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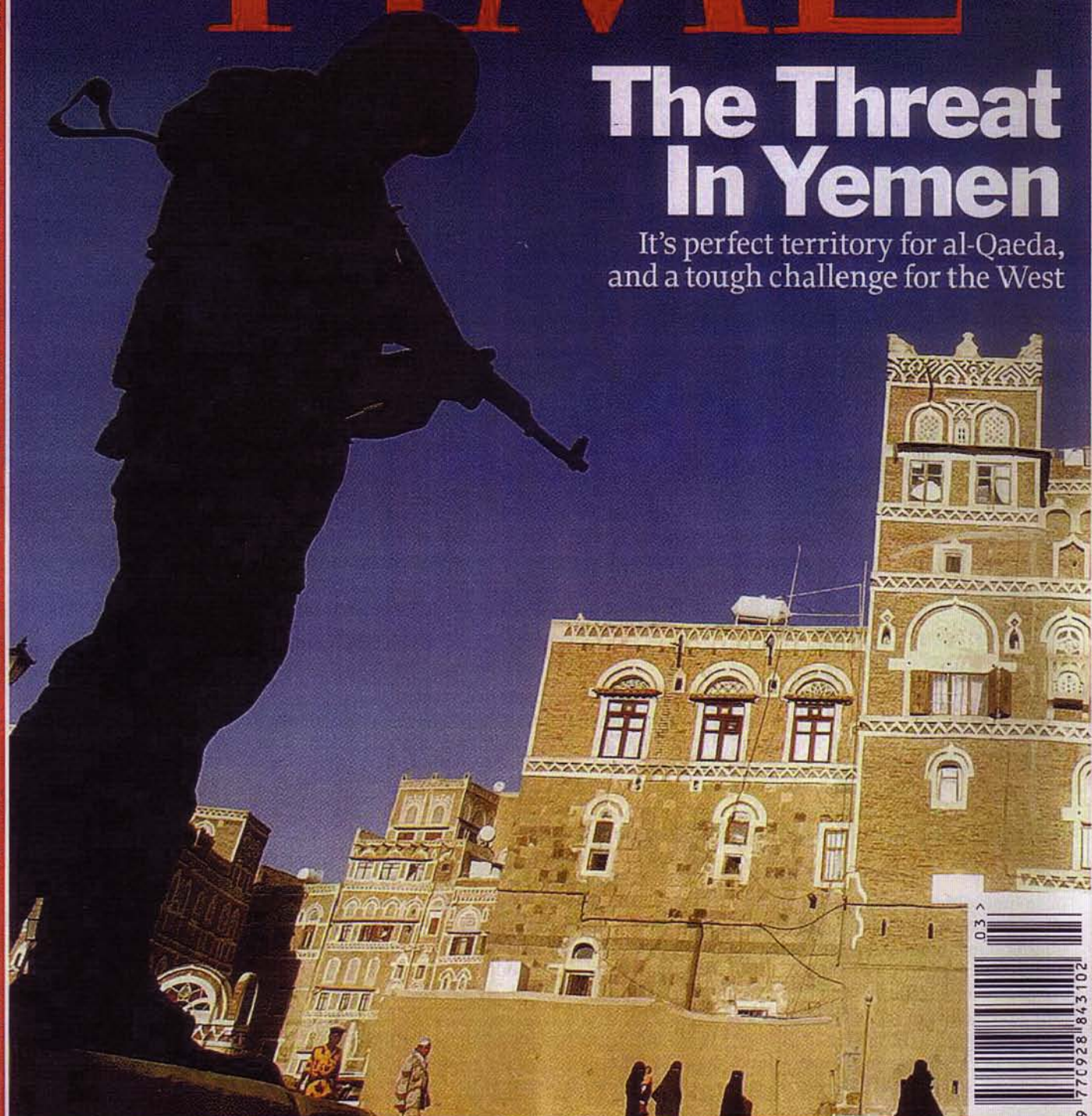


Spain's Santander: The Old-Fashioned Bank That Works

TIME

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BANKING

The Most Boring Bank in the World. By controlling risk and employing sophisticated software, Santander has emerged from the recession even stronger

BY JOSH LEVINE/MADRID

BANCO SANTANDER'S NO-NONSENSE HEADQUARTERS sprawls across a dusty hilltop a little over 12 miles (20 km) from downtown Madrid. But it seems a world removed from Spain's capital, with its long naps and midnight dinners. Santander City's squat, red-brick bunkers don't try to make any lofty architectural statements, and its workers would be too busy to notice even if they did. Travel between buildings is underground on white shuttle buses. Cigarette breaks don't last long; the leafy inner courtyards

have no place to sit. "This is a place to work," says a spokesman wearing the standard-issue Santander red tie.

