

# RISK MANAGEMENT



- **OVERALL RISK MAP**
- **CREDIT RISK MANAGEMENT**
- **RISK MANAGEMENT IN MARKET AREAS**
- **STRUCTURAL RISKS**
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Risk-management at BBVA is considered an intrinsic part of the banking business and a source of competitive advantage.

Monitoring risk as an essential component of value creation enables a decision-making process to be established, based on significant measurements that contribute to the sustainability of profits in the medium and long term and guarantee the institution's capital solvency to shareholders.

In a diversified and internationally active financial group, proper identification, measurement and evaluation of the different types of risk is a key requirement for expanding business in an orderly fashion in accordance with corporate strategy and the desired risk profile.

BBVA's different types of business activities involve many types of risk that call for an overall risk management system prevailing throughout the organisation.

For some years, the BBVA Group has been building up such an overall management system, under which customer needs and shareholder and other stakeholder expectations are rendered compatible with regulators' requirements.

This system entails numerous premises, such as the following:

- It must be based on prudent, consistent, experience-based risk valuation criteria.
- It must be consistently applied to all the Group's activities and businesses, using unified methods suited to each type of risk.
- It must be based on a corporate risk governance framework which, in accordance with the recommendations of supervisory bodies, establishes a clear separation of functions and responsibilities and guarantees the independence of the risk function.
- It must be backed up by a common risk culture shared across the Group and handled by a qualified risk-management team.
- Finally, the system must enable each type of risk (credit, market, structural and operational) to be managed, and at the same time facilitate an integrated overview of risk.

To that end, the Group's risk-management system incorporates elements of three types:

- Consistent measuring and monitoring tools that cover the business activities and risks

involved in customer portfolios, products, processes, balance sheets, etc.

- Databases that enable the necessary information to be gathered, calculation engines and management systems that help to obtain figures for expected losses and economic capital from the most basic aggregate levels, providing the measurements that make up the basis of overall risk management.
- Management criteria, circuits and procedures, translated into risk policies that ensure the management model is integrated into the day-to-day decision-making process from the most basic level to the highest ones such as the Risks Committee of the board of directors and the board itself.

Proper integration of these components enables an overall risk profile to be drawn up and monitored per business unit and type of risk, quantified in terms of economic capital and expected losses.

Under this general framework and in line with its business strategy, the Group determines and applies risk policies in its day-to-day business, setting ceilings for maximum credit risk exposure by counterparties or by group, establishing limits for maximum exposure in market and structural risks and analysing operational risks incurred in its various activities with a view to mitigating their impact. Moreover, to improve the decision-making process and ensure process feedback, sensitivity analyses are performed to assess the risk arising from market disturbances, as reflected in a number of simulated scenarios and movements of underlying risk factors.

To determine the extent to which the risk management system has been implemented in the organisation, risk maps are drawn up by business units to identify the gaps between the current situation and the target situation under the risk model. On the basis of these maps, action plans are drawn up to close those gaps and ensure that central risk management methods extend to all the Group's activities in a comprehensive, consistent fashion.

Following the publication of the Basel II Capital Accord, the Group has intensified its efforts and applied more resources to ensure success in tackling the new regulatory framework, which will enable capital consumption to be

determined on the basis of internal models as from 2008.

Along these lines, and within the framework of current regulations, the Bank has begun using its own internal market risk model (after obtaining proper authorisation) to calculate capital.

In regard to credit and operational risk, the Group is adopting advanced models in both cases, applying them initially to the main part of risk exposure (more than 80% of the total), as required under the Basel regulation, including the parent bank and BBVA Bancomer (Mexico).

In accordance with the agenda laid down by regulators, the relevant documents or application forms (drawn up by the Bank of Spain and called *Cuadernos de Solicitud*) concerning credit risk were handed over in 2005 so as to enter the process of validation of advanced internal models (IRB Advanced). The calendar is due to extend throughout 2006 and 2007. This process was begun by the Spanish regulator and has also been adopted by its Mexican counterpart, which places both financial systems at the forefront of the processes to implement Basel II internationally.

In all other countries where the Group operates, it will continue seeking the validation of advanced models, gradually complying with the processes for adaptation to Basel of the Home Supervisor and the Host Supervisors and Regulators of each financial system.

Without doubt, the gradual adoption of the Accord on the international stage, following the recommendations of the Accord Implementation Group of the Basel Committee on Banking Supervision, will help to improve risk management at financial institutions and will result in greater stability and solvency in financial systems.

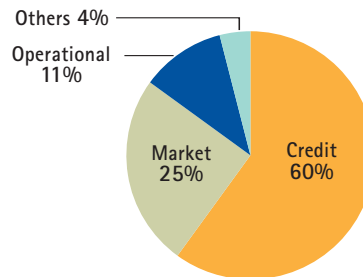
## ● OVERALL RISK MAP

The Group's consumption of economic capital at year-end 2005 stood at €15,701m, with year-on-year growth of 23%.

Economic capital for credit risk records the greatest dynamism, accounting for 60% of the Group's total risks at the end of the year. In turn, market risk accounts for 25% and operational risk for 11%.

### Map of the BBVA Group's economic capital. Distribution by risk types

(Data in attributable terms, 31-12-05)

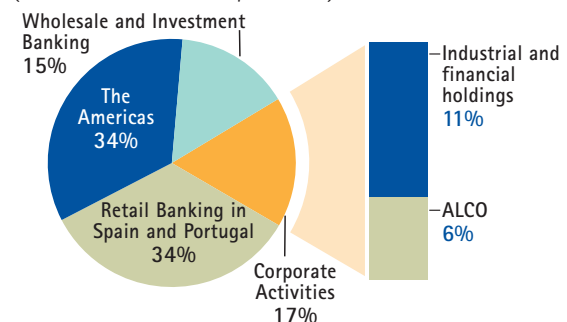


By business areas, 34% of economic capital consumption corresponds to Retail Banking in Spain and Portugal, 34% to the Americas (where Bancomer accounts for 60%), 15% to Wholesale and Investment Banking and 17% to Corporate Activities.

In accordance with profit generation and with average consumptions of economic capital and expected losses during the year, the business areas have achieved a risk-adjusted return (RAR) well above the cost of capital, consistent with the Group's high returns on capital and its ability to create value.

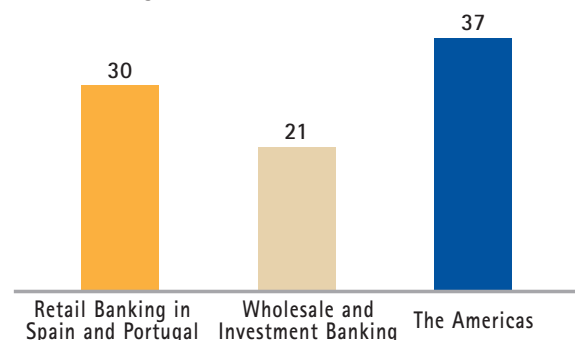
### Map of the BBVA Group's economic capital. Distribution by areas

(Data in attributable terms, 31-12-05)



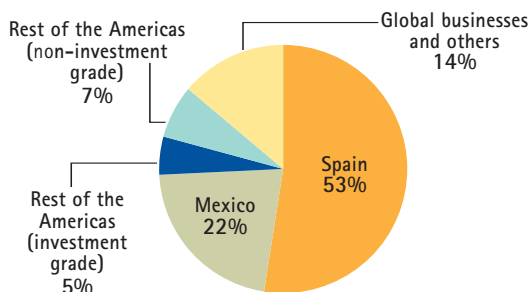
### Risk-Adjusted Return by business areas

(2005. Percentage)



**Map of the BBVA Group's economic capital. Geographical distribution**

(Data in attributable terms, 31-12-05)



An analysis of economic capital consumption by country reveals that the largest portion is concentrated in Spain (53%) and Mexico (22%), whereas the consumption of economic capital in the Americas linked to non-investment grade countries amounts to 7%.

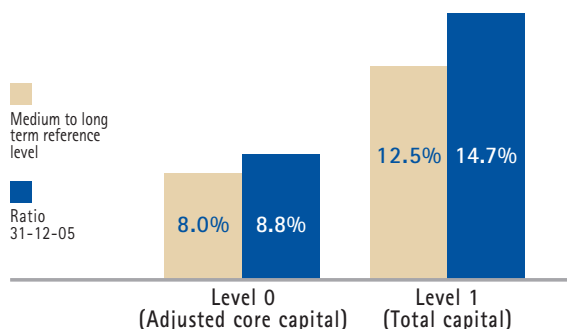
The monitoring of the Group's financial solvency level is performed through what are referred to as capital adequacy ratios, which relate risk weighted assets, implicit in the consumption of economic capital, to the level of capital available, on two levels:

- Level 0. Adjusted core capital, equal to the Group's balance-sheet value (adjusted by latent capital gains and by the difference between loan loss provisions and expected losses).
- Level 1. Total capital, which in addition to the above includes preferred shares and eligible subordinated debt.

The medium and long-term benchmark ratios that have been established in accordance with BBVA's current rating levels are 8% for level 0 and 12.5% for level 1. At year-end 2005, the ratios stood at 8% and 14.7% respectively, which reflects a comfortable situation to face new risks through growth.

**Capital adequacy ratios**

(31-12-05)



Finally, within the framework of overall risk analysis and as a complement to economic capital, major progress has been made in 2005 in the systemisation of sensitivity to risk factors and scenario analysis.

Accordingly, a recurring assessment of the impact of different risk scenarios is made, quantifying those scenarios in terms of macroeconomic and financial variables and measuring the effect in macroeconomic terms, on the income statement and on net worth. Shocks are measured in an integrated and coherent manner for all the different risk types and businesses.

Furthermore, an analysis of mainstream sensitivities to specific risk factors is made: for example, quantifying the impact of a change in the yield curve on assets and liabilities, trading book positions, losses in lending portfolios and growth in business margins.

