a base case portfolio DR coefficient variation of 61% in the analysis.

Fast amortisation. Class A notes bear a very short risk exposure to counterparties and possible macroeconomic deterioration because expected WAL is 0.7 years under 0% CPR due to the fast amortisation of credit lines.

Risk from credit lines (CLs). This product poses revolving and refinancing risks which result in increased portfolio default rates under stress scenarios. However, the rating assigned to the class A notes reflects i) the credit strength of Santander; as well as ii) its strong track record in originating and managing credit lines; coupled with iii) the very short life of the credit lines in this portfolio. These factors strongly mitigate refinancing risk and thus the short-term default rate volatility of the portfolio credit lines. The WA usage level of these CLs is 42% and could only theoretically increase to 100% in the next six months.

Related reports

SME CLO Rating Methodology, dated May 2015.

Rating Methodology for Counterparty Risk in Structured Finance Transactions (Call for Comments), dated July 2015.

Structured Finance Instruments Methodology Guidelines, dated July 2014.

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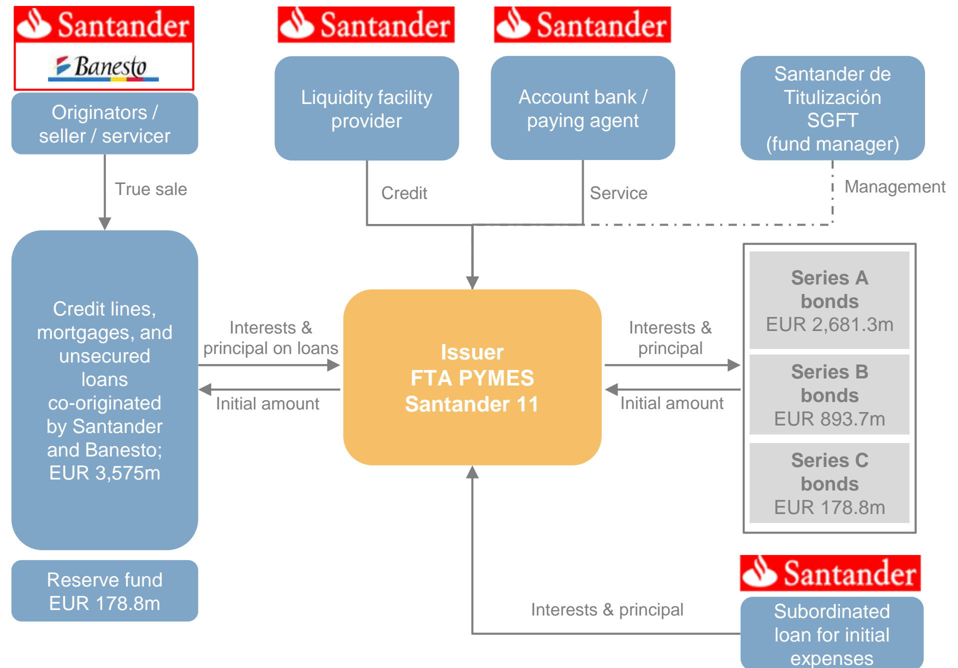
TRANSACTION SUMMARY

Figure 1. Simplified transaction diagram



FTA PYMES SANTANDER 11 is the 11th transaction in Santander's SME loan securitisation programme and the second rated by Scope. It consists of the securitisation of a portfolio of EUR 3,575m selected out of a EUR 3,681m preliminary portfolio comprising 59,592 loans and credit lines, co-originated by Banco Santander and Banesto granted to 54,662 Spanish SMEs and self-employed individuals.

FINANCIAL STRUCTURE

Capital structure

Three classes of sequentially subordinated notes were issued. The proceeds from class A and class B notes were used to purchase the initial portfolio of assets. The proceeds from class C notes were used to fully fund a cash reserve fund (RF) on the closing date.

The notes pay quarterly interest referenced to 3-month Euribor plus a margin. The amortisation is strictly sequential, but under very benign scenarios class C could receive principal payments before class B. These payments would correspond to reductions in the required RF level.

The issuer's initial expenses are covered by the proceeds from a dedicated subordinated loan. This loan will be amortised out of excess spread in the early stages of the transaction.

Reserve fund (RF)

The structure features a fully-funded cash reserve fund of EUR 178.8m or 5% of the initial portfolio balance. This RF is significantly smaller than the RF in the structure of PYMES 10 (20%) and largely explains the weaker credit quality of the class B notes in this transaction compared to the previous one. The RF is the primary source of credit enhancement for the class B notes.

The RF, combined with the provisioning mechanism, traps excess spread and enables the structure to accelerate amortisation of class A notes whenever assets are classified as defaulted, until the RF is fully depleted in high stress scenarios.

The RF is a source of negative carry for the transaction as the cash is held in an account of the issuer that yields 3-month Euribor flat, while the WA coupon of the notes is always higher than this index. Negative carry directly impacts class C notes.

We believe the amortisation of the RF will be unlikely under most portfolio default scenarios, despite being theoretically possible. The RF follows the standard mechanism of most Spanish securitisations where the required balance can be reduced subject to: i) non-defaulted assets more than 90dpd represent less than 2.5% of the non-defaulted assets; ii) more than two years have elapsed since closing; and iii) the RF was fully funded at its required level on the previous payment date.

Amortisation and provisioning

The amount accrued for principal amortisation is the amount required to match the balance of the notes to the balance of non-defaulted assets on every payment date. However, this calculation accounts for adjustments on the balances of credit lines which could trigger an unlikely principal retention if the usage level of credit lines drops below the usage level at closing. Principal collected from a reduction of the average usage level of credit lines would not be used to amortise the balance of the notes, but is retained in the structure. This protects the structure by reducing additional liquidity need upon a subsequent sudden increase of the average usage level of credit lines.

This mechanism constitutes both a principal retention and a provisioning mechanism. Principal retention is conditional on the usage level of credit lines, and it disappears when no more credit lines are in the portfolio.

Provisioning mechanism allows for accelerated amortisation of the most senior class

The provisioning mechanism allows for the accelerated amortisation of the most senior class, making use of RF money and excess spread. As long as cash remains in the RF the mechanism ensures outstanding notes will be collateralised by non-defaulted assets.

Credit lines are classified as defaulted when they are more than six months in arrears, and loans when they are over 12 months in arrears. Credit lines and loans can be classified as defaulted if the servicer subjectively considers them to be unrecoverable.

Priority of payments

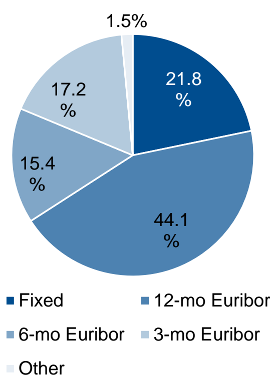
Combined priority of payments is the main protection against payment interruption

The structure features a combined priority of payments which provides material protection against payment interruption. Principal collections from assets can be used to pay timely interest on the senior class notes. Furthermore, only a few days' worth of collections suffice to pay senior class interest and other more senior items, even if an unlikely servicer disruption event occurs. The combined priority of payments is also effective in allowing losses from negative carry or interest rate mismatches to be covered by credit enhancement. See Figure 2.

Scope's analysis takes into account the demotion trigger on class B interest. The rating of class B notes captures any loss from the time value of missed interest resulting from a postposition of class B interest payments. Missed interest payments do not accrue interest for any classes in this structure—unlike class A in PYMES 10.

Unhedged interest rate risk

Interest rates in the portfolio



Scope believes the materiality of unhedged interest-rate risk is limited in view of: i) the current low interest rate environment; and ii) because floating rate assets are referenced to indices highly correlated with the 3-month Euribor index of the notes. Potential losses for negative carry are factored into the ratings and thus covered by available credit enhancement.

The transaction is exposed to interest-related risks because: i) there is no hedging agreement in place; ii) 21.8% of the assets pay a fixed interest rate whereas 100% of the issuer's liabilities are referenced to 3-month Euribor; and iii) the reset frequencies and dates of the assets create a rate mismatch between assets and liabilities.

Interest-related risks are covered by credit enhancement and the combined priority of payments. This makes it possible to use principal collections from the assets to pay interest on the most senior class of notes. The mechanism effectively transfers any losses from interest-rate mismatches to the equity part of the structure.

Figure 2. Priority of payments and available funds

Pre-enforcement priority of payments	Post-enforcement priority of payments
Available funds Collections from assets, excluding retained principal to cover decreases of credit line usage and amortise the liquidity facility; proceeds from interest and treasury accounts and RF.	**Available funds** All SPV moneys, including funds from liquidation of assets.
1) Taxes and expenses (ordinary and extraordinary, including servicer fee if Santander were replaced) 2) **Class A interest** pari-passu with liquidity facility interest (pro-rata) 3) Class B interest, if not demoted 4) **Principal for class A**, and then class B 5) Class B interest, if demoted when a) Class A still outstanding after payment date b) Total defaulted assets > 5% of portfolio balance at closing 6) RF to its required level 7) Class C interest 8) Principal for class C (i.e. equivalent to reduction of required RF amount) 9) Subordinate loan interest 10) Principal for subordinate loan 11) Servicer fee for Santander 12) Excess spread for originator as variable class C interest	1) Taxes and expenses (ordinary and extraordinary, including servicer fee if Santander were replaced) 2) **Class A interest** pari-passu with liquidity facility interest (pro-rata) 3) **Principal for class A** pari-passu with liquidity facility balance 4) Class B interest 5) Principal for class B 6) Class C scheduled interest 7) Principal for class C 8) Subordinated items including servicer fee for Santander and excess spread for the originator

Accounts

The issuer has two accounts as long as there are credit lines in the portfolio.