Spend an hour in Santander City and it's easier to understand Banco Santander's unlikely march during the last quarter century from sixth biggest bank in Spain to largest bank in the euro zone. Since Emilio Botín took over from his father in 1986, Santander has spent more than \$60 billion buying banks in Spain, Latin America, Europe and, more recently, the U.S. But it's not just about being the biggest. By sticking to old-fashioned banking practices, while shrewdly employing the firm's sophisticated banking software, Botín has also made Santander the most profitable bank in the world outside China, earning close to \$25 billion in the last two years, even as the world's economies teetered on the brink.

In Santander City the functional is exalted and the fancy eschewed. The bank runs the same way, thanks to Botín's commitment to banking's stodgiest virtues: conservatism, patience and the sort of loans that don't need to be sliced and diced into nonsensical instruments like those that caused the meltdown on Wall Street. Botín loves brick-and-mortar branches because he wants to be able to look into his customers' eyes before he lends them a penny. Santander now has 13,390 branches worldwide, more than any of its competitors. Botín also loathes risk. If any of his managers want to make a loan of much more than 10 million euros, they had better be able to convince Botín it's going to get repaid. "Our customers and our shareholders expect us to be leaders in customer service, to be strong, sound and profitable," Botín told *TIME* by e-mail. "Some may find that boring, but it actually requires a lot of determination, focus and very hard work. If there is one lesson to be learned from the crisis, it is that good risk management is essential in banking."

Harry Kamen, retired chairman of Metropolitan Life and a former Santander board member, recalls learning of Santander's risk-management committee in the mid-1990s. The independent committee reports directly to the Santander board and is charged with reining in managers overeager to drum up new business without looking hard enough at the pitfalls. "I asked who was doing this at MetLife and was told the actuaries were, but no one was looking at the whole picture," says Kamen, who promptly instituted a similar structure at MetLife. "I learned a lot about risk by watching Emilio in action." Today, the Botín family owns only around 2% of the bank, but "Emilio runs Santander as if it was wholly owned by him," says one of the firm's top executives.

Santander's fixation with controlling risk is largely why it came through the recent banking crisis smelling like a Valencia orange. Going into the crisis, Santander had set aside funds to cover 151% of its expected loan losses, compared to 85% for its European peers. Nearly two years on, Santander's so-called coverage ratio is 72%, compared to 58% for big European banks in general. It didn't hurt either that earlier banking crises had led the Bank of Spain to impose punishing restrictions on the kind of high-flying investments that crashed to earth at some U.S. and European banks. Santander expects profits in 2009 to stay roughly even with last year's \$12.8 billion, making it the third most profitable bank in the world. Little wonder Santander is now worth around \$137 billion, more than double its market value in 2000.

People who know Botín don't expect him to stop here. "Botín likes to do only two things—run a bank and play golf," says Mauro Guillén, a Wharton professor who has written a history of the bank. "Unlike U.S. bankers, Botín doesn't think banking is boring." Botín's golfing needs have been met through an 18-hole course designed by

Rees Jones at Santander City. His banking needs are another story. "He wants to retire as the biggest banker in the world and at age 75 he doesn't have much time left," says Guillén. "I think Santander will end up owning one of the top three U.S. banks."

For now, Santander has its hands full making its most recent acquisitions work. In September, it sold off 16% of its Brazilian subsidiary for \$7 billion. The \$1.6 billion capital gain from the IPO will help Santander expand its branch network in the blistering Brazilian market, where it has vaulted overnight into the top three banks.

In Europe, Santander has come out ahead with its 2007 purchase of a chunk of ABN Amro. Santander joined forces with the Royal Bank of Scotland and Belgium's Fortis to buy the ailing Dutch giant for \$103.7 billion. But while both RBS and Fortis are now on the casualty list themselves, Santander's \$17 billion stake in the Brazilian wing of ABN Amro is worth about \$49 billion after merging with Santander's existing business in Brazil. In 2007, the firm spent just under \$10 billion for Italy's Banca Antonveneta, which it promptly

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—EMILIO BOTÍN,
SANTANDER CEO



sold off for a \$3.74 billion profit.