The combination of the framework of economic capital allocation and risk-adjusted returns, the assessment of financial solvency, the ability to assume risks, and the overall sensitivity analysis to risk factors, provide a clear view of the Group's overall risk positioning, facilitate the fine-tuning of the business portfolio and allow for foresight in responding to changes in the environment.

## ● CREDIT RISK MANAGEMENT

### Methodologies for credit risk quantification

A credit risk profile is drawn up in two ways: expected loss and economic capital (the latter related to unexpected loss). The Group has implemented tools for loan classification (ratings and scorings) and an infrastructure for keeping records of past risk to allow for an estimation of the necessary inputs (probability of default, loss given default and exposure at default) for calculating the expected loss and capital. These techniques, in turn, play a key role on two levels: internal risk management itself and compliance with regulatory requirements.

Insofar as management is concerned, these tools are an essential component within the management framework based on value creation. Their use alongside data on costs and returns allows measures to be applied for assessing how risk and return are combined. Such measures have a wide range of possible applications, from decision-making on business strategy through to the acceptance of individual operations.

The development of the internal RAR information system (supporting the internal risk model) has led to the introduction of databases that can be used to accurately estimate the risk parameters required in the calculation of capital and expected loss, following best practices on the market and the guidelines of the New Capital Accord (Basel II).

**Group master scale.** BBVA has a master scale designed to facilitate the homogeneous classification of the Group's different risk portfolios. There are two versions of this scale: the narrow one, which classifies outstanding risks into 17 groups, and the broad one, which breaks them down into 34 degrees.

**Probability of default.** BBVA has two classification tools (scorings and ratings) that allow for measuring the creditworthiness of operations or customers, as applicable, by allocating a score. Besides, they allocate the

### BBVA MASTER SCALE

(Narrow version)

Master scale rating	Default probability (in basis points)		
	Average	Minimum from >=	Maximum to <
AAA	1	0	2
AA+	2	2	3
AA	3	3	4
AA-	4	4	5
A+	5	5	6
A	8	6	9
A-	10	9	11
BBB+	14	11	17
BBB	20	17	24
BBB-	31	24	39
BB+	51	39	67
BB	88	67	116
BB-	150	116	194
B+	255	194	335
B	441	335	581
B-	785	581	1,061
C	2,122	1,061	4,243

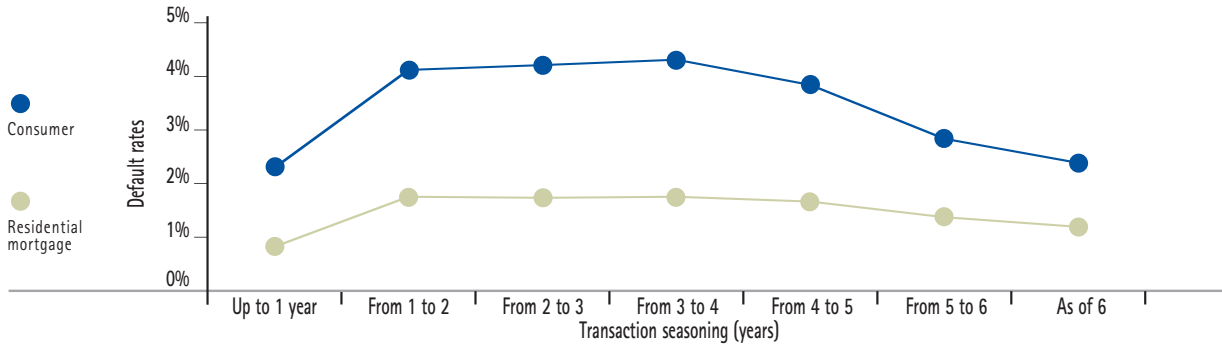
probability of default by using BBVA's historical databases to ascertain how this probability varies in terms of the scores allocated by these tools and of other potentially relevant factors (e.g. the seasoning of the transaction).

**Scorings.** These are the tools used to score retail operations (consumer loans, mortgages, credit cards, retailers, etc.). The accompanying graphs show the default rates, at one-year intervals, for some of the Group's tools.

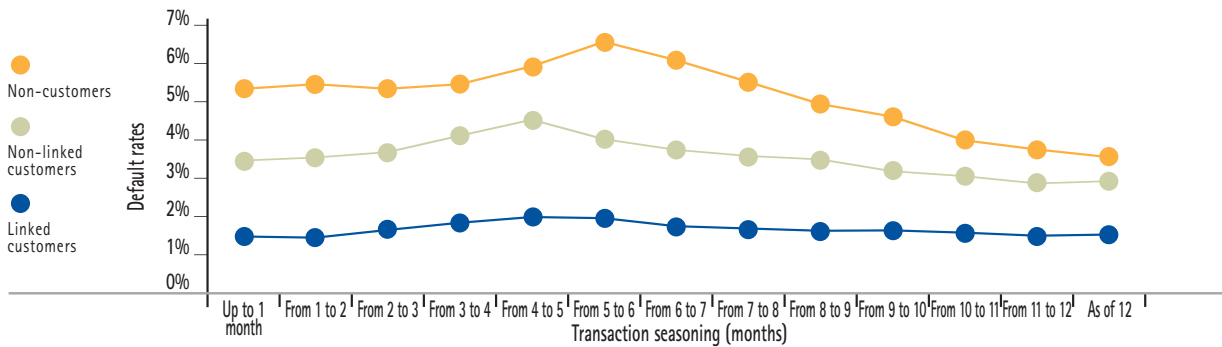
The time at which the maximum probability of default is reached is called peak seasoning. The default rates are shown for consumer and mortgage tools at one-year intervals in terms of the contracts' seasoning in years. Given that the seasoning process is very fast, the default rates for credit card tools are shown on a monthly basis.

**Ratings.** Rating tools classify customers (not retail-type transactions). The Group has different rating tools for classifying different customer segments.

**Consumer loan scoring tool calibration. Default rates by seasoning**



**Card loan scoring tool calibration. Default rates by seasoning**



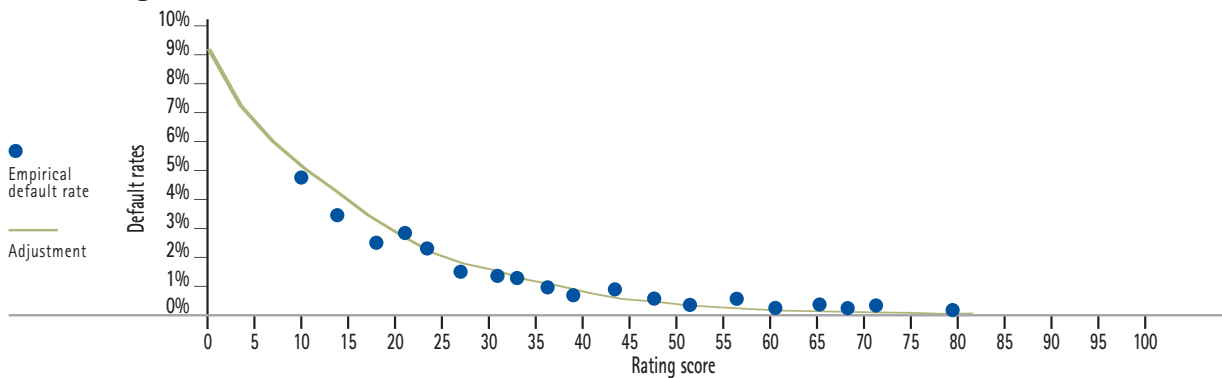
As an example, the following graph shows the adjusted probabilities of default for the tool for SME business rating (firms with turnover between €5m and €150m) against the historical record of defaults.

In those wholesale portfolios in which the default rate is very low (e.g. sovereign borrowers, financial institutions and large

corporates) internal information is complemented by external data on defaults provided by rating agencies.

Once the probability of default has been obtained for transactions/customers and adjusted to the business cycle, this probability is linked to the BBVA Group master scale.

**SME rating tool calibration**



**LGD (Loss given default).** In 2005, the BBVA Group has continued to further its knowledge and analysis of LGD rates in its portfolios, both at facility level (retail) and obligor level (for non-retail exposures). Defined as the percentage of risk exposure that is not expected to be recovered in the event of default, loss given default (LGD) constitutes one of the key factors in quantitative risk assessment.

The method the BBVA Group mainly uses for the calculation of LGD is the “Workout LGD”. This method is based on discounting the cash flows of the defaulted exposure that have been collected at different times of the recovery process. In the case of portfolios with low-default rates, without enough data to obtain a reliable estimate by means of the Workout LGD method, other methods are used, such as external sources for obtaining market references on LGD rates suited to the internal portfolio.

The graph provided shows the LGD rate distribution for the BBVA Spain mortgage portfolio. This bimodal LGD pattern is also repeated in other operating areas. It may be noted that in an extremely high percentage of cases (90%) involving mortgages, almost all the outstanding debt is recovered, whereas small recoveries are observed only in few cases.

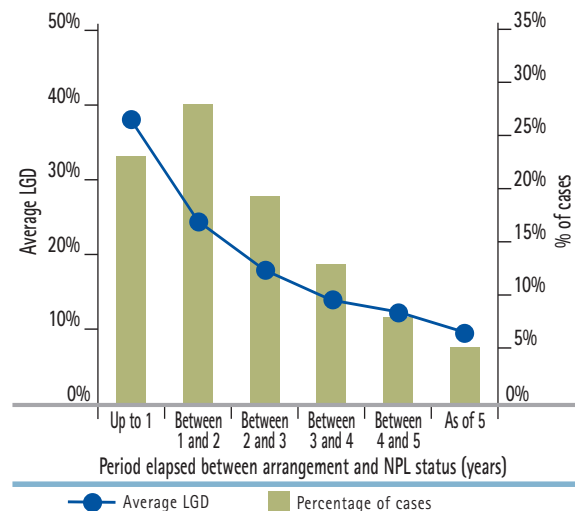
As in the case of the calculation of probabilities, the databases built in the RAR project are used to analyse the link between the LGD and the nature of the transactions or customers.

For illustrative purposes, a number of analyses carried out on the BBVA portfolio in Spain are shown.