The first, the treasury account, is used to hold and retain principal collections from the assets until the balance of credit lines is lower than the balance of credit lines at closing. The account is used to service average balance increases from the credit lines using daily principal collections. The treasury account is linked to a liquidity facility that can be drawn should principal collections not be enough to cover the increased balance of credit lines.

The second, the interest account, holds the RF and interest collections from the assets.

Accounts represent commingling exposure to Santander, the account bank

The accounts represent commingling exposure to Santander as the account bank—see Counterparty Risk on page 6. The accounts also represent a source of negative carry as their yield is lower than the WA coupon on the notes. Any loss from negative carry is covered by available excess spread and credit enhancement.

Liquidity facility

The structure features a liquidity facility to fund any increase in the balance of the credit lines above the closing balance. The liquidity facility is set at 10% of class A notes, resulting in issuer's liquidation if this balance proved insufficient.

Any increase in the balance of the credit lines in the portfolio under stress can be serviced from principal collections from performing assets

Scope has not modelled the use of the liquidity facility because we believe that any increase in the balance of the credit lines in the portfolio under stress can be serviced from principal collections from performing assets.

If drawn, the liquidity facility would become a super-senior liability for the issuer, as its balance would be set off against daily principal collections in the issuer's treasury account. The liquidity facility is linked to the treasury account, which effectively acts as a credit account that yields interest on positive balances, and charges a fee on negative balances, i.e. overdrafts. There is no interest or fee on the unused commitment.

Clean-up call

Scope's analysis has not incorporated an option that allows the originator and seller to terminate the transaction before final legal maturity if the assets' balance is less than 10% of the original portfolio balance. This is because the exercise of the option is discretionary and would require the notes be fully repaid.

LEGAL STRUCTURE

Legal framework

This securitisation is governed by Spanish law and represents the true sale of the assets to a bankruptcy-remote vehicle without legal personality, represented by Santander de Titulización S.G.F.T. S.A., the management company.

This securitisation has been grandfathered by the Spanish securities regulator (Comisión Nacional del Mercado de Valores, CNMV) and incorporated as a 'Fondo de Titulización de Activos' (FTA, asset securitisation fund), a now extinct legal form defined in the Spanish securitisation framework contained in royal decree 926/1998. This choice of legal form is credit neutral.

The new Spanish law for the promotion of corporate financing (Ley 5/2015), effective since publication on 28 April 2015, reformed the Spanish securitisation framework and replaced FTA funds and 'Fondos de Titulización Hipotecaria' (FTH, mortgage securitisation funds) with a single, more flexible form called 'Fondo de Titulización' (FT, securitisation fund).

Asset replacement

Santander undertakes to replace or repurchase any asset transferred to the portfolio that does not comply with eligibility criteria in the documentation. No asset more than 30 days in arrears at the time of transaction closing can be transferred to the portfolio. This is greater than the 15-day threshold defined for PYMES 10, which resulted in technical delinquencies being transferred to the final pool. We believe the risk or weaker assets transferred to the final portfolio is covered by our mean default rate assumption for the portfolio.

Permitted variations

The documentation allows for obligor-initiated modifications to the terms of the contracts in the portfolio, notably interest rate and maturity. In all case negotiations with obligors would follow the originator's standard procedures and approval processes.

Documentation includes covenants to prevent the economic imbalance of the transaction as a result of permitted variations. Scope believes that these covenants limit any material migration of the portfolio beyond that related to asset performance.

Use of legal opinions

The transaction conforms to Spanish securitisation standards effective until 28 April 2015.

Scope has reviewed the legal opinions produced for the Issuer by Cuatrecasas Gonçalves Pereira, S.L.P. and trusts the regulatory oversight of CNMV to gain comfort on the legal structure of the issuer. The transaction conforms to securitisation standards in Spain effective until 28 April 2015 and supports the general legal analytical assumptions of Scope.

ORIGINATOR AND SELLER

Santander's functions, systems, processes and staff meet the highest standards of European banking

Banco Santander is an experienced originator of SME CLOs. Santander generally securitises all eligible assets in its loan book, with the exception of mortgage loans eligible to back cedulas hipotecarias (i.e. Spanish mortgage-covered bonds) and assets excluded by the Spanish securitisation law (i.e. real estate development loans or syndicated loans).

Santander is a sophisticated bank whose functions, systems, processes and staff meet the highest standards of European banking. The ability and stability of Santander as originator is illustrated by Santander's A+ rating from Scope. Scope analysts met Santander executives in Madrid on 29 October 2014 to deepen their understanding of the

underwriting and servicing aspects that are relevant to the analysis of this securitisation and confirmed with the originator that the processes and strategies presented back then, remain substantially in place.

Underwriting

Strong underwriting standards for the assets in this portfolio

Scope believes the underwriting standards for the assets in this portfolio are strong. Santander has applied tight underwriting standards to contracts originated since the crisis. Since 2009, Santander has successfully applied a conservative, loss-control driven lending strategy to strengthen its balance sheet. This period coincides with the seasoning of the preliminary portfolio.

Servicing and recovery

Scope applied a relatively low cure rate assumption of 15% to the analysis of this transaction because Santander's pre-delinquency monitoring processes and early-delinquency management processes are highly efficient. Santander reported a 47% improvement in the volume of pre-90dpd arrears in under two years (a 28% improvement in 2013 and 26% for year-to-date September 2014).

Scope believes that Santander's interests are strongly aligned with the noteholders. As a provider of the 5% RF and holder of the entire capital structure since closing, Santander has a significant subordinate interest in the transaction. In addition, the Spanish securitisation framework does not allow securitised assets to be treated differently from non-securitised assets on the bank's balance sheet. Santander's servicing and recovery processes aim to maximise prospects of recovery in the shortest possible time.

COUNTERPARTY RISK

Santander performs all counterparty roles and the transaction's exposure to Santander is captured in the ratings. Scope considers the exposure is not excessive, (i.e. crystallisation of counterparty risk would not prompt a downgrade of more than 6 notches, as defined in Scope's Rating Methodology for Counterparty Risk in Structured Finance Transactions – Call for Comments, dated 16 July 2015) available on www.scoperatings.com.

Operational risk from servicer

Scope does not consider the replacement of Santander as servicer of the portfolio. We believe a servicer replacement would be more disrupting than the probable continuation of Santander operating as a going concern throughout a hypothetical resolution process. This view is supported by Santander's relevance to the Spanish economy and the framework for orderly bank restructuring in Europe.

Comingling risk from the exposure to the servicer is not material because of the short-term exposure and credit strength of the bank. Collections from assets are transferred to the issuer's account generally intraday, but in any case no later than 48 hours.

Commingling risk from account bank and paying agent

Commingling risk is sufficiently remote as not to represent material risk for class A notes

The class A notes have a very short expected WAL of just 0.7 years under 0% CPR. Given Santander's current rating of A+/S-1/Stable Outlook, Scope considers the risk of commingling losses sufficiently remote as immaterial for class A notes. This is so even in the absence of counterparty risk protection features in the structure with a reference to Scope's ratings.

Scope believes credit risk arising from exposure to the account bank is negligible and mitigated in the structure by other risk-substitution covenants. We judge a counterparty eligible for the role of account bank and paying agent if upon the loss of a BB Issuer Credit-Strength Rating (ICSR) the structure triggers risk-substitution, in accordance with Scope's Rating Methodology for Counterparty Risk in Structured Finance Transactions (Call for Comments). The lack of rating triggers on Scope's ICSR has no effect our rating on the class A. However, it is marginally important for the monitoring phase of the life of the transaction as the class A notes' rating could be capped by counterparty risk.

Set-off risk from originator

Scope believes set-off risk from the originator is immaterial

Scope does not believe set-off risk from the originator is material in the context of Spanish law and under terms of the documentation. The structure incorporates an undertaking by the seller to compensate the issuer for any set-off loss resulting from rights existing prior to the asset transfer. Furthermore, set-off rights would cease to exist after obligor notification following a servicer event or upon the insolvency of either obligor or seller.

Exposure to set-off from linked contracts is negligible and restricted to insurance contracts in the context of mortgage loans. The exposure is largely to the insurance business of Santander and limited to premia paid up front and capitalised in the mortgage balance. This represents a negligible amount that is covered by available credit enhancement in the transaction.

ASSET ANALYSIS

Securitised assets

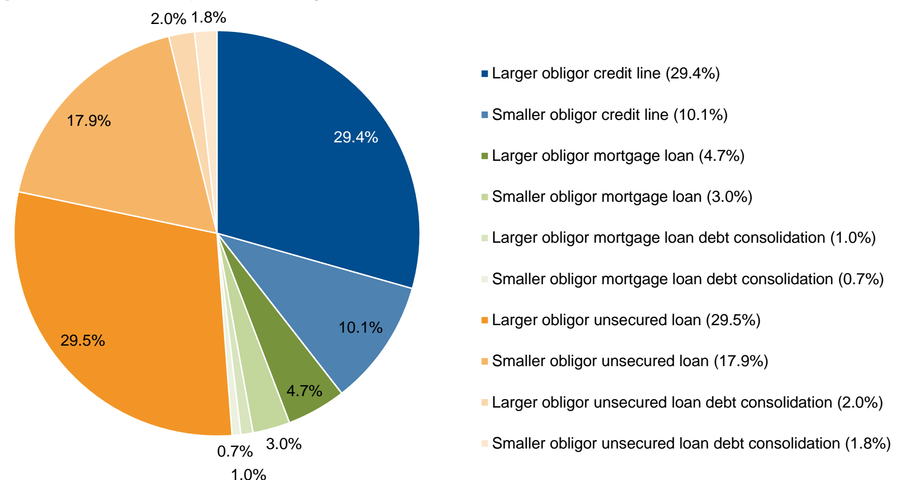
The preliminary portfolio comprises 10 segments the result of a classification of assets by: i) obligor size; ii) product type; and iii) debt-consolidation status. These segments are also the same as the previous PYMES 10 transaction.

