

RISKS

IDENTIFICATION, MEASUREMENT, MANAGEMENT, CONTROL AND INTERNAL COMMUNICATION OF RISKS TO WHICH ARE OR MAY BE EXPOSED THE ENTITY.

Since its foundation in 1857, Banco Santander has had among its priorities the development of a forward-looking risk management strategy, through a sound control environment. This has enabled the Group to deal appropriately with changes in the economic, social and regulatory context in which it operates, contributing to the progress of people and businesses.

Risk management is therefore one of the key functions in ensuring that Santander remains a robust, safe and sustainable bank, that guarantees a management aligned with the interests of its employees, customers, shareholders and society.

The risk management and control model deployed by the Santander Group is based on the principles set down below, which are also aligned with the Group's strategy and, in addition take into account the regulatory and supervisory requirements, as well as the best market practices:

- 1. An advanced and comprehensive risk management policy, with a forward-looking approach** that allows the Group to maintain a medium-low risk profile, through a risk appetite defined by Banco Santander's board of directors and the identification and assessment of all risks.
- 2. Lines of defence** that enable risk to be managed at source, controlled and monitored, in addition to an independent assessment.
- 3. A model predicated on autonomous subsidiaries with robust governance** based on a clear committee structure that separates the risk management and control functions.
- 4. Information and technological management processes** that allow all risks to be identified, developed, managed and reported at appropriate levels.
- 5. A risk culture integrated throughout the organisation**, composed by a series of attitudes, values, skills and action guidelines to deal with all risks.
- 6. All risks are managed by the units that generate them**, using advanced models and tools.

These principles, combined with a series of relevant interrelated tools and processes in the Group's strategy planning, detailed below, allow an adequate **identification, measurement, control and communication** of all risks to which the Santander Group is exposed.

1. Risk Map

The identification and assessment of all risk is the cornerstone for their control and management. The Santander Group has established the following first level risks in its general risk framework:

- **Credit risk:** is the risk of financial loss arising from the default or credit quality deterioration of a customer or other third party, to which the Santander Group has either directly provided credit or for which it has assumed a contractual obligation.
- **Market risk:** is the risk incurred as a result of changes in market factors that affect the value of positions in the trading book.

- **Liquidity risk:** is the risk that the Group does not have the liquid financial resources to meet its obligations when they fall due, or can only obtain them at high cost.
- **Structural risk:** is the risk arising from the management of different balance sheet items, not only in the banking book but also in relation to insurance and pension activities.
- **Capital risk:** is the risk of Santander Group not having an adequate amount or quality of capital to meet its internal business objectives, regulatory requirements or market expectations.
- **Operational risk:** is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. This definition includes legal risk¹.
- **Conduct risk:** risk arising from practices, processes or behaviours which are not adequate or compliant with internal regulation, legal or supervisory requirements.
- **Reputational risk:** the risk of current or potential negative economic impact to the Bank due to damage to the perception of the Bank on the part of employees, customers, shareholders/investors and the wider community.
- **Model risk:** is the risk of loss arising from inaccurate predictions, causing the Bank to make suboptimal decisions, or from a model being used inappropriately.
- **Strategic risk:** is the risk of loss or damage arising from strategic decisions or their poor implementation, that impact the long term interests of our key stakeholders, or from an inability to adapt to external developments.

2. Risk governance

As mentioned before, one of the main principles of the Group is to count with a solid governance, based on a clear committees structure, that separates the risk management and control functions and, therefore allows for an adequate and efficient risk decision making, as well as an effective risk control within the risk appetite defined.

The **Group Chief Risk Officer** (GCRO) oversees this function within the Group, advises and challenges the executive line and also reports independently to the risk, regulatory and compliance committee and to the board.

Risk appetite and structure of limits

Santander defines risk appetite as the amount and type of risks considered reasonable to assume for implementing its business strategy, so that the Group can maintain its ordinary activity in the event of unexpected circumstances. For the latter, severe scenarios that could have a negative impact on the levels of capital, liquidity, profitability and/or the share price, are taken into account.

¹ Legal risk includes, but is not limited to, exposure to fines, penalties, or punitive damages resulting from supervisory actions, as well as private settlements.

The board is responsible for annually setting and updating the risk appetite, monitoring the Bank's risk profile and ensuring consistency between both of them.

The risk appetite is set for the whole Group, as well as for each of the main business units in accordance with a corporate methodology adapted to the circumstances of each unit/market. At local level, the boards of the subsidiaries are responsible for approving the respective risk appetite proposals once they have been validated by the Group.

Risk identification and Assessment (RIA)

Santander Group carries out the identification and assessment of the different risks it is exposed to involving the different lines of defence to strengthen its advanced and proactive risk management practice, establishing management standards that not only meet regulatory requirements but also reflect best practices in the market, and being also a risk culture transmission mechanism. The function includes all the risk identification and assessment processes, as well as its integration within the Santander Group risk profile, its units and activities, thereby keeping the risk map up to date.

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In addition to identifying and assessing the Group's risk profile by risk type and unit, RIA analyses the evolution of risks and identifies improvement areas in each of the blocks that compose it:

- Risk performance, enabling understanding of residual risk by risk type through a set of metrics and indicators calibrated using international standards.
- Assessment of the control environment, measuring the degree of implementation of the target operating model, pursuant to advanced standards.
- Forward-looking analysis of the unit, based on stress metrics and identification and/or assessment of the main threats to the strategic plan (Top Risks), enabling specific action plans to be put in place to mitigate potential impacts and monitoring these plans.

Scenario Analysis

Santander conducts advanced management of risks by analyzing the impact that different scenarios could trigger in the environment in which the Bank operates. These scenarios are expressed both in terms of macroeconomic variables, as well as other variables that alter management.

Scenario analysis is a very robust and useful tool for management at all levels. It enables the assessment of the Bank's resistance to stressed environments or scenarios, and puts into force a set of measures that reduce its risk profile to these scenarios. The objective is to maximise the stability of the income statement and capital and liquidity levels.

The robustness and consistency of the scenario analysis exercises are based on the following pillars:

- Development and integration of mathematical models that estimate the future evolution of metrics (e.g. credit losses), based on both historic information (internal to the Bank and external from the market), as well as simulation models.

- Inclusion of expert judgement and know-how of portfolios, questioning and backtesting the models results.
- The backtesting of the models results against the observed data, ensuring that the results are adequate.
- The governance of the whole process, covering the models, scenarios, assumptions and rationale of the results, and their impact on management.

Reporting

In recent years, Santander Group has developed and implemented the necessary structural and operating improvements to reinforce and consolidate enterprise-wide risk, based on complete, precise and regular data. This allows the Group's senior management to assess risk and act accordingly. In this sense, the strategic risk transformation plan is aligned with regulatory requirements, as evidenced in the review performed by the European supervisor with regard to compliance with the standards defined by the Basel Committee (BCBS 239).

In 2017, the Group has worked to consolidate the comprehensive data and information management model, and the implementation and renewal of technology systems, thereby enabling a balanced reporting taxonomy to be maintained that covers all the key risk areas within the Organisation, in compliance with the Group's size, risk profile and activity.

Therefore, three reports are submitted each month to senior management relating to risk management issues and the subsequent decision-making: the Group risks report, the risks report for each unit and a report for each risk factor.

For further details of the issues discussed above, see [chapter 5 of the annual report](#). Likewise, the evolution of the risk profile is available on a regular basis in the [quarterly financial reports](#) (<http://www.santander.com>).