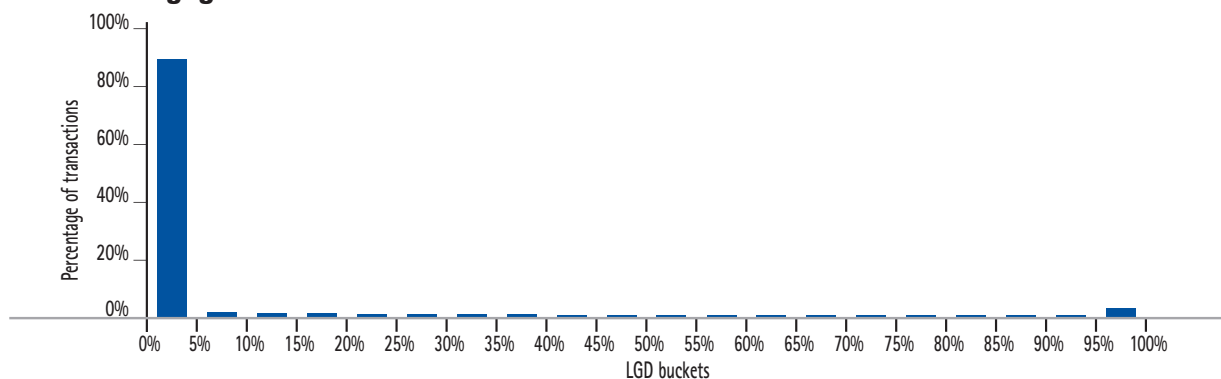
**a) Seasoning**

One of the key factors for determining LGD is the period elapsed between contract arrangement and default. The graph shows that the longer the seasoning of the contract, the lower its LGD. The axis on the left corresponds to average LGD, while the axis on the right reflects the percentage of cases for each portfolio time bucket.

**LGD in consumer loans**



**LGD in mortgage loans**



**b) Loan/value ratio**

The amount of the loan and the value of the property ratio, or LTV (loan to value), is a specific characteristic of mortgage products, and is expected to have a bearing on LGD. The graph shows that LGD increases in step with the rise in the LTV percentage. However, this relationship does not hold for mortgages with a LTV exceeding 85%, given the usual presence in these cases of additional guarantees and guarantors.

**c) Time elapsed in default**

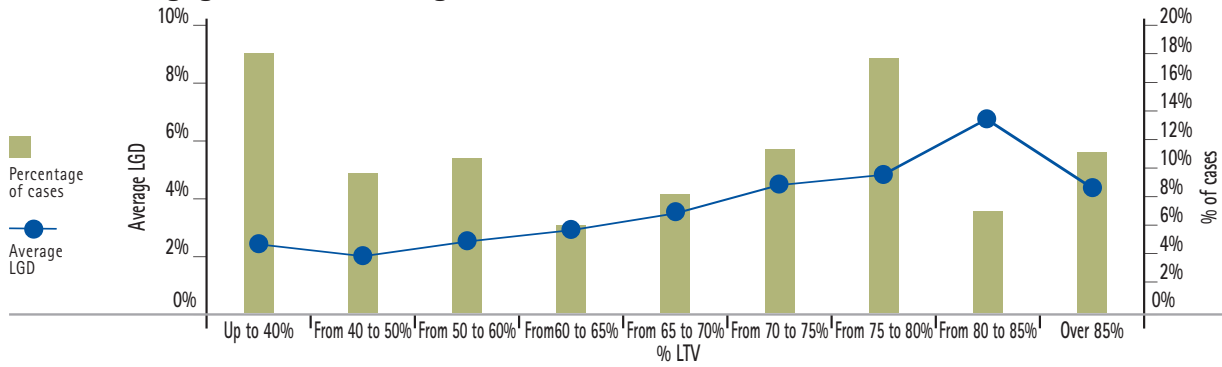
A further significant factor in LGD estimations is the time that a transaction remains in default. The graph compares this ratio for

retail portfolios involving consumer loans, residential mortgages and personal credit cards. It is noted that the curves profile for consumer loans and credit cards is very similar, whereas the curve for mortgages, given the intrinsic characteristics of the products, is significantly lower.

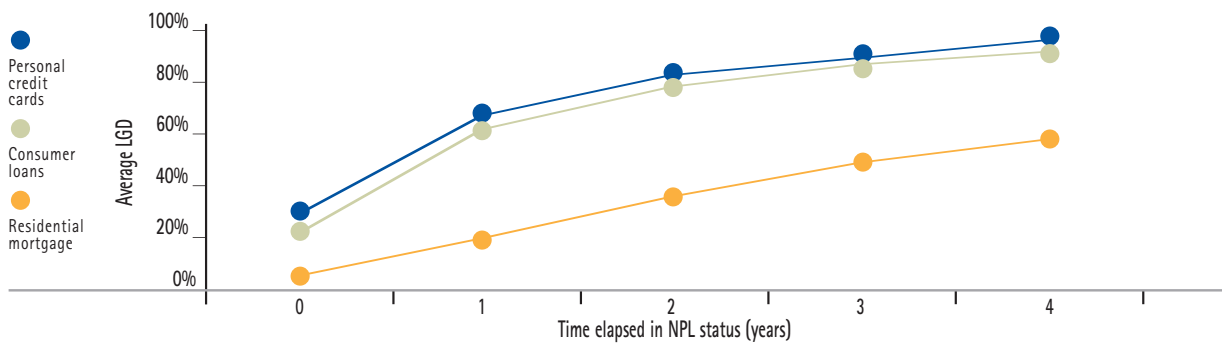
**d) Combination of significant factors**

The graph presents an aggregate display, for unsecured loans, credit lines and receivables, of how the LGD trend depends jointly on two significant factors: the time elapsed from arrangement to customer default and the time the customer is in default. Each line on the graph corresponds to different seasonings.

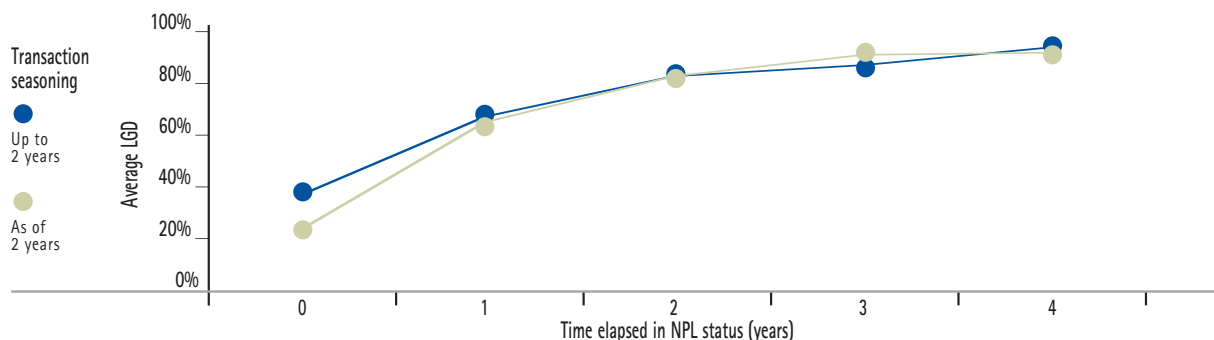
**LGD in mortgage loans according to % of LTV**



**Comparison of LGD curves for NPL transactions involving BBVA retail products**



**Variation over time in LGD for SME products (loans, credit lines and receivables)**



The BBVA Group assigns different LGD rates to the outstanding receivables (defaulted and non-defaulted) according to the combinations of significant factors, depending on each product's characteristics and the presence of collateral. These LGD rates are allocated in order to determine expected losses, economic capital and regulatory capital.

For example, a table showing LGD rates for mortgages is provided here with LTV between 65% and 85%, the result of combining significant factors.

Finally, research has been carried out in 2005 on the development of an in-house method for including the uncertainty relative to LGD in capital calculations. This methodology aims to provide a solution to the requirements laid down by the Basel Committee on Banking Supervision regarding the estimation of a downturn LGD. This takes the form of an adjustment applied to all portfolio transactions with certain differences depending on their status (defaulted or non-defaulted).

**Exposure at default.** Exposure at default (EAD) is another input needed to calculate the expected loss and capital in Group operations. Additional studies have been carried out in 2005 on the estimation of conversion factors required for determining exposure at default, on the basis of the same data infrastructure as that used for estimating the other risk parameters. The estimation of these conversion factors will be further analysed in 2006, ensuring the application of the market's best practices.

**Adjustment to the business cycle.**

Adjustment to the business cycle is a key factor to achieve stable estimates of expected loss and capital throughout the cycle. To calculate the business cycle adjustment coefficients, the conditions prevailing during the information-gathering period are linked with the steady state of the economy. In 2005, the adjustments to the cycle have been updated with new information available.

**LGD FOR MORTGAGE LOANS WITH LTV BETWEEN 65% AND 85%**

Transaction seasoning	Time in NPL status (in years)						
	Not in NPL status (period=0)	Up to 1	Between 1 and 2	Between 2 and 3	Between 3 and 4	Between 4 and 5	As of 6
Up to 1 year	7.3%	27.8%	50.4%	65.1%	71.8%	75.2%	100%
Between 1 and 2 years	5.7%	23.0%	45.3%	57.8%	63.0%	65.2%	100%
Between 2 and 3 years	4.2%	17.4%	33.7%	54.9%	59.5%	61.5%	100%
Between 3 and 4 years	3.4%	17.4%	33.7%	38.3%	41.3%	50.7%	100%
As of 4 years	3.1%	17.4%	33.7%	38.3%	41.3%	50.7%	100%

This method is supplemented by a stress analysis on estimations. The stress of underlying risk factors for the different asset classes is made. It can thus be determined to what extent future expected losses could be affected by scenarios of economic downturn, high interest rates or, in the specific case of the mortgage portfolio, corrections in the real-estate market.