Figure 3. Portfolio segmentation criteria used in the analysis

Obligor size	Product type	Debt-consolidation status
Larger obligor (LO): managed by inclusion in the portfolio of an agent	**Credit lines (CL)** Note: all credit lines are non-reconducted	**Non-reconducted (NR)**: the contract is not a debt-consolidation product
Smaller obligor (SO): managed under standard processes	**Mortgage loans (ML)**	**Reconducted (R)**: the contract is a debt-consolidation product
	Unsecured loans (UL)	

Note: Scope uses the abbreviations shown on this table to simplify the reference to the 12 portfolio segment names.

Figure 4. Preliminary portfolio segmentation



Credit lines—refinancing and revolving risk

Credit lines add two risks not present in static portfolios of amortising loans: i) revolving risk; and ii) refinancing risk.

Scope sees credit lines as a form of SME exposure that adds two risks not present in static portfolios of amortising loans: i) revolving risk; and ii) refinancing risk, because of the bullet nature of credit line products. Credit lines in Spain can be drawn even when obligors are already in default (“concurso de acreedores”) and cannot be cancelled prior to maturity. However, the short WA remaining term of the credit line portfolio segment limits its contribution to the portfolio default rate.

Scope considered the full commitment of the credit line to be at risk of default rather than the current balance, but only to the extent allowed by the amortisation of the assets. See Appendix III.

The preliminary portfolio contains 39.5% of credit lines considering the current balance, with negligible exposure to restructured contracts. The current balance of credit lines does not reflect the balance under a stress scenario where bad obligors would use the credit line to remain current on other debts before defaulting.

Using vintage data analysis, Scope estimated a low mean lifetime default rate of 2.9%, a default rate CoV of 132% and a hard RR of 48% for this segment. The credit line segment can be seen as a revolving part of the portfolio which could use collected principal from other performing assets. There are no debt consolidation contracts in the credit line portfolio segment.

Scope does not stress the credit line balance above and beyond the initial commitment

Scope does not subject the balance of credit lines to stress above and beyond the initial commitment. Under exceptional circumstances the balance of the contract can be increased up to 105% of the initial commitment over a short period. The overdraft must in all cases be approved by the risk department of Santander, and the obligor must provide evidence that he will be able to return the balance to normal within a short time frame.

The effective maturity of these contracts is less than one year. The credit lines will be removed from the portfolio at the earliest renewal date or on the maturity date, significantly mitigating refinancing risk.

Scope is comfortable that the refinancing risk of credit lines is not material for the class A notes. Exceptional refinancing risk would only crystallise in scenarios where Santander is not able to provide a new credit line to the obligor at maturity (or refund the issuer at the renewal date).

Scope does not believe that the transaction will utilise the liquidity facility to service credit line balance increases. Potential drawings amount to EUR 972m but this amount would require an unrealistic increase of the average usage level of the credit lines—currently at 42%—in a context of macroeconomic recovery. We believe the expected amortisation of the portfolio will provide sufficient principal repayments to service any credit line drawings should the usage level increase. The liquidity facility is set to represent 10% of the class A notes' current balance.

Unsecured loans: weak recovery under stress

The unsecured loans segment accounts for 51.2% of the preliminary portfolio, of which 7.5% are restructured loans (the share of restructured loans in this segment was 5.9% for PYMES 10). From vintage data analysis, Scope estimated a mean lifetime default rate of 15.8%, a default rate CoV of 57% and a hard RR of 30% in this segment.

Santander generally applies tighter underwriting standards to these loans given the lack of mortgage security. This results in better performance than mortgage loans. In the context of this transaction, "unsecured" means "not secured by mortgage", although most of these loans benefit from personal guarantees or other types of security that are generally effective at reducing delinquencies or increasing recovery. Yet these forms of alternative security are difficult to validate and their impact on performance is already captured in the performance references used for the analysis.

Unsecured loans comprise a significant amount of bullet loans

The average maturity of the segment is four years. The standard amortisation scheme is French. However, this segment shows a significant amount of bullet loans (14% of the segment's balance), which pose higher refinancing risk. Scope takes into account the high risk captured by the performance references of the vintage data, as it belongs to a period of stress.

Mortgage loans—slow recovery and tail concentration risk

The mortgage loans segment accounts for 9.3% of the preliminary portfolio—significantly less than PYMES 10, where the mortgage share was 22.2%. Restructured contracts represent 17.8% of this segment (a similar share as for PYMES 10 where 19.7% of mortgages were restructured loans). From vintage data analysis, Scope estimated a mean lifetime default rate of 28.9%, a default rate CoV of 93% and a hard RR of 41% in the segment. These results demonstrate the very high volatility of default rates in this segment, and the relatively low recovery rate, given the secured nature of these contracts.

Mortgages on real estate assets have long maturities exceeding 10 years on average. The weighted average current LTV for these secured loans is 73% based on original appraisals.

Mortgage loans are more exposed to debt consolidation risk

Mortgage loans are more exposed to debt consolidation risk, relative to other segments of the portfolio. This was to be expected, as Santander generally asks for mortgage guarantees when it originates debt consolidation products.

This segment carries concentration risk for the class B notes, as the tail of the life of the transaction will be exposed to mortgage loans. This risk is mitigated by credit enhancement build-up from deleveraging of the transaction.

Risk from debt consolidation products—restructured

The portfolio contains assets, originated to consolidate other debts of the obligor in a larger contract with conditions better adapted to the payment capacity of the SME. Santander names these debt-consolidation contracts "reconducted" and does not grant them to obligors in arrears[1].

Debt-consolidation products pose higher risks

Scope believes debt-consolidation products pose higher risks, despite corresponding to performing obligors. Scope has stressed the 5.5% exposure to debt consolidation products in the preliminary portfolio by considering a higher mean lifetime default rate for those assets (WA mean of 80% vs 8.0% for non debt consolidation).

This stress is justified because historical data provided by Santander for these segments lacks granularity and exhibits significant volatility around mean default rate values that are already very high. See Appendix II. Vintage Data on page 18.

Portfolio characteristics

Final portfolio selection

Santander has not provided the final pool selected out of the preliminary portfolio which was audited, and on which we based our rating analysis. Nevertheless, the limited flexibility available in selecting the final assets, offers comfort that the final portfolio characteristics are substantially the same as those of the preliminary portfolio. The preliminary portfolio balance of EUR 3,681m on 14 April 2015 compares to the final portfolio balance of EUR 3,575m on 19 May 2015 (i.e. only 3% lower, without amortisation over one month).

Fast amortisation and barbelled amortisation profile

Class A has a short risk exposure to counterparties and possible macro-economic deterioration

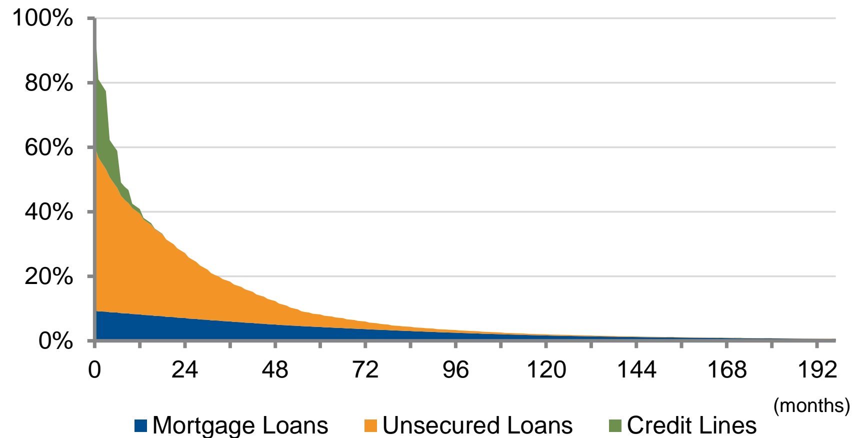
Class A has a short risk exposure to counterparties and possible macro-economic deterioration because its expected weighted average life is 0.7 years under 0% CPR.

The preliminary portfolio would be reduced by 50% of the original balance only 7 months after closing under a 0% CPR and 0% defaults assumption. This fast portfolio amortisation is driven by credit lines with a WAL of just 4.2 months (even faster than for PYMES 10, were it was 5.3 months).

The portfolio creates three distinct periods in the life of the transaction: i) an early stage with a fast amortisation segment of credit lines that lets class A amortise rapidly; ii) a mid stage when the portfolio is exposed to unsecured loans and mortgages; and iii) a late stage when the portfolio will comprise mostly mortgages with a potentially lumpy tail. Credit enhancement build-up over the life of the transaction will be adequate to cover tail risk from concentration, as the amortisation of the notes is strictly sequential.

[1] Santander calls contracts granted to refinance obligors in arrears "restructured", with a different meaning to the one used by Scope in this report. Contracts refinancing debts in arrears are riskier than the "reconducted" contracts included in this securitisation.

Figure 5. Portfolio amortisation under 0% CPR and 0% default rate



Granular portfolio—low obligor concentration

The portfolio is granular and well diversified according to the calculated diversity indices (DI): obligor DI 702, industry DI 12; and region DI 9.