Santander still has to prove itself in the U.S., however. In 2006, the Spanish firm spent \$2.9 billion to buy 25% of Sovereign Bancorp, a regional bank in the northeast. By October 2008 Sovereign's stock had fallen 85% and Santander exercised its right of first refusal to buy the remaining 75% for \$1.9 billion. Now it has to hope Sovereign is worth more than the peanuts Santander paid for it. "If a bank is strong, it is not for sale. Banks are sold, not bought," says Juan Rodríguez Inciarte, Santander's director general and an architect of its international expansion. Inciarte says Santander will give Sovereign the same treatment it gave the U.K.'s Abbey National bank, an ailing mortgage provider it bought for \$11.2 billion in stock in 2004. It was Santander's first foray into Anglo-Saxon territory, and it met contemptuous resistance to Botín's "Spanish paper," in the words of one shareholder.

The deal was even less popular when Abbey's new CEO António Horta-Osório slammed the brakes on new mortgage lending in 2006, right in the middle of a housing boom. But Horta-Osório looked prescient when U.K. banks such as Alliance & Leicester and Bradford & Bingley kept on lending and then found themselves in crisis when the market crashed. Santander bought them both—in B&B's case, it was only the deposits and branches—for about one-fifth of what it had paid for Abbey.

Santander's Other Secret

THE ABBEY TURNAROUND CAME STRAIGHT from the Santander playbook—and highlights the second key to the company's incredible success: software. First step, in goes Santander's proprietary Parthenon software, which organizes a bank's business by customer instead of by product line, as had been the case at Abbey. "This is the kind of sophisticated information JPMorgan still didn't have, and I saw it at a Santander branch in Chile," says Davide Serra, head of the U.K.'s Algebris hedge fund. The system facilitates cross selling to existing customers while allowing Santander to cut back-office staff drastically (Santander never cuts the flesh pressers out front). In Abbey's case, total employees dropped from 25,331 to 16,489, while costs have come down from 70% of income to around 40%, in line with Santander's overall cost-to-income ratio. The average cost-to-income ratio in this sector of the U.K. banking business is 55%. Those cost savings translate into lower lending rates, which has allowed Abbey to regain its share of the mortgage market and then some. It now makes 1 in 7 new mortgages in the U.K. and Abbey's 1,300 branches will



A quiet bank Santander's headquarters embodies its ethos of no-nonsense banking

sport red Santander logos next year.

Santander would rather be profitable than interesting. Santander's U.K. profits for the first half of 2009 were up 33% from the year before, if you don't count acquisitions, and almost 63% if you do. It remains to be seen if Santander can work similar magic at Sovereign. Inciarte says cost to income at the U.S. bank has already fallen from 65% to 57%, but that getting down to

40% "will take us quite a while."

Santander's only stumble has been steering some of its private-banking clients into Bernard Madoff's Ponzi machine through its Geneva-based Optimal hedge funds. It moved fast to make good, offering to repay 100% of the sums invested. Santander says 94% of its Madoff victims have accepted, costing the bank \$64.8 billion at current exchange rates. It also returned \$235 million to the Madoff estate in a settlement of claw-back claims with U.S. trustee Irving Picard.

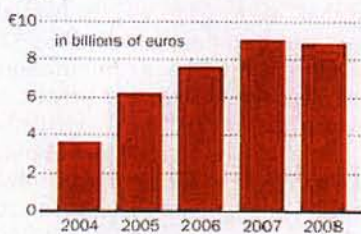
Still, for a bank that can get a bit smug about its meticulousness, the Madoff stain, albeit minor, will be hard to rub out. It's also one of the reasons why Santander's private-banking business is in the red. "We were caught in a fraud, but it was still a mistake," concedes chief financial officer Juan Antonio Alvarez.

The ongoing parlor game in Madrid now is betting who's going to succeed Emilio Botín whenever he decides to step down. Santander was founded in 1857; a Botín has run it since 1920. Current chief executive Alfredo Saenz came to the bank when it bought Banesto in 1994, bringing the Parthenon operating platform with him. He's very smart and at most other banks he'd be a shoo-in. But Botín is a dynastic kind of guy, and his daughter Ana Patricia, 49, currently heads Banesto, which is still run as a separate network.

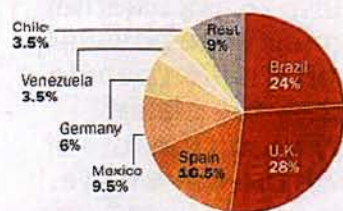
For anyone handicapping this one, Santander City might supply another clue. There among the modern brick buildings are rows of olive trees Botín had brought in, their trunks gnarled and twisted. You won't find one under 1,000 years old. Tradition still counts for a lot here.

Steady going. Profits are off but geographic spread has helped growth

Profit



Customer distribution by country



Source: Santander