**Portfolio model.** In 2005, the BBVA Group has developed its own portfolio model, with a view to improving its measurement for credit risk economic capital bearing in mind the effects of diversification/concentration that are typical of the investment structure. In short, a more accurate measurement of our risk profile. Accordingly, the model contains the interrelations amongst the different factors that affect the loan losses the Group might have to face. This model, developed in joint cooperation among the areas of Risk, Financial Management and Economic Research, provides BBVA with a key tool for lending risk management and has been designed taking into account the requirements of the second pillar of Basel II.

The model's multi-factorial nature (see diagram provided) implies that economic capital is sensitive to the potential existence of geographical diversification, a crucial aspect in a global entity such as BBVA. In turn, the tool is sensitive to the potential concentration existing in certain loan exposures.

On the one hand, the model considers the foreseeable performance of default rates, explained in terms of macroeconomic and financial variables, for each of the economies in which the BBVA Group is active.

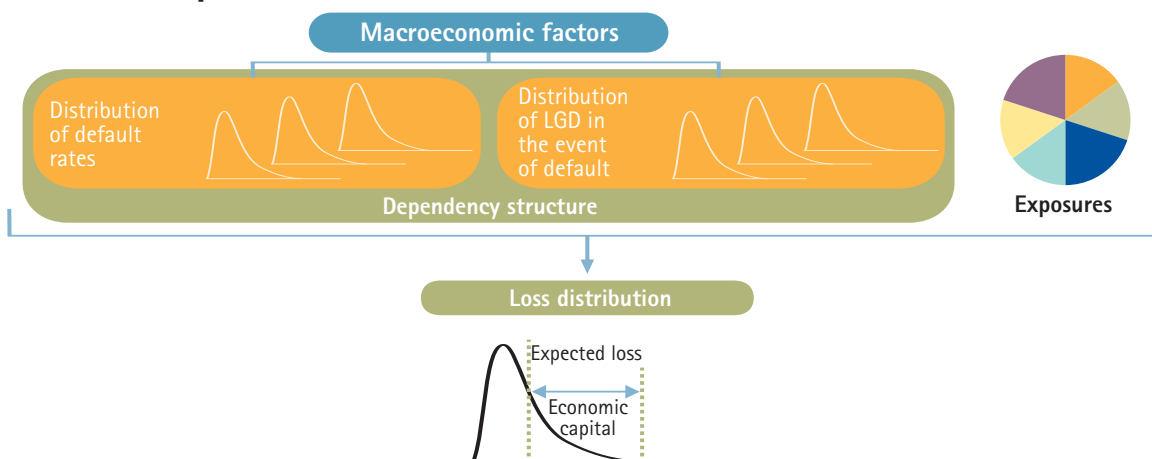
On the other hand, the model considers the uncertainty in the performance of LGD in the event of default, as well as the fact that the LGD may be related to the performance of default rates. The most clarifying example to illustrate this phenomenon is the case of the mortgage portfolio, whose LGD has been linked, through the ratio between loan exposure and the value of the mortgage guarantee (LTV), with the trend in real estate prices. The performance of this variable is the one that determines the dependence between LGD and default.

The results of the portfolio model developed will also be used to enrich the parameters that feed the information system for risk management, thereby achieving greater accuracy in the risk/return analysis of transactions. This model forms the mainstay for progress towards a future model that will take into account all the interrelations between the different types of risk, and not only credit risk, managed by the BBVA Group.

### Credit risk in 2005

The Group's maximum exposure to credit risk stood at €455,282m at year-end 2005, a year-on-year increase of 24.2%. By business areas, Retail Banking in Spain and Portugal

#### Structure of the portfolio model



**MAXIMUM EXPOSURE TO CREDIT RISK**

(Million euros. 31-12-05)

	GROUP TOTAL	Retail Banking	Wholesale Banking	The Americas	Others
<b>GROSS CREDIT RISK (DRAWN)</b>	<b>252,275</b>	<b>137,914</b>	<b>69,412</b>	<b>48,522</b>	<b>(3,573)</b>
Loans and receivables	222,413	131,114	47,724	45,720	(2,145)
Contingent liabilities	29,862	6,800	21,688	2,802	(1,428)
<b>TRADING ACTIVITY</b>	<b>118,005</b>	<b>11,411</b>	<b>35,136</b>	<b>40,132</b>	<b>31,327</b>
Credit entities	27,470	282	13,400	10,431	3,357
Fixed income	82,010	11,129	16,708	26,202	27,970
Derivatives	8,526	-	5,028	3,498	-
<b>THIRD-PARTY LIABILITIES</b>	<b>85,001</b>	<b>33,263</b>	<b>41,845</b>	<b>21,410</b>	<b>(11,571)</b>
<b>TOTAL</b>	<b>455,282</b>	<b>182,588</b>	<b>146,393</b>	<b>110,063</b>	<b>16,236</b>

accounted for 40.1% of the exposure, Wholesale and Investment Banking for 32.2% and the Americas for 24.2%.

All items recorded significant increases: customer lending risks (55% of the total, including contingent liabilities) rose by 27.3%, third-party liabilities (accounting for 19%) by 40.0% and the potential exposure to lending risk in market activities including potential exposure for derivatives (26% of the total) by 9.7%.

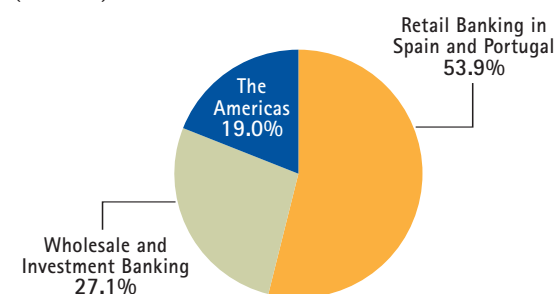
Insofar as lending risk is concerned, the incorporation in 2005 of Laredo National Bancshares, Hipotecaria Nacional and Granahorrar, as well as the strengthening of currencies in the Americas against the euro, have altered the distribution by business and geographical areas. The year has thus witnessed an increase in the relative weight of the Americas and a fall off in Retail Banking in Spain and

Portugal by 3.3 percentage points (now accounting for 53.9% of the Group's total risk) and by 0.5 points in Wholesale and Investment Banking, down to 27.1% of the total.

By geographical areas, the Group in Spain (including branches abroad, largely in Europe)

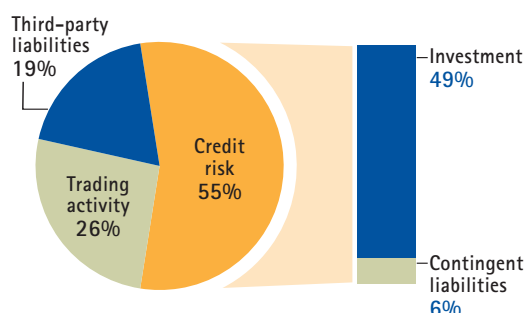
**Exposure. Gross credit risk. Distribution by business areas**

(31-12-05)



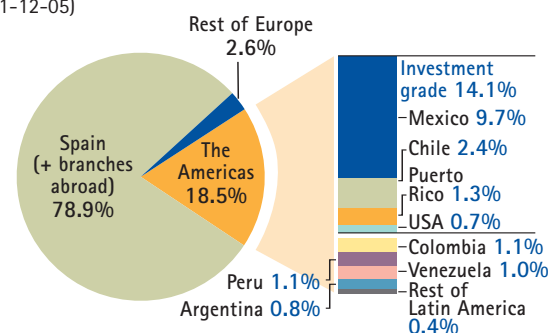
**Maximum exposure to credit risk**

(31-12-05)



**Exposure. Gross credit risk. Geographical distribution**

(31-12-05)



accounts for 78.9%, the rest of Europe for 2.6% and exposure in the Americas for 18.5% (14.5% in 2004). The vast majority of the latter (75.9%, as opposed to 73.9% in 2004) is concentrated on investment grade countries.

The accompanying table provides a breakdown of customer lending distribution by sectors at year-end 2005. Lending to the resident private sector in Spain amounted to €140 billion, with risks being equally divided

between lending to private individuals (50%) and business activities (50%), without significant concentrations in sectors more sensitive to the current economic climate.

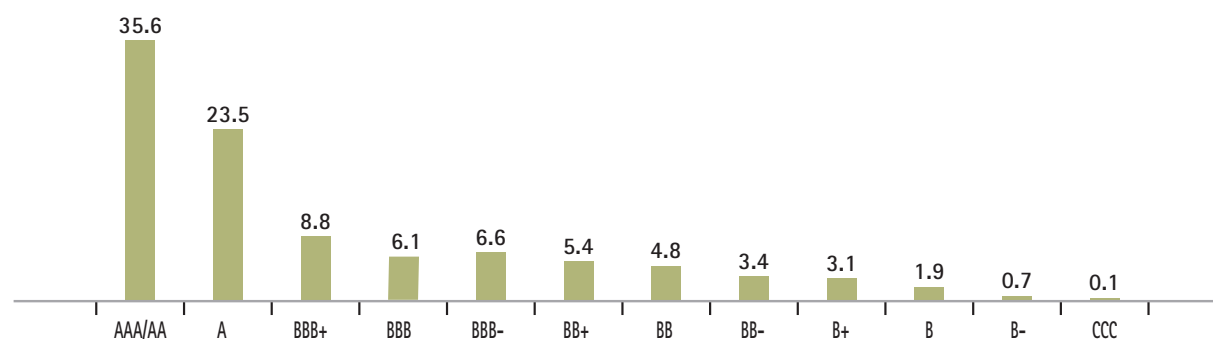
The distribution of the exposure by ratings, including companies, financial entities, institutions and sovereign obligors, reveals that over 59% of the exposure to lending risk is concentrated on customers with an A rating or higher.