Scope has addressed obligor concentration by applying a 20% stress to the CoV of this segment

The preliminary portfolio is exposed to eleven obligors each representing more than 0.5% for a total combined exposure of 7.05% of the preliminary portfolio; a higher concentration than PYMES 10, where top eight obligors represented 4.95%. Eight of these obligors are known to be of better credit quality than the portfolio average based on the bank´s internal probability of default (PD). One obligor exhibits a 100% PD according to the originator, although it is currently performing; whereas the other two have no PD in the portfolio data file. Scope has addressed obligor concentration by applying a 20% stress to the coefficient of variation of this segment and also considered 18.5% of top obligor balance to be effectively defaulted.

Figure 6. Preliminary portfolio industry distribution

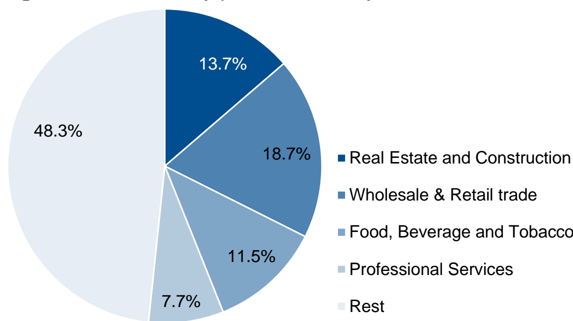


Figure 7. Preliminary portfolio regional distribution

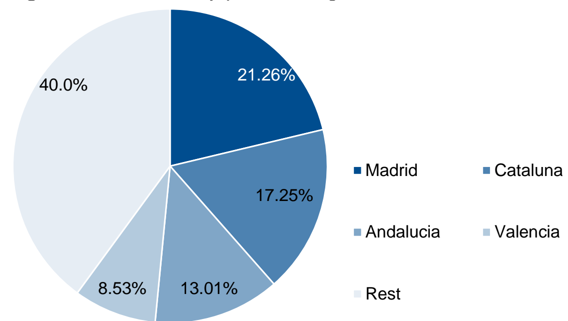


Figure 8. Exposures of largest obligors in the preliminary portfolio

Top #	Balance (EURm)	Balance (%)	Portfolio segment (all are larger obligors)	Sector	Region	Amortization schedule	Santander 1yr PD
1	27.0	0.73%	Unsecured loan	Wood & paper products	Galicia	French	0.2%
2	25.0	0.68%	Unsecured loan	Wholesale & retail trade	Valencia	French	0.5%
3	24.9	0.68%	Unsecured loan	Real Estate: Development	Aragon	French	1.6%
4	24.8	0.67%	Unsecured loan	Construction & materials	Andalucia	French	0.5%
5	24.7	0.67%	Credit line	Energy	Extremadura	Bullet	na
6	24.6	0.67%	Unsecured loan	Energy	Madrid	French	na
7	23.4	0.64%	Credit line	Real Estate: Development	Madrid	Bullet	6.0%
8	22.5	0.61%	Unsecured loan (smaller obligor)	Real Estate: Development	Cataluna	French	100.0%
9	—	0.00%	Credit line	Food, beverage & tobacco	Cataluna	Bullet	0.1%
	21.9	0.60%	Unsecured loan	Food, beverage & tobacco	Cataluna	French	0.1%
10	21.6	0.59%	Unsecured loan	Transportation & logistics	Pais Vasco	French	0.2%
11	19.0	0.52%	Unsecured loan	Real Estate: Development	Aragon	Bullet	4.9%

Lifetime default rate

Vintage data covers a period of high stress for Spanish SMEs

Scope adjusted the portfolio modelling base case assumptions using vintage data from 2007 to 2014, a period of high stress for Spanish SMEs: high defaults and relatively low recoveries, particularly for mortgages because the recovery from Spanish real estate collateral is slow, due to a disrupted property market. Scope has modelled a mean lifetime 90dpd default rate of 13.9%, a coefficient of variation of 61% and a base case recovery rate of 35%. These modelling assumptions incorporate the base case adjustments for top obligors and credit lines in Appendix III. Analytical Notes on Default Analysis. The most relevant data used for the analysis is included in Appendix II. Vintage Data.

Figure 9 shows preliminary portfolio default rate modelling assumptions and summarised adjustments applied to address risk from credit line and obligor concentrations in the portfolio. The figure also shows comparison with the PYMES 10 transaction.

Figure 9. Summary of mean default rate adjustments and comparison with PYMES 10

	PYMES 11		PYMES 10	
	Mean DR	DR CoV	Mean DR	DR CoV
Vintage result (unadjusted)	11.9%	59.1%	16.3%	37.8%
After adjustment for credit lines	12.7%	59.1%	16.8%	39.9%
Default modelling assumptions (after adjustment for top obligors)	**13.9%**	**61.0%**	17.8%	40.8%

Recovery rate

Scope analysed the recovery vintage data provided by Santander for the 12 segments of products present in the preliminary portfolio. The 35% WA RR for the portfolio is lower than the 44% recovery rate for PYMES 10. Scope only considered accumulated recoveries up to three years after the moment of default when deriving the RR base case from vintage data.

The historical recovery rate of mortgages showed lower values than under a market value decline (MVD) approach

Scope did not calculate RRs of the mortgage segment of the pool considering the value of the real estate collateral available as security. The historical recovery rate of mortgages showed lower values than those under a market value decline (MVD) approach. This is because a weighted average recovery lag of 31 months is considered too short to allow for mortgage recovery in a disrupted real estate market.

Scope modelled the portfolio with fixed recovery rate assumptions subject to conditional stress. Scope applied haircuts of different magnitudes to the base case recovery rate derived from vintage data analysis. These haircuts are a function of the target rating of the tranche. The use of rating-conditional recovery rates produces increased rating stability as it ensures higher ratings are subject to higher recovery rate stresses.

Figure 10 provides the indicative stress levels Scope has taken into account per rating category for rating this transaction.

Figure 10. Rating conditional recovery rates

Rating Stress	Haircut to base case	PYMES 11 Rating-level conditional recovery rate	PYMES 10 Rating-level conditional recovery rate
AAA	40%	**21.0%**	26.4%
AA	32%	**23.8%**	29.9%
A	24%	**26.6%**	33.4%
BBB	16%	**29.4%**	37.0%
BB	8%	**32.2%**	40.5%
B (base case)	0%	**35.0%**	44.0%

Cure rate (CR)

Scope arrived at a low cure rate of 15% from 90dpd recovery vintage data to estimate the share of 90dpd delinquent assets that do not migrate into default as classified by the transaction documents. The low cure rate results from Santander's highly proactive monitoring processes, resulting in most 'curable' delinquencies being fixed before they breach the 90dpd threshold. Santander did not provide 360dpd default rate vintage data to refer a true default rate to the 90dpd base case assumption for the portfolio.

This 15% cure rate assumption was considered constant in our analysis (i.e. not rating conditional as recovery rates are), as a share of the portfolio is assumed to be delinquent as a function of the default rate scenario in Scope's cash flow modelling.

Constant prepayment rate—making extreme assumptions

Scope tested the class A notes against a most conservative 0% CPR assumption

Scope tested class A notes against the most conservative 0% CPR assumption as class A benefits from prepayments. Scope used a CPR assumption of 12% to analyse the class B and class C notes.

This is justified as Santander did not provide product-specific prepayment information and Scope relied on references available from previous PYMES transactions. These showed very volatile historical CPR values from 3% to 11%.

MODELLING

Scope used a bespoke cash flow model to analyse this transaction

Scope used a bespoke cash flow (CF) tool to analyse the transaction. Scope modelled the preliminary portfolio with three distinct but perfectly correlated portfolio segments: i) credit lines; ii) unsecured loans; and iii) mortgages loans.

The CF tool was combined with the normal inverse Gaussian probability distribution to calculate the probability-weighted (i.e. *expected*) loss of each of the rated tranches under rating-level conditional recovery rate assumptions. The CF tool also produces the expected WAL of each of the rated tranches.

Besides the base case, Scope also analysed the transaction under a long-term view, as described in its SME CLO Rating Methodology. Appendix IV. Long-term Default Analysis describes how we performed this adjustment in the context of the Spanish economic cycle and the period in which performance data was available. Figure 11 shows the rating impact of this long-term adjustment.

Figure 11. Sensitivity of model results to long-term adjustment of portfolio default rates

Long-term (sensitivity in notches)	Class A
Base case DR x 0.7 and CoV = 80%	**+1**
Base case DR x 0.7 and CoV = 72%	**+2**

The agency assigned an A_{SF} rating to the class A notes based on the results of the cash flow analysis on the long-term adjusted portfolio default rate distribution. This analysis is supported by the positive macroeconomic environment combined with the relatively tight underwriting standards of Santander during 2014, when more than 50% of the assets have been originated.

To eliminate doubt, no single output figure of the tool determines the final rating decision of the committee. Scope gave great consideration in its analysis to long-term sensitivity scenarios which indicated that the modelling was overly sensitive to the coefficient of variation input (i.e. from an indication of AA- for a coefficient of variation of 64% to an indication of A- for a coefficient of variation of 80%). The volatility of portfolio default rates was overstated as it was driven by the refinancing risk assumptions on very fast amortising credit lines. Additionally, credit lines are of better average credit quality than the other assets in the portfolio.

Figure 12. Modelling assumptions

	Ratings	Expected WAL	Mean DR	CoV	Cure Rate	Applicable RR	Recovery lag	CPR	Default timing
Series A	A_{SF}	0.7 years	13.9%	61.0%	15.0%	26.6%	31 months	0.0%	Front loaded
Series B	$B\text{-}_{SF}$	3.9 years				35.0%		12.0%	
Series C	C_{SF}	11.3 years				45.0%		12.0%	

Scope considered a front-loaded default timing term structure. Back-loaded default scenarios would not be as severe because of credit enhancement build-up and the effect of seasoning on the portfolio.

The cumulative default timing assumptions are shown on Figure 13. These assumptions imply the front-loading of delinquencies, starting on the first month of the life of the transaction. The chart shows defaults as classified according to the definitions in the documentation (i.e. six months past due for credit lines, 12 months past due for loans).

Figure 13. Default timing assumptions for the three product types

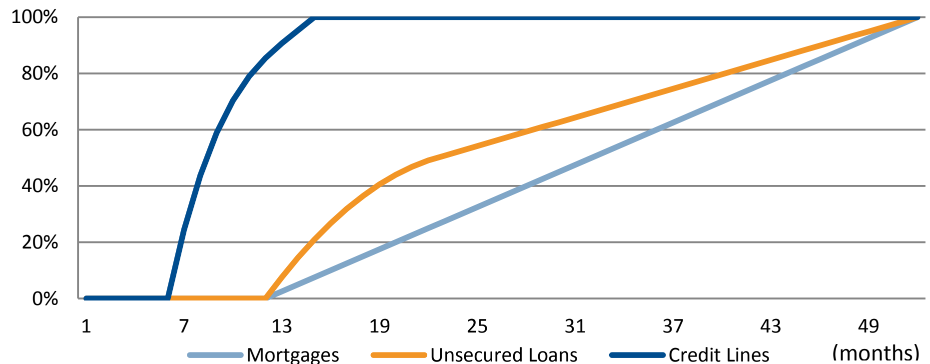
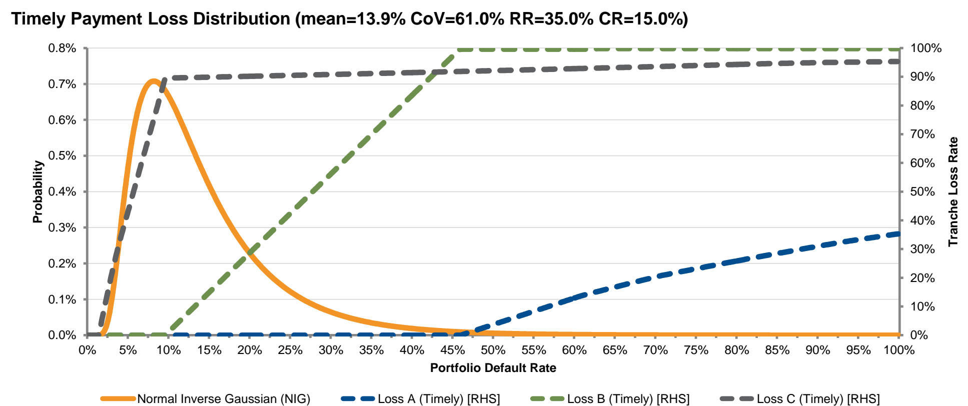


Figure 14 shows the losses of each of the tranches for all portfolio default rates. It is notable how the class C benefits from excess spread that is not trapped by the transaction until the first assets are classified as defaulted. This allows the class C to have maximum losses that are lower than the maximum losses possible for the class B. The probability-weighted loss for the class B is, of course, far smaller than for the class C.

Figure 14. CF model results for base case mean DR, CoV, RR and cure rate and 0% CPR



RATING STABILITY

Rating sensitivity

The strong protection mechanisms of the structure support the stability of the ratings

The strong protection mechanisms of the structure, the rating level conditionality of recovery rates assumed by Scope and the use of a long-term performance reference for Spain support the stability of the ratings.

Scope tested the model results against the reference shifts in modelling assumptions as per our SME CLO Rating Methodology. These shifts are only designed to illustrate the sensitivity of the modelling approach to changes in modelling assumptions. These shifts do not represent likely or even plausible deviations from the expected base case performance. This section shows the impact on the model results of changes to the base case values of the portfolio mean default rate, the default rate CoV and the portfolio RR. See Figure 15 and subsequent below.

The rating on the class A as of closing would be sensitive to the stresses. The highest sensitivity is with respect to shifts in the default rate coefficient of variation. The class A would be downgraded up to five notches upon a deviation of 50% of the base case. This is because the base case coefficient of variation is already very high and the deterministic sensitivity stress becomes totally unrealistic.

The class B rating is less sensitive to shifts in modelling assumptions because of the initially lower rating. Model results deteriorate by up to one rating category under high default rate shifts and combined shifts of other assumptions. The rating of the class C is

insensitive towards changes in the modelling assumptions because it is already at the C_{SF} category.

Figure 15. Model-results sensitivity to shifts in the portfolio default rate coefficient of variation

DR CoV (Sensitivity in notches)	Class A	Class B	Class C
Base case CoV + 25%	-2	—	—
Base case CoV + 50%	-5	-1	—

Figure 16. Model-results sensitivity to shifts in the portfolio recovery rate

RR (Sensitivity in notches)	Class A	Class B	Class C
Base case RR - 25%	-1	-1	—
Base case RR - 50%	-2	-1	—

Figure 17. Model-results sensitivity to shifts in the portfolio mean DR

DR (Sensitivity in notches)	Class A	Class B	Class C
Base case DR + 25%	-2	-1	—
Base case DR + 50%	-4	-3	—

Figure 18. Model-results sensitivity to combined shift in the portfolio mean DR and recovery rate

Combined DR/RR (Sensitivity in notches)	Class A	Class B	Class C
Base case DR + 25%, Base case RR - 25%	-3	-3	—

Break even analysis

Under a zero RR assumption, the class A would not experience any loss under portfolio default rates of 37% or lower

The resilience of the class A rating is better illustrated in the break even default rate analysis. The class A would not experience any loss at portfolio default rates of 37% or lower, under a zero RR assumption. The class A would not experience any loss at portfolio default rates of 49% or lower under the A_{SF} recovery rate assumption for this portfolio of 26.6% (compared to the base case RR assumption of 35%).

The class B would not experience any loss for portfolio default rates of 11% or lower under the B recovery rate assumption of 35%. This class would not have losses at portfolio default rates of 7% or lower, under a zero RR assumption.

The class C has its break even point at a portfolio default rate of 0.9% under the base case recovery assumption. This break-even default rate can be seen as a measure of excess spread given the first-loss nature of this tranche.

Figure 19. Break-even default rate analysis as a function of prepayments and recovery rates

Break-even DR (for a cure rate of 15%)				
Prepayments	0% CPR		12% CPR	
Portfolio RR	26.6% (A_{SF} RR)	0.0% (Zero RR)	35.0% (B_{SF} RR)	0.0% (Zero RR)
Class A	49.2%	36.8%	55.9%	36.4%
Class B	10.3%	7.7%	10.8%	7.1%
Class C	1.5%	1.1%	0.9%	0.6%

SOVEREIGN RISK

Sovereign risk does not limit the transaction's ratings

Sovereign risk does not limit the ratings on this transaction. The risks of an institutional framework meltdown, legal insecurity or currency convertibility problems, due to a hypothetical exit of Spain from the eurozone, are not material for the rating of the class A notes, and less so given the very short expected WAL of this tranche.

Scope factors the positive economic outlook into the rating analysis, as Spain's GDP continues to grow. Spanish SMEs' financial performance is consequently likely to improve in 2015-2016 boosted by growing domestic demand and increased credit availability.

The challenges to this recovery trend are not a material threat for the credit strength of the class A notes, again because of the short expected WAL. But macroeconomic imbalances and crystallisation of political risk could dissolve the positive impact of this economic trend for the class B and the class C notes. These imbalances are the high level of public and private debt, the still large budget deficit, the negative net investment position and the very high unemployment.

MONITORING

Scope will monitor this transaction on the basis of the performance reports produced by the management company and any other information received from the originator. The ratings will be monitored continuously and reviewed at least once a year, or earlier if warranted by events.

Scope analysts are available to discuss all the details surrounding the rating analysis

Scope analysts are available to discuss all the details surrounding the rating analysis, the risks which this transaction is exposed to and the ongoing monitoring of the transaction.

APPLIED METHODOLOGY AND DATA ADEQUACY

For the analysis of this transaction Scope applied its SME CLO Rating Methodology, dated 6 May 2015, available on our website www.scoperatings.com. Appendix III. provides additional details on the vintage analysis performed to produce portfolio-default modelling inputs.