### CUSTOMER LENDING BY SECTORS

(Million euros. 31-12-05)

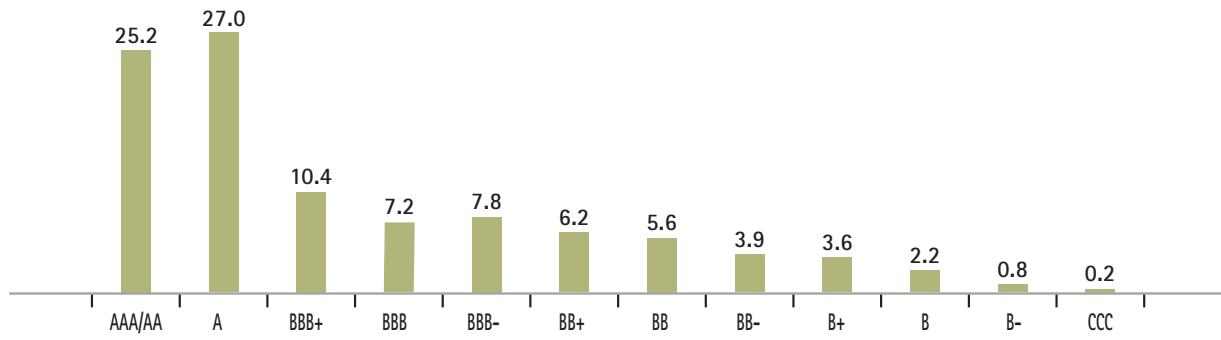
	Total	Residents	Non-residents
Public Sector	22,125	16,089	6,036
Agriculture	2,504	1,550	955
Industry	17,930	14,774	3,155
Real estate and development	36,562	24,937	11,624
Commercial and financial	36,194	11,736	24,459
Loans to individual customers	82,583	67,964	14,619
Leasing	6,726	5,910	816
Others	17,370	13,167	4,203
<b>SUBTOTAL</b>	<b>221,995</b>	<b>156,128</b>	<b>65,866</b>
Interest, fees and others	418	109	309
<b>TOTAL</b>	<b>222,413</b>	<b>156,237</b>	<b>66,176</b>

### Distribution by ratings<sup>(1)</sup> (Exposure 31-12-05. Percentage)



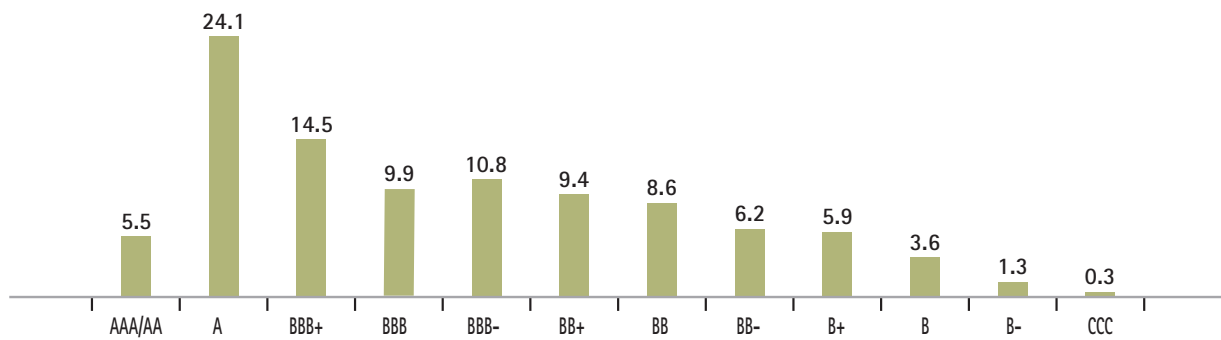
(1) Activities of parent bank and subsidiaries in Spain. Companies, financial entities and sovereign risks.

**Distribution by ratings<sup>(1)</sup>. Excluding sovereign risks** (Exposure 31-12-05. Percentage)



(1) Activities of the parent bank and subsidiaries in Spain. Companies, financial entities and institutions.

**Distribution by ratings. Companies<sup>(1)</sup>** (Exposure 31-12-05. Percentage)



(1) Activities of the parent bank and subsidiaries in Spain. It includes only the Banking Book.

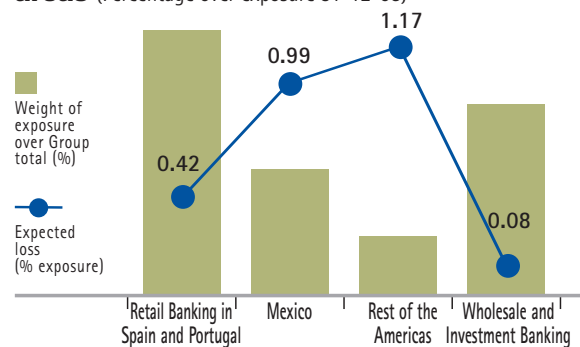
If sovereign risks are excluded, 52% is still rated at A or higher and 77% of the exposure has a rating equal to or better than BBB-.

A display is likewise made of the rating distribution of the segment corresponding to the parent bank.

**Expected losses.** In accordance with the above ratings distribution, the Group's expected losses (adjusted upwards in line with the business cycle) are estimated to be €1,664m.

As may be seen in the graph, attributable expected losses by main business areas according to their exposure – Retail Banking in Spain and Portugal accounts for 41% of the exposure and Wholesale and Investment Banking for 30% – stand at 0.42% and 0.08%, respectively, with the expected loss in Mexico being 0.99% and 1.17% for the rest of the Americas.

**Attributable expected losses by business areas** (Percentage over exposure 31-12-05)



There follows a detail of economic capital consumption and expected loss in the parent bank's main portfolios in Spain. It should be noted that in 2005 economic capital has included a component linked to LGD volatility.

**RISK STATISTICS FOR THE MAIN BBVA, S.A. PORTFOLIOS**

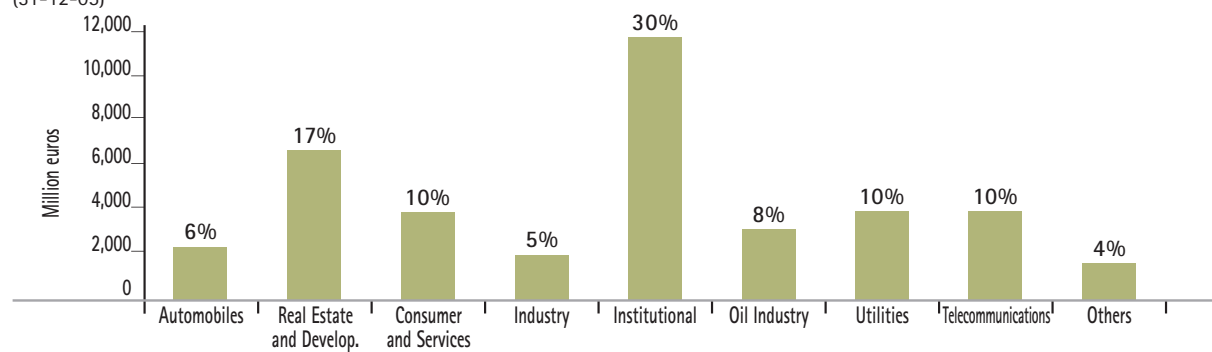
(31-12-05)

Portfolios	Exposure <sup>(1)</sup>	Expected losses		Economic capital	
	Million euros	Million euros	%	Million euros	%
Consumer loans	6,278	62	0.99	285	4.54
Mortgage	56,826	98	0.17	978	1.72
SMEs	15,952	63	0.40	571	3.58
Corporates	39,273	28	0.07	803	2.04

(1) Includes off-balance-sheet positions to which the corresponding conversion factors are applied. Segmentation according to tool used for rating.

**Concentration. Distribution by sector**

(31-12-05)

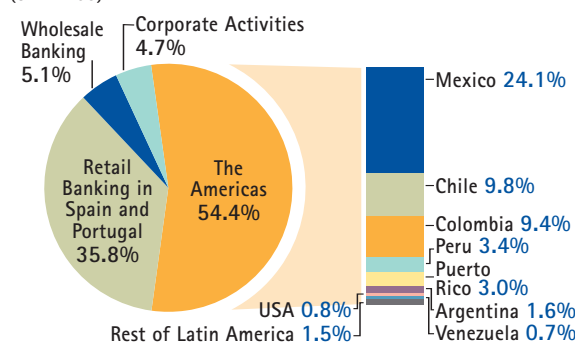


**Concentration.** The BBVA Group has 79 groups with credit risk exposure (investment + guarantees) that exceeds €200m, amounting to a total risk of €37,151m, ie, 14.7% of the Group's overall risk, of which 95% has an investment degree loan rating. From the perspective of transaction source, 67% is concentrated in Spain, 21% in the foreign network and 12% in Latin America (9% in Mexico). The major sectors are: institutional (30%), real-estate and development (17%), telecommunications (10%) and utilities (10%).

**Non-performing loans (NPL).** Over the course of the year, BBVA has upheld the trend for improvement in credit risk quality indicators, which is a constant in the Group's evolution. The value of NPL (customer lending and contingent liabilities) stood at €2,382m at year-end 2005, as opposed to €2,248m twelve months earlier. Nonetheless, adjusting for the perimeter enlargement effect in Mexico, USA and Colombia and of exchange rate variations, NPL went down by €189m.

**NPL. Distribution by business areas**

(31-12-05)



This drop is due to a new reduction in the non-performing loans ratio over credit risk, despite the more stringent criteria for NPL accounting, falling from 1.08% in 2004 to 0.86% in 2005, and to a better recovery rate rising to 36.5% of the critical mass (debit balances plus new entries), as opposed to 31.4% for 2004.

The accompanying table provides a breakdown of movements in non-performing loans in 2005 and 2004.

### TREND IN NPL

(Million euros)

	2005	2004
<b>BEGINNING BALANCE</b>	<b>2,248</b>	<b>3,028</b>
Entries	1,943	1,988
Recoveries	(1,531)	(1,575)
<b>NET ENTRY</b>	<b>412</b>	<b>413</b>
Transfers to write-offs	(667)	(713)
Exchange differences and others	389	(480)
<b>FINAL BALANCE</b>	<b>2,382</b>	<b>2,248</b>

All business areas have recorded a good performance, based on the trend in net entries, as shown in the table provided.