APPENDIX I. TRANSACTION COMPARISON

Figure 20. Comparison of recent Santander PYMES transactions

Key Features	PYMES 11	PYMES 10	PYMES 9	PYMES 8
Originator	**Santander and Banesto**	Santander and Banesto	Santander	Santander
Closing date	**22 May 2015**	4 Dec 2014	20 May 2014	20 May 2014
Portfolio balance (EURm)	**3,681**	4,215	558	1,591
Number of assets	**59,592**	50,411	3,333	23,404
^{2}Ddiversity index	**911**			
Number of obligors	**54,662**	45,303	3,176	20,779
^{2}Ddiversity index	**702**			
Average asset size (EUR)	**61,764**	89,188	167,426	67,961
Maximum asset size (EUR)	**27,000,000**	28,394,000	4,977,296	15,543,924
SME	**98.1%**	86.6%	86.3%	95.0%
Self-employed	**1.9%**	13.4%	13.7%	5.0%
Concentrations				
Largest obligor	**0.7%**	0.7%	0.9%	1.0%
Top 10 obligors	**6.5%**	5.6%	6.2%	6.7%
Top 20 obligors	**10.8%**	9.0%	10.2%	10.6%
Largest region	**21.3%**	23.6%	21.0%	30.7%
Top 3 regions	**51.5%**	53.5%	51.2%	57.0%
Largest sector	**18.7% Wholesale & Retail trade**	15.7% Real Estate & Construction	23.9% Real Estate & Construction	12.03% Real Estate & Construction
Top 3 sectors	**43.9%**	38.5%	60.5%	31.7%
WAL (0%DR and 0%CPR) (years)	**1.9**	2.8	5.3	1.8
WA Santander's internal 1yr PD	**5.6%**	3.2%	na	na
Current WA coupon	**3.4%**	3.8%	3.0%	4.4%
Fixed rate assets (% of balance)	**21.8%**	19.4%	1.0%	25.8%
WA coupon of fixed rate assets	**4.8%**	5.2%	4.7%	5.1%
WA margin of floating rate assets	**2.7%**	2.8%	2.3%	4.2%
Amortizing loans	**53.2%**	71.8%	98.8%	89.0%
Bullet loans	**46.8%**	28.2%	1.2%	11.0%
Credit lines	**39.5%**	17.8%	0.0%	23.3%
of which reconducted	**0.0%**	4.5%	na	na
WA Santander's internal 1yr PD	**2.2%**	3.5%	na	na
Mortgages	**9.3%**	22.3%	79.8%	5.2%
of which reconducted	**18.3%**	19.7%	na	na
for which WA LTV	**72.9%**	64.4%	84.1%	75.6%
WA Santander's internal 1yr PD	**18.5%**	3.0%	na	na
Unsecured loans	**51.2%**	59.8%	20.2%	71.4%
of which reconducted	**7.4%**	5.6%	na	na
WA Santander's internal 1yr PD	**5.9%**	3.2%	na	na
Debt consolidation (reconducted or refinancing)	**5.5%**	8.7%	15.2%	5.5%

PYMES 11 vs. PYMES 10

This transaction securitises a portfolio of weaker obligors, when compared to that of its predecessor PYMES 10. In terms of Santander's internal probabilities of default, the average quality of the obligors in PYMES 11 (WA PD of 5.6%) is 74% worse than in PYMES 10 (WA PD of 3.2%). Particularly, non-credit line obligors in the portfolio have a WA PD of 7.8%, one and half times higher than for PYMES 10. See Figure 20 for more details on the differences of the portfolio segments.

However, we have assigned a mean lifetime default rate to this transaction (13.9%) which is lower than the one we assigned to PYMES 10 (17.8%). This is because of the shorter WAL of this portfolio (1.9 years versus 2.8 years for PYMES 10) which prevents defaults accumulating.

This transaction has higher probability of seeing large portfolio default rates under stressed scenarios than PYMES 10. The nature and lower average quality of the obligors makes them more vulnerable to downturns. For example, only 1.9% of this portfolio are self-employed individuals—versus 13.4% in PYMES 10—who have more stable credit performance than micro-SMEs because SMEs benefit from limited liability.

The rating assigned to the class A notes of PYMES 11 reflects the credit strength of Santander and the very short life of the credit lines in the portfolio. These factors strongly mitigate the short-term default rate volatility of the credit lines in the portfolio.

The capital structure of this transaction offers 31% less credit enhancement to the class A notes than PYMES 10—30%, down from 43.5% for PYMES 10. The difference in credit enhancement is very significant for instruments with expected average lives of less than two years.

APPENDIX II. VINTAGE DATA

The following figures show the granularity of the vintage data used to derive modelling assumptions and the historical performance of the most relevant segments present in the portfolio.

Scope uses the abbreviations shown on this table to simplify the reference to the 12 portfolio segment names:

Legend of portfolio segmentation criteria for vintage data		
Product type	Obligor size	Debt-consolidation status
CL – Credit lines	**LO – Larger obligor**: managed by inclusion in the portfolio of an agent	**NR – Non-reconducted**: the contract is not a debt-consolidation product
ML – Mortgage loans	**SO – Smaller obligor**: managed under standard processes	**R – Reconducted**: the contract is a debt-consolidation product
UL – Unsecured loans		

Coverage and granularity

90dpd delinquency data

Figure 21. Coverage and granularity of vintage data for 90dpd delinquencies (non-debt consolidation)

Non-Reconducted	UL SO NR	ML SO NR	CL SO NR	UL LO NR	ML LO NR	CL LO NR
Total volume (EURm)	7,115	2,779	6,879	30,700	15,202	40,406
Total count	148,204	9,189	88,012	52447	6,781	55,042
Series	32	32	31	32	32	32
Series period (mo)	3	3	3	3	3	3
Period covered	2007 to 2014	2007 to 2014	2007 to 2014	2007 to 2014	2007 to 2014	2007 to 2014

Figure 22. Coverage and granularity of vintage data for 90dpd delinquencies (debt consolidation)

Reconducted	UL SO R	ML SO R	CL SO R	UL LO R	ML LO R	CL LO R
Total volume (EURm)	1,591	2,245	804	5,993	14,546	5,214
Total count	26,145	6,594	10,026	10,432	6,072	3,313
Series	32	32	32	32	32	32
Series period (mo)	3	3	3	3	3	3
Period covered	2007 to 2014	2007 to 2014	2007 to 2014	2007 to 2014	2007 to 2014	2007 to 2014

180dpd recovery data

Figure 23. Coverage and granularity of vintage data for 180dpd delinquency recoveries (non-debt consolidation)

Non-Reconducted	UL SO NR	ML SO NR	CL SO NR	UL LO NR	ML LO NR	CL LO NR
Total volume (EURm)	6,410	2,634	6,679	28,507	14,961	38,468
Total count	123,188	8,448	84,411	46,285	6,710	53,412
Series	30	23	30	31	31	31
Series period (mo)	3	3	3	3	3	3
Period covered	2007 to 2014	2007 to 2012	2007 to 2014	2007 to 2014	2007 to 2014	2007 to 2014

Figure 24. Coverage and granularity of vintage data for 180dpd delinquency recoveries (debt consolidation)

Reconducted	UL SO R	ML SO R	CL SO R	UL LO R	ML LO R	CL LO R
Total volume (EURm)	1,582	2,241	793	5,844	14,520	5,170
Total count	25,897	6,564	9,781	10,192	6,049	3,292
Series	31	31	28	30	31	31
Series period (mo)	3	3	3	3	3	3
Period covered	2007 to 2014	2007 to 2014	2007 to 2014	2007 to 2014	2007 to 2014	2007 to 2014

Relevant vintage data

90dpd delinquency data

Figure 25. 90dpd delinquency data consolidated by year non-debt consolidation (NR) unsecured loans (UL) to larger obligors (LO)

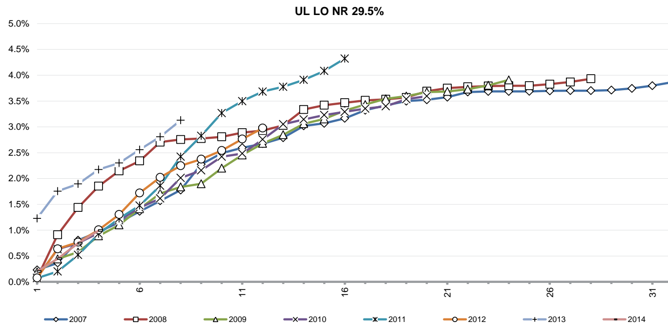


Figure 26. 90dpd delinquency data consolidated by year non-debt consolidation (NR) unsecured loans (UL) to smaller obligors (SO)

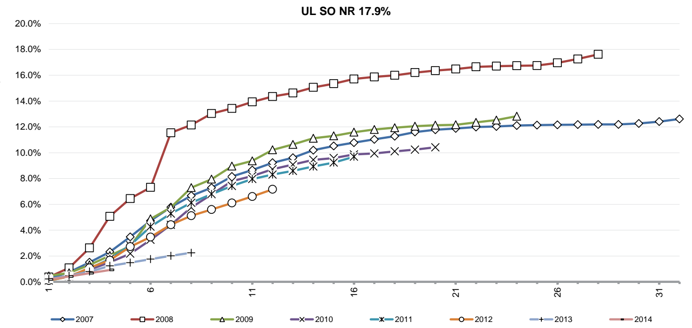


Figure 27. 90dpd delinquency data consolidated by year non-debt consolidation (NR) credit lines (CL) to larger obligors (LO)

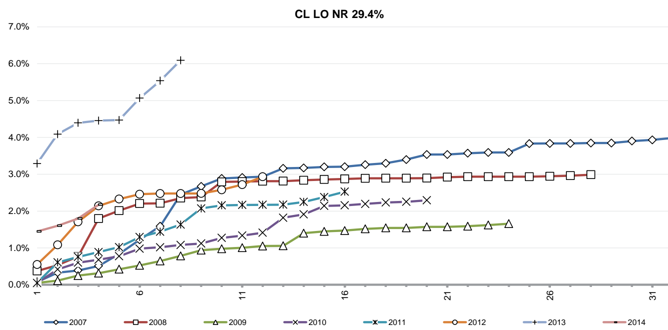


Figure 28. 90dpd delinquency data consolidated by year non-debt consolidation (NR) credit lines (CL) to smaller obligors (SO)

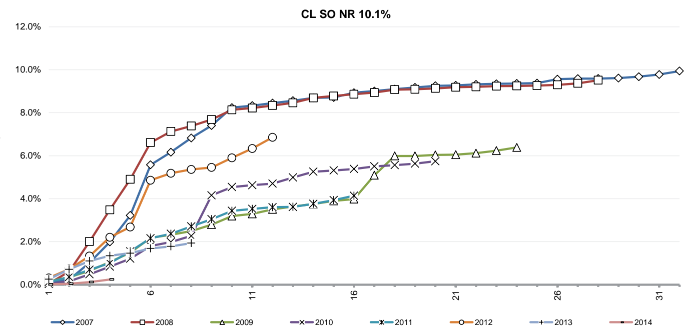
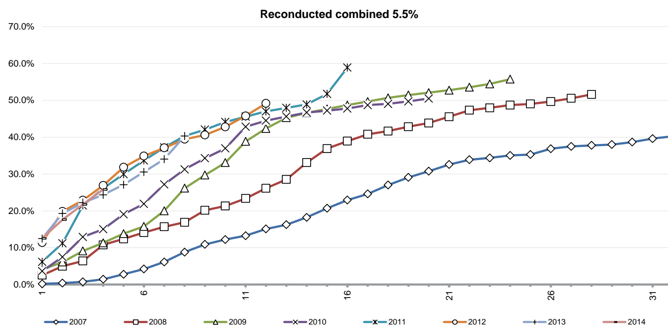


Figure 29. 90dpd delinquency data consolidated by year debt consolidation loans combined



180dpd recovery data

Figure 30. 180dpd delinquency recovery data consolidated by year non-debt consolidation (NR) unsecured loans (UL) to larger obligors (LO)

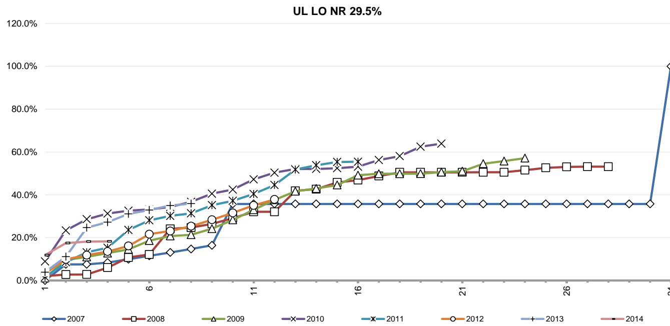


Figure 31. 180dpd delinquency recovery data consolidated by year non-debt consolidation (NR) unsecured loans (UL) to smaller obligors (SO)

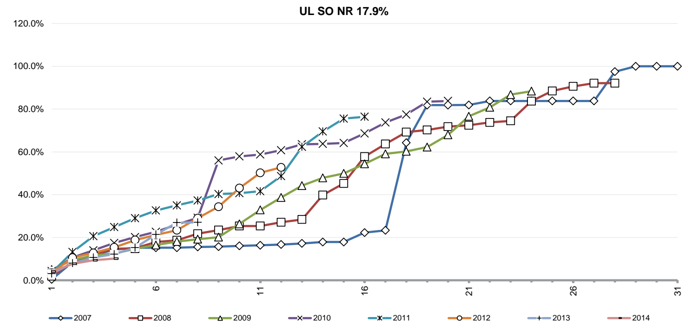


Figure 32. 180dpd delinquency recovery data consolidated by year non-debt consolidation (NR) credit lines (CL) to larger obligors (LO)

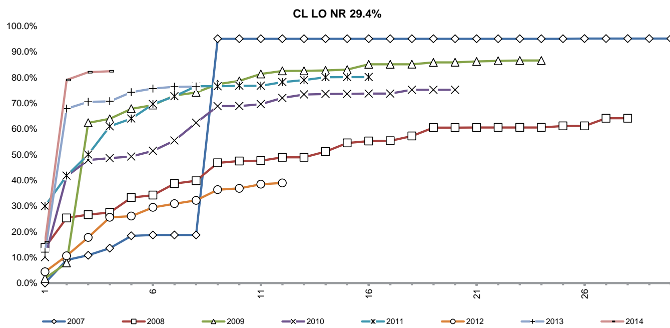


Figure 33. 180dpd delinquency recovery data consolidated by year non-debt consolidation (NR) credit lines (CL) to smaller obligors (SO)

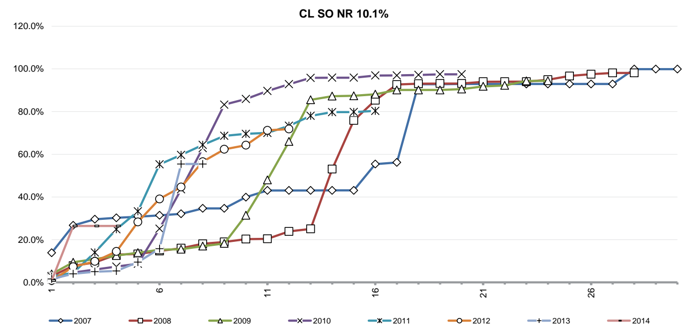
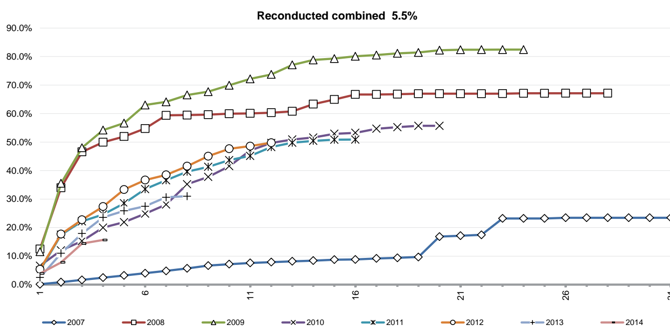


Figure 34. 180dpd delinquency recovery data consolidated by year debt consolidation loans combined



Note: the large jumps in recovery data are explained by the low granularity of 180dpd vintage data.

APPENDIX III. ANALYTICAL NOTES ON DEFAULT ANALYSIS

This section complements the analytical approach explained in the SME CLO Rating Methodology of Scope. Scope has divided the portfolio into 12 different segments for which Santander has provided 90dpd and 180dpd delinquency and recovery vintage data sets.

Inter-segment correlation

Scope believes that the vintage data provided by Santander provides good information about asset correlation. This is because it reflects the deterioration of asset performance during the last credit crisis from the starting point of a benign period.

Adjustments for credit lines

Adjustment for credit lines

	Before	After
Mean DR	11.9%	12.7%
DR CoV	59.1%	59.1%

The credit lines in the portfolio can increase their balance using principal received from performing assets or the liquidity facility available to the transaction. Scope believes that the liquidity facility will not be used because of the amortisation speed of this transaction and the short lived exposure to credit lines.

This represents a revolving risk component, because principal that survived the probability of default of one obligor can still default under a credit line if the money is used to increase the balance of a credit line.

Scope has overweighted credit line segments in the portfolio to reflect the increased risk stemming from fully drawn credit lines. The results of vintage analysis have been stress tested by considering preliminary portfolio segment weights that make up a total sum of segment weights that is greater than 100%, overall.

This overweighting results in an increase of the mean default rate for the portfolio which effectively addresses revolving risk in credit lines.

The rationale for this approach is justified because: i) draw-down of undrawn commitment increases the implicit portfolio balance; ii) draw-downs will mostly be serviced from principal collections; iii) the liquidity facility repayments are super-senior in the structure and set-off in the treasury account occurs before and outside the priority of payments.

The evolution of the segment weights within the portfolio is determined by the amortisation profile of the different product segments. Figure 35 shows the stressed weights of the different credit line segments present in the portfolio, as allowed by the worst possible evolution making use of collected principal from performing assets. The sum of stressed weights adds up to 127.2% of the preliminary portfolio balance.

Figure 35. Portfolio segment weights relative to the preliminary portfolio balance

Segment Name	Product Type	Enterprise Size	Note	Weight	Stressed Weight
UL SO NR	Unsecured loan	Smaller		17.9%	17.9%
ML SO NR	Mortgage loan	Smaller		3.0%	3.0%
CL SO NR	Credit Line	Smaller		10.1%	17.0%
UL LO NR	Unsecured loan	Larger		29.5%	29.5%
ML LO NR	Mortgage loan	Larger		4.7%	4.7%
CL LO NR	Credit Line	Larger		29.4%	49.6%
UL SO R	Unsecured loan	Smaller	Debt consolidation	1.8%	1.8%
ML SO R	Mortgage loan	Smaller	Debt consolidation	0.7%	0.7%
CL SO R	Credit Line	Smaller	Debt consolidation	0.0%	0.0%
UL LO R	Unsecured loan	Larger	Debt consolidation	2.0%	2.0%
ML LO R	Mortgage loan	Larger	Debt consolidation	1.0%	1.0%
CL LO R	Credit Line	Larger	Debt consolidation	0.0%	0.0%
Portfolio total				**100.0%**	**127.2%**

The adjusted portfolio mean default rate that results is 12.7%, up from 11.9% before the adjustment for credit lines.

Additionally, we doubled the intra-segment CoV of credit lines when deriving the portfolio CoV before obligor concentration adjustments. This CoV stress addresses the higher tail risk of credit lines from refinancing risk and the exposure to the originator to provide such refinancing.

Adjustment for obligor concentration

	Before	After
Mean DR	12.7%	13.9%
DR CoV	59.1%	61.0%

Obligor concentration adjustments

The adjustment for obligor concentration has addressed: i) the risk that top obligors are of below-average credit quality; and ii) the risk that top obligors might default with a higher correlation under tail-risk scenarios.

Scope applied adjustments to the combined exposure of obligors, which each represent more than 50bp of the initial portfolio balance. The preliminary portfolio has eleven concentrated obligors, which amount to 7.1% of the preliminary portfolio balance.