As a result of strong growth in lending and the containment of past-due balances, there is a

further reduction in the Group's NPL ratio by 19 basis points, down to 0.94% at year-end 2005, as opposed to 1.13% at year-end 2004.

All business areas reduced their NPL ratio: Retail Banking in Spain and Portugal by 20 basis points, down to 0.62%, Wholesale and Investment Banking by 12 basis points to 0.18% and the Americas by 77 basis points to 2.67%.

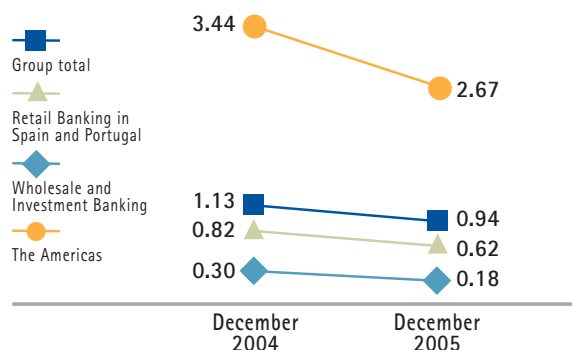
Given that provisioning for credit risk in the customer lending portfolio rose by 21.8% to €6,015m, the BBVA Group's NPL coverage rate increased to 252.5% (219.7% at year-end 2004), thereby reinforcing the Group's solvency. This performance has been recorded across the board in all business areas, rising to 315.7% in Retail Banking, 728.7% in Wholesale Banking and 183.8% in the Americas.

### NPL TREND BY BUSINESS AREAS

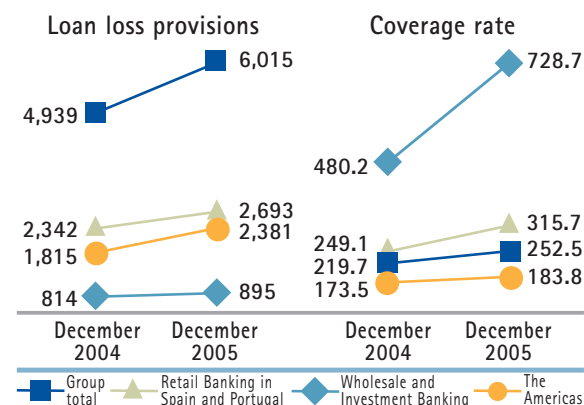
(Million euros)

	Retail Banking		Wholesale Banking		The Americas		Others	
	2005	2004	2005	2004	2005	2004	2005	2004
<b>BEGINNING BALANCE</b>	<b>940</b>	<b>1,040</b>	<b>169</b>	<b>255</b>	<b>1,046</b>	<b>1,687</b>	<b>93</b>	<b>46</b>
<b>NET ENTRY</b>	<b>121</b>	<b>170</b>	<b>(39)</b>	<b>(44)</b>	<b>326</b>	<b>260</b>	<b>4</b>	<b>27</b>
Transfers to write-offs	(205)	(219)	(15)	(36)	(443)	(458)	(4)	-
Exchange differences and others	(3)	(51)	8	(6)	367	(443)	17	20
<b>FINAL BALANCE</b>	<b>853</b>	<b>940</b>	<b>123</b>	<b>169</b>	<b>1,296</b>	<b>1,046</b>	<b>110</b>	<b>93</b>

### NPL rates



### Coverage



## ● RISK MANAGEMENT IN MARKET AREAS

The BBVA Group manages jointly credit and market risk in trading activity, within a limits system framework approved by the Executive Committee and adapted to the nature of the business.

The most widely used measurement model is Value-at-Risk, VaR (the maximum loss that could be incurred by the portfolios for a given confidence level, as a result of adverse fluctuations in market variables), with a confidence level of 99%, and a one-day horizon. This measurement includes basis risk, spread, convexity and other risks associated with embedded options and structured products.

The structure for market risk limits has been supplemented and reinforced in 2005; it includes an overall VaR per business unit and involves specific sub-limits according to the type of risk, business activity and trading unit.

Risk monitoring in terms of VaR is undertaken using two complementary and dynamic methods. Priority is given to the use of limits based on the measuring of 1-day VaR with equally weighted observations of the daily information on the past year's market (VaR without smoothing), and monitoring is also made of the VaR that gives greatest importance to the immediate past (with exponential smoothing). Limits are likewise established for economic capital and VaR stress situations, considering the impact of past financial crises and potential and foreseeable future scenarios.

The dynamic nature of the limits allows for linking authorised risk levels for market business units to their performance over the year, reducing the limits in the event of negative aggregate results. In order to foresee and mitigate the effects of these situations, loss limits and other control measures, such as delta sensitivities, are also introduced. The proactive management of this limits structure is accompanied by a broad range of indicators and warning alerts that immediately trigger procedures designed to cope with those

situations that might possibly compromise the activities of the business area.

In order to assess impacts of less liquid markets, regular settlement VaR calculations are made in certain portfolios, taking into account the liquidity conditions in financial markets at any given time. Finally, the market risk measurement model incorporates back-testing or ex-post comparison, which helps to ensure the accuracy of the risk measurements made, comparing day-to-day management results at different levels with the corresponding VaR measurement.

The inclusion of Mexico in the implementation of the new risk measurement platform, now fully operational in the Europe and US Global Business unit, paves the way for the integration of market risk with credit risk for the whole of the perimeter for which the BBVA Group has requested the application of the Advanced Internal Model for capital allocation. This new and more powerful platform uses historical and Monte Carlo simulation, applying full-valuation to derivatives, with a consequent increase in estimated risk accuracy.

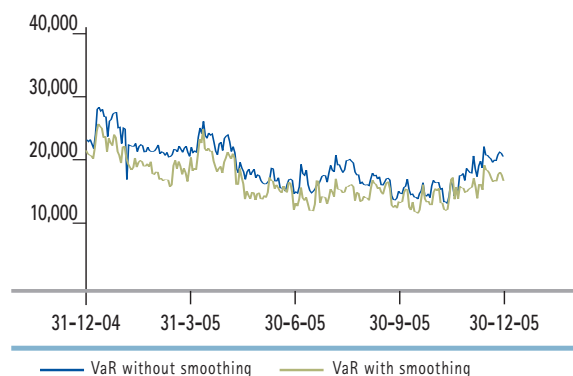
The planned enlargement of the Advanced Internal Model platform and perimeter is underway in all the other Latin American units in the BBVA Group.

### **Market risk 2005**

The BBVA Group's market risk in 2005 has generally remained at moderate levels, with a downward trend over the first three quarters and a slight upturn towards the end of the year, mainly as a result of the increased exposure. The year closed with an average weighted limits consumption of 33% (29% for the method with exponential smoothing) with low volatility regarding this average value. The main developed markets ended the year with significant advances in the stock markets, whereas in emerging markets there has been a cut-back in country risk spreads, public debt performed well and stock markets made significant gains. Greater liquidity in fixed-income markets has been the common denominator in all Latin American countries in 2005.

### Trend in market risk

(Thousand euros)

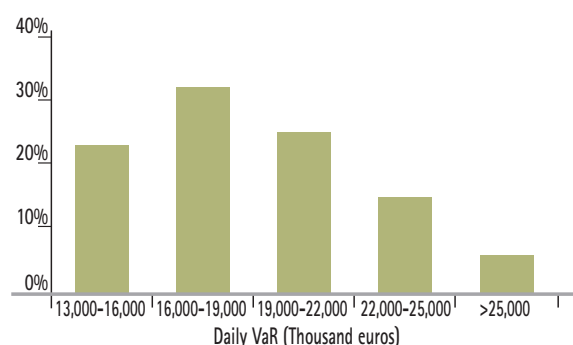


The BBVA Group's market risk in 2005, in terms of VaR, has averaged €19,040m.

The main risk the Group faces is interest rate risk (62% of the total at year-end 2005), which includes systematic risk and the specific risk linked to spreads. Vega and correlation risks each account for 7% of the total, and equity risk and FX risk account for 9% and 7%, respectively.

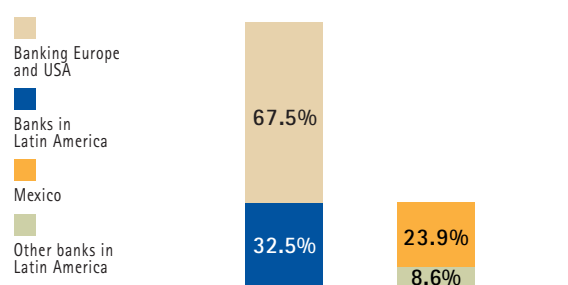
By geographical areas, 67.5% of the market risk corresponds to banking in Europe and the United States, and 32.5% to the Group's banking companies in Latin America, of which 23.9% is concentrated in Mexico.

### Distribution of market risk frequencies in 2005



### Market risk by geographical areas

(Average 2005)



### MARKET RISK BY RISK FACTORS IN 2005

(Thousand euros)

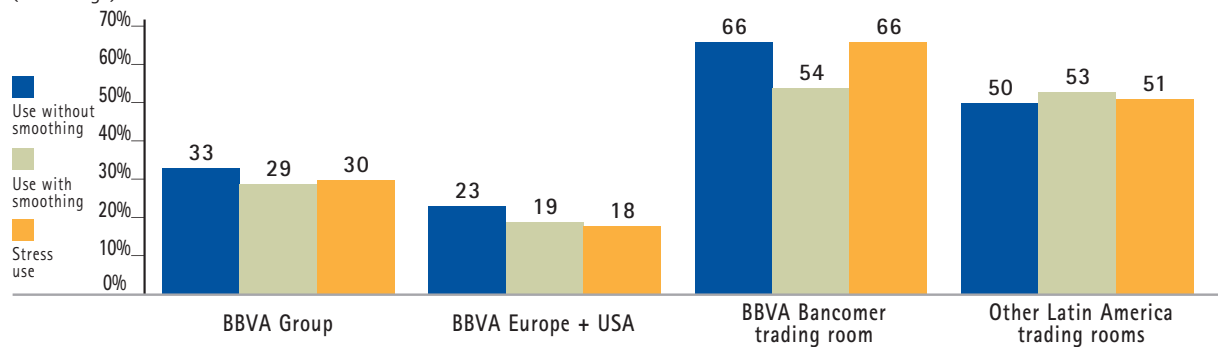
	31-12-05	Daily VaR		
		Average	Maximum	Minimum
Interest <sup>(1)</sup>	14,232	12,150	20,178	7,005
Exchange rate <sup>(1)</sup>	1,717	1,646	5,692	475
Equity <sup>(1)</sup>	2,024	2,113	4,751	1,026
Vega and correlation	5,009	5,487	6,985	4,243
Diversification effect	(2,559)	(2,357)	-	-
<b>TOTAL</b>	<b>20,424</b>	<b>19,040</b>	<b>28,314</b>	<b>12,918</b>

(1) Includes gamma risk of fixed-income, exchange rate and equity options, respectively. Interest risk includes the spread.

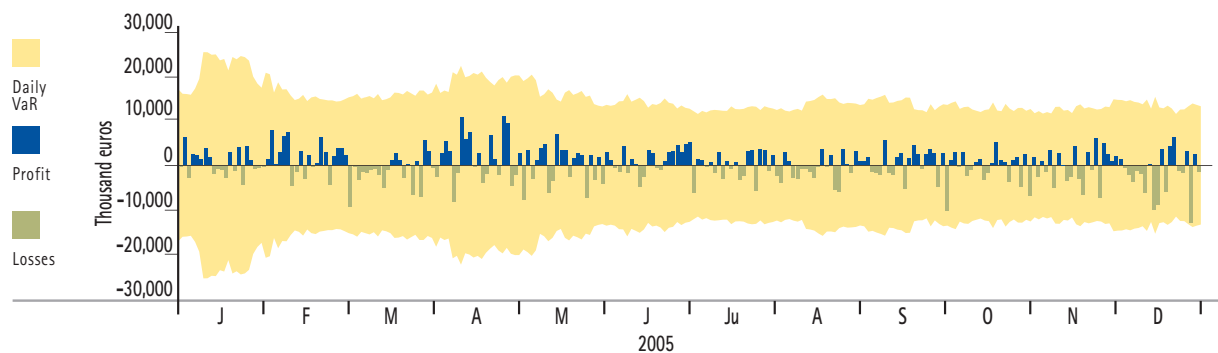
Regarding average limits use by the Group's main business units, as calculated without exponential smoothing, it amounted to 23% for trading rooms in developed markets, 66% for the Bancomer trading room and 50% for the remainder of Latin America trading rooms.

The back-testing comparison performed with management results for the BBVA SA perimeter market risk in 2005, which makes a day-to-day comparison between positions results and risks level estimated by the model, confirms the adequacy of the risk management model.

**Market risk. Average use of limits in 2005**  
(Percentage)



**BBVA, SA internal back-testing model** (Overall risk. VaR versus daily earnings)



### Credit risk in market activities

The credit risk in OTC financial instruments is calculated by considering the daily marking to market of the positions held, plus an estimate of maximum potential increase in value through to maturity.

The measurement system is based on Monte Carlo simulation for all operations:

- It takes into account the portfolio effect, considering correlations that exist between the different market variables, thereby reflecting the offsetting effect between transactions.
- It incorporates the term effect, whereby portfolios comprising short and long-term operations are dealt with jointly.
- It measures risk with counterparties with whom legal netting and collateral contracts are set (ISDA, CSA, CMOF, etc.).

- It enables exotic products to be measured adequately.

The equivalent maximum credit risk exposure to counterparties at year-end 2005 was €15,777m, with a year-on-year increase of 25%.

The policy of entering into netting and collateral agreements continued. The overall reduction – in terms of exposure – due to master agreements is €10,749m, reducing the gross figure of €15,777m to a net risk of €5,028m.

The net market value of the instruments mentioned in the portfolio at year-end 2005 is €1,254m, with 75 month average residual term, whereas the gross replacement value is €12,951m.

The accompanying table shows the distribution by maturities of the equivalent maximum exposure amounts with OTC financial instruments.

### OTC DERIVATIVES. EQUIVALENT MAXIMUM EXPOSURE

(Million euros)

OTC financial instruments	Gross replacement value	Net replacement value	Equivalent maximum exposure	Weighted average term
IRS	10,032	1,715	12,120	68
FRA's	24	13	31	12
Interest rate options	509	(154)	606	56
OTC interest rate diversification			(25)	
<b>TOTAL OTC INTEREST RATE</b>	<b>10,565</b>	<b>1,575</b>	<b>12,732</b>	<b>68</b>
Forward FX	633	42	1,308	31
Currency swaps	419	58	788	66
Currency options	102	(92)	92	23
OTC exchange rate diversification			(309)	
<b>TOTAL OTC EXCHANGE RATE</b>	<b>1,155</b>	<b>8</b>	<b>1,879</b>	<b>58</b>
OTC equity	623	(588)	728	31
Fixed income and others	609	260	986	121
OTC equity and others diversification			(146)	
<b>TOTAL OTC EQUITY AND OTHERS</b>	<b>1,231</b>	<b>(328)</b>	<b>1,569</b>	<b>110</b>
<b>TOTAL DIVERSIFICATION</b>			<b>(404)</b>	
<b>TOTAL</b>	<b>12,951</b>	<b>1,254</b>	<b>15,777</b>	<b>75</b>

**DISTRIBUTION BY MATURITIES. MAXIMUM EXPOSURE IN OTC FINANCIAL INSTRUMENTS**

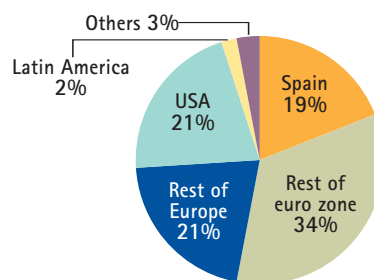
(Million euros)

Type of product	2005							
	Up to 6 months	Up to 1 year	Up to 3 years	Up to 5 years	Up to 10 years	Up to 15 years	Up to 25 years	As of 25 years
OTC interest rate	12,732	12,540	11,171	6,802	4,098	1,071	718	185
OTC exchange rate	1,879	1,202	798	438	248	79	58	1
OTC equity and others	1,522	1,569	1,527	1,071	734	543	425	91
Total diversification	(358)					(1)		
<b>TOTAL</b>	<b>15,777</b>	<b>15,312</b>	<b>13,496</b>	<b>8,311</b>	<b>5,080</b>	<b>1,692</b>	<b>1,201</b>	<b>277</b>

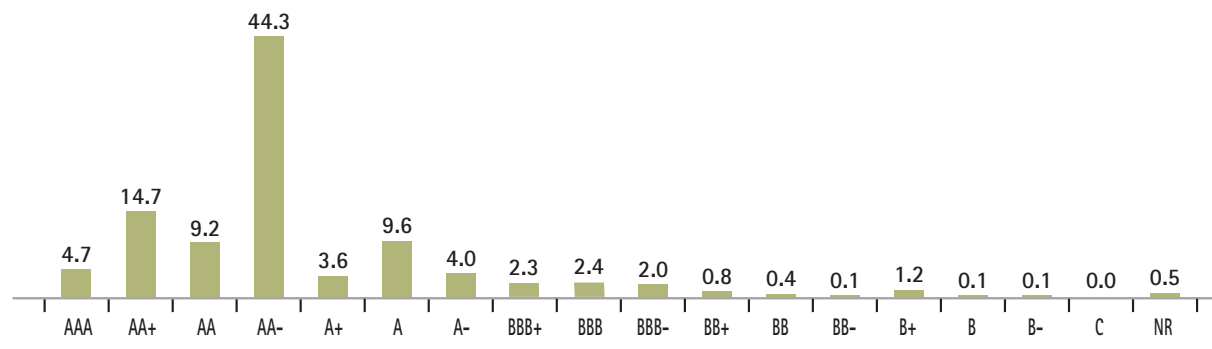
The counterparty risk assumed in this activity involves entities with a high credit rating, equal to or higher than A- in 90% of cases. The exposure is concentrated in financial entities (89%) with the remainder (11%) in corporations and obligors, and is suitably diversified.

By geographical areas, the greater weight lies in Europe (74%) and North America (21%), which account for 95% of the total.

**Equivalent maximum exposure. Distribution by geographical areas**  
(Percentage)



**Equivalent maximum exposure. Distribution by ratings** (Percentage)



## ● STRUCTURAL RISKS

### Structural interest rate risk

The BBVA Group's exposure to variations in market interest rates is one of the financial risks inherent to banking. Both the parallel movements of yield curves and the change in their slope, as well as the embedded options sensitivity present in certain banking operations, are taken into account when assessing risk.

The Assets and Liabilities Committee (ALCO) actively manages the BBVA Group's asset and liability risk, excluding trading activity, in accordance with the exposure profile established by the BBVA Group. Decision-making explicitly considers interest rate risk

measures, whose monitoring and supervision are carried out by the Risk Area, as an independent unit responsible for this assessment, as well as the design of systems for measuring, monitoring, reporting and supervising limits policies. The increasing sophistication of financial products and the strategies designed by the ALCO, as well as risk assessment models, have led in 2005 to the BBVA Group including new measurement tools in order to further enlarge upon its scope for calculation and analysis.

The accompanying table of gaps shows the different asset and liability items distributed by time buckets in accordance with their date of maturity or repricing, depending on whether they are fixed or variable rate.

### MATRIX OF MATURITIES OR REPRICING DATES ON THE CONSOLIDATED BALANCE SHEET IN EUROS. EX TRADING ACTIVITY

(Thousand euros)

	Balance	1 month	1-3 months	3-12 months	1-2 years	2-3 years	3-4 years	4-5 years	As of 5 years
<b>ASSETS</b>									
Money market	22,152,972	11,371,856	6,368,653	2,998,655	53,257	107,798	430,407	613,376	208,969
Lending	151,893,957	26,451,775	38,874,654	70,207,121	4,563,639	3,365,508	2,083,676	1,384,401	4,963,182
Securities portfolio	31,892,613	5,904,803	1,544,025	8,305,483	4,554,387	2,467,314	2,397,515	570,977	6,148,109
Other sensitive assets	15,020,690	12,665,504	48,275	185,180	49,118	807,063	892,497	203,784	169,268
Derivatives	59,138,298	5,939,477	6,213,714	3,702,912	7,224,242	3,052,961	6,919,629	8,832,821	17,252,542
<b>TOTAL SENSITIVE ASSETS</b>	<b>280,098,530</b>	<b>62,333,416</b>	<b>53,049,322</b>	<b>85,399,351</b>	<b>16,444,644</b>	<b>9,800,644</b>	<b>12,723,723</b>	<b>11,605,360</b>	<b>28,742,071</b>
<b>LIABILITIES</b>									
Money market	11,889,969	8,579,119	2,638,078	603,658	-	-	-	-	69,114
Customer funds	78,986,774	16,906,164	6,087,826	6,517,900	589,579	11,164,717	1,169,648	18,569,199	17,981,740
Wholesale financing	70,514,749	7,202,093	28,074,446	2,547,345	3,500,734	536,475	5,287,789	7,588,348	15,777,519
Other sensitive liabilities	53,614,098	36,098,031	4,861,219	5,724,512	1,303,269	953,372	619,974	487,765	3,565,957
Derivatives	62,016,353	19,350,156	29,744,088	7,718,755	588,303	613,016	677,039	323,511	3,001,486
<b>TOTAL SENSITIVE LIABILITIES</b>	<b>277,021,944</b>	<b>88,135,562</b>	<b>71,405,658</b>	<b>23,112,169</b>	<b>5,981,885</b>	<b>13,267,581</b>	<b>7,754,450</b>	<b>26,968,822</b>	<b>40,395,816</b>
<b>GAPS</b>	<b>3,076,587</b>	<b>(25,802,146)</b>	<b>(18,356,336)</b>	<b>62,287,182</b>	<b>10,462,759</b>	<b>(3,466,937)</b>	<b>4,969,273</b>	<b>(15,363,463)</b>	<b>(11,653,745)</b>

This characterisation of the balance sheet leads to an initial approach to repricing, complemented by the subsequent quantification of the impact on the net interest income and the economic value of the BBVA Group in the light of changes in market interest rates. The graph shows the interest rate risk profile for the BBVA Group's main entities.

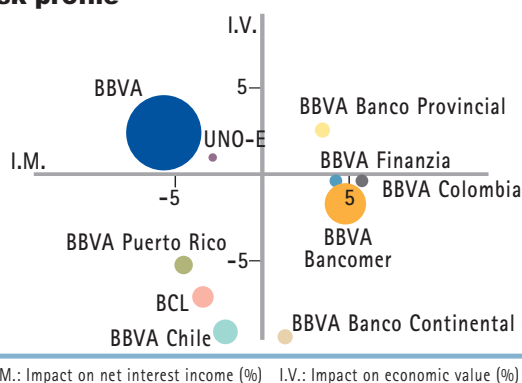
Bearing in mind that sensitivity measures do not contain all sources of interest rate risk, an in-depth analysis has been carried out in 2005 on foreseeable scenarios and risk measurements on the basis of curve simulation processes, thereby enabling an assessment of different changes in slope, curvature and parallel

movements to be made. These simulations provide statistical distributions of impact on net interest income and economic value, thereby specifying the maximum negative variations for a predetermined confidence level.

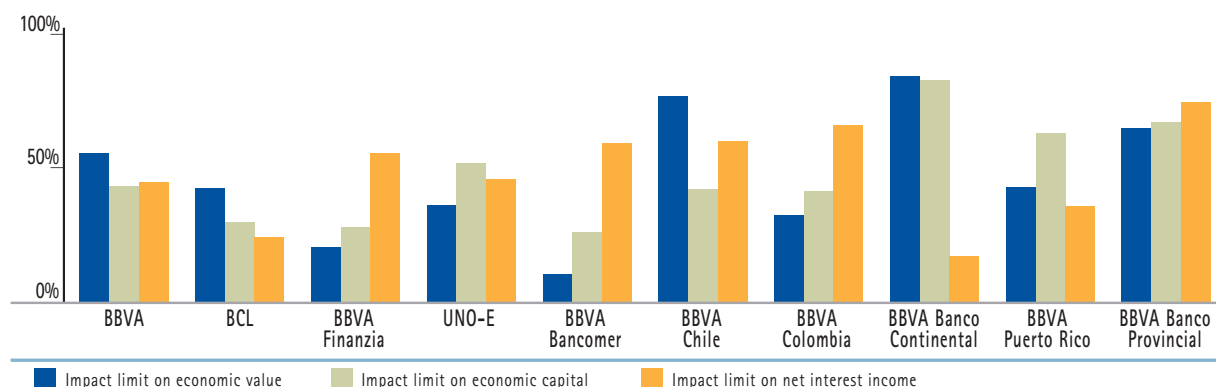
The limit structure for asset and liability interest rate risk was expanded in 2005 to include an economic capital limit for asset and liability interest rate risk, in addition to sensitivity limits for net interest income and economic value, which implies setting a 99% confidence level for unexpected economic losses through interest rate risk. This limit structure, which is approved annually by the Executive Committee, is one of the main tools the BBVA Group has for the risk supervision of asset and liability interest rate risk. The graph provided shows the average use of limits in 2005, in which interest rate risk has shown an upward trend within a context of rising interest rates.

In 2005, the ALCO has adopted a hands-on approach to asset and liability interest rate risk, with both hedging derivatives and balance-sheet instruments. At year-end 2005, there is a fixed interest rate assets portfolio of €31,249m, with a view to offsetting or reducing the negative effect of the decline in interest rates on the Group's net interest income. In the year, the portfolio has generated €264m in net interest income and €80m in net trading income.

**BBVA Group structural interest rate risk profile**



**Structural interest rate risk. Average use of limits**



### **Structural exchange rate risk**

The measurement of structural exchange rate risk quantifies the exposure to losses in the value of the BBVA Group's strategic positions as a result of exchange rate variations.

Investments in Latin America, which account for a long position in foreign currencies, are the main source of structural exchange rate risk in the BBVA Group.

The Risk Area makes regular assessments on the basis of a 99% value-at-risk model based on stochastic simulations that also consider the possibility of exchange rate crises, adjusted to the specific characteristics of exchange rate markets and to the nature of structural exchange rate positions. The horizon is adjusted for each currency depending on market liquidity and existing management possibilities. This measurement constitutes the economic capital or unexpected loss through structural exchange rate risk, providing an individual breakdown of the contribution each currency makes to risk.

This calculation procedure is applied both to the net positions derived from the investment's net asset value, and to the results forecast, taking into account possible hedges of the exchange rate position by the ALCO.

Exchange rate risk management has been undertaken in 2005 with the strengthening of Latin American currencies against the dollar, as well as of the dollar against the euro. The net exposure of investment has increased over this period by the increased value of the holdings. Accordingly, the risk level has followed an upward trend, always within the limit for economic capital authorised by the Executive Committee and which, on average, has consumed 64% in 2005. The exchange rate risk of results in 2005 has been actively managed, with a significant part of the exposure being covered by the profits foreseen for 2006.

At year-end 2005, BBVA maintained a 44% global coverage of the BBVA balance sheet in the Americas, with levels of perfect hedge of 39% in Mexico, 100% in the United States, 75% in Chile and 29% in Peru. These coverage levels do not consider long positions in dollars

upheld by certain affiliate banks at local level. In 2005, the transfer to reserves resulting from the strengthening of Group affiliate banks' base currencies against the euro has risen to almost €700m, whereas the financial cost of the capital hedge has been €57m net of tax. In addition, results hedging policy in 2005 has reduced the results of financial transactions by €70m net of taxes, a sum that has been offset by the higher than expected results, expressed in euros, that the Group's units in the Americas recorded.

### **Liquidity risk**

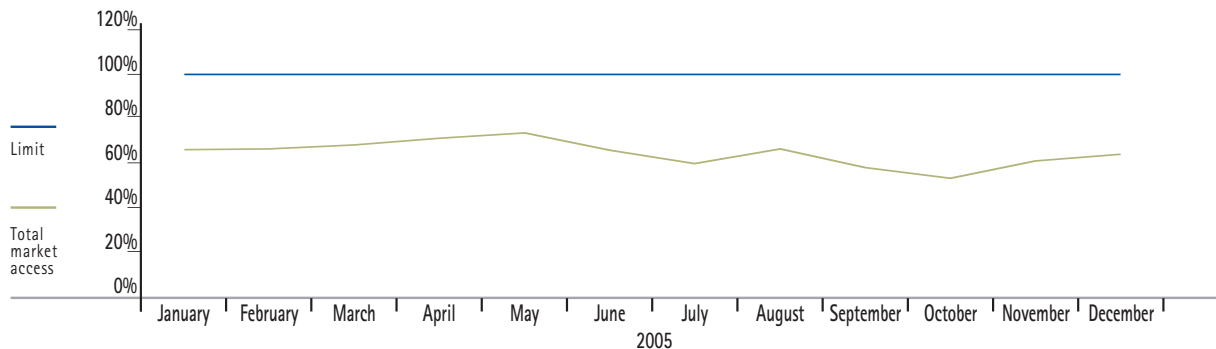
The ultimate goal of liquidity risk management and monitoring in the BBVA Group is to ensure that each unit meets its payment obligations, without having to obtain funds on burdensome terms.

The Risk Area assesses and monitors liquidity in a very different manner to the way it is managed. Accordingly, it permanently monitors quantitative and qualitative indicators that reflect the overall positioning in terms of liquidity, anticipating possible stresses both in the short term, basically up to 90 days, as in the medium term, and within a