Eight of these obligors are known to be of better credit quality than the portfolio average, based on Santander´s internal probability of default (PD). Of the other three one exhibits a 100% PD according to the originator despite being currently performing.

The final base case mean default rate assumption for the portfolio after obligor concentration adjustments is 13.9%. Scope assumes a lifetime default rate of 100% for 18.5% of the balance of obligors which individually represent more than 50bp of the preliminary portfolio balance; and the portfolio average lifetime default rate for the remainder top obligors balance.

Scope has addressed the risk of higher correlation from obligor concentration by applying a 20% stress to the CoV of this exposure. The resulting CoV is 61% (compared to 59.1% before this obligor concentration adjustment).

The impact of this adjustment is limited because obligor concentration is low in the preliminary portfolio.

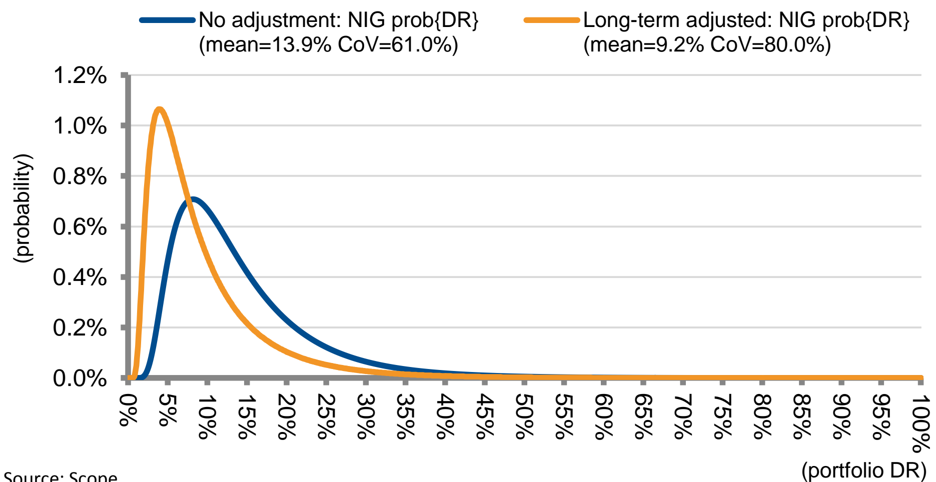
APPENDIX IV. LONG-TERM DEFAULT ANALYSIS

This appendix shows the application of the long-term analysis of this transaction as described in the SME CLO Rating Methodology. This analysis is designed to improve the stability of AAA_{SF} credit enhancement levels and reduce the procyclicality of ratings.

The analysis considers modified portfolio default rate modelling assumptions which consider our view on the long-term performance of the portfolio under average full-cycle stresses. The modified assumptions are used to assess the adequacy of protection levels for AAA-rated tranches, whereas lower rating categories gradually take a more forward-looking view. The B_{SF} level is analysed exclusively under the forward-looking view.

Figure 36 shows the long-term adjusted portfolio default rate distribution compared to the unadjusted—base case—distribution. The following sections explain how the long-term adjustment was derived.

Figure 36. Long-term adjusted portfolio default rate distribution compared to base case



Source: Scope.

Adjustment of the portfolio mean default rate

Scope has assigned a long-term adjusted mean default rate for this portfolio of 9.2% (after applying a reduction factor of 0.7 to the unadjusted mean default rate, 13.9%), and a default rate coefficient of variation of 80% (which results from full cycle volatility analysis, higher than the unadjusted 61%).

The reduction factor results from the relative stress of the period covered by vintage data and the full cycle. The adjustment is summarised in Figure 37.

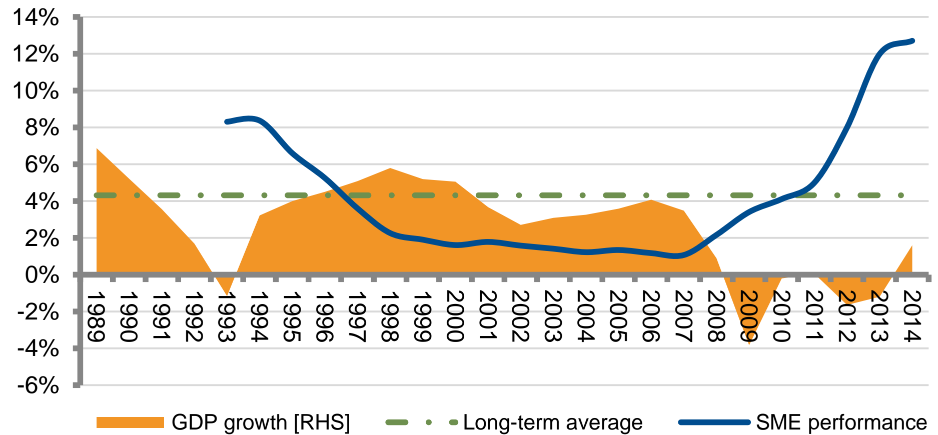
Figure 37. Long-term adjustment of the portfolio mean default rate

Vintage period	Full cycle
2007–2014 (7 years)	1993–2014 (a full cycle)
Portfolio mean DR = 13.9%	
Average market cumulative performance after two years during the vintage window (i.e. average of synthetic cohorts for the market corresponding to the vintage period, 2007 through 2014) = 12.8%	Average market cumulative performance after 2 years during the full cycle (i.e. average of synthetic cohorts for the market corresponding to the full cycle, 1993 through 2014) = 8.5%
The multiplier is obtained by dividing the average for the cycle by the average for the vintage period: $\textbf{Adjustment factor} = \frac{\text{(Average market performance through–the–cycle)}}{\text{(Average market performance over vintage period)}} = \frac{8.5\%}{12.8\%} = \mathbf{0.7}$	
Long-term-adjusted portfolio mean DR = 9.2% (= 13.9% x 0.7)	

We consider 1993–2014 to be representative of a complete economic cycle in Spain (see Figure 38). The average market would have a long-term cumulative default rate of 8.5% over a full cycle for portfolios with WAL of two years; whereas the performance over the period analysed with vintage data, 2007–2014 yields a higher cumulative default rate of 12.8%.

The following chart shows the Spanish cycle and the average credit performance of the market, as well as the long-term average.

Figure 38. The economic cycle and the long-term average 90dpd performance of SMEs



Source: Bank of Spain and Scope.

Adjustment of the portfolio default rate coefficient of variation

The long-term adjustment overrides volatility derived from default vintage data with the volatility estimated for the entire market over a full economic cycle. Scope has derived an adjusted portfolio default rate coefficient of variation of 80% for portfolios with WAL of 2 years.

Figure 39. Long-term adjustment of the portfolio default rate coefficient of variation

Vintage period	Full cycle
2007–2014 (7 years)	1993–2014 (a full cycle)
Unadjusted coefficient of variation = 61%	
	Coefficient of variation of average market default rates for 2 years WAL = 80.0%
Adjusted coefficient of variation = 80%	

APPENDIX V. REGULATORY AND LEGAL DISCLOSURES

Important information

Information pursuant to Regulation (EC) No 1060/2009 on credit rating agencies, as amended by Regulations (EU) No. 513/2011 and (EU) No. 462/2013

Responsibility

The party responsible for the dissemination of the financial analysis is Scope Ratings AG, Berlin, District Court for Berlin (Charlottenburg) HRB 161306 B, Executive Board: Torsten Hinrichs (CEO), Dr. Stefan Bund.

The rating analysis has been prepared by Carlos Terré, Lead Analyst. Guillaume Jolivet, Committee Chair, is the analyst responsible for approving the rating.

Rating history

The rating concerns newly-issued financial instruments, which were evaluated for the first time by Scope Ratings AG. Scope had already performed preliminary ratings for the same rated instruments in accordance with Regulation (EC) No 1060/2009 on rating agencies, as amended by Regulations (EU) No 513/2011 and (EU) No 462/2013.

Instrument ISIN	Date	Rating action	Rating
ES0305070007	13 May 2015	new	(P) A_{SF}
ES0305070015	13 May 2015	new	(P) $B-_{SF}$
ES0305070023	13 May 2015	new	(P) C_{SF}

Information on interests and conflicts of interest

The rating was prepared independently by Scope Ratings but for a fee based on a mandate of the issuer of the investment, represented by the management company.

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Key sources of Information for the rating

Offering circular and contracts; operational review visit with the originator; delinquency and recovery vintage data; loan-by-loan preliminary portfolio information; legal opinion; and portfolio audit report.

Scope Ratings considers the quality of the available information on the evaluated entity to be satisfactory. Scope ensured as far as possible that the sources are reliable before drawing upon them, but did not verify each item of information specified in the sources independently.

Examination of the rating by the rated entity prior to publication

Prior to publication, the rated entity was given the opportunity to examine the rating and the rating drivers, including the principal grounds on which the credit rating or rating

outlook is based. The rated entity was subsequently provided with at least one full working day, to point out any factual errors, or to appeal the rating decision and deliver additional material information. Following that examination, the rating was not modified.

Methodology

The methodology applicable for this rating is "SME CLO Rating Methodology", dated May 2015. Scope also applied the principles contained in the call-for-comments paper "Rating Methodology for Counterparty Risk in Structured Finance Transactions (Call for Comments)", dated July 2015. Both files are available on on www.scoperatings.com. The historical default rates of Scope Ratings can be viewed on the central platform (CEREP) of the European Securities and Markets Authority (ESMA): http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. A comprehensive clarification of Scope's default rating, definitions of rating notations and further information on the analysis components of a rating can be found in the documents on methodologies on the rating agency's website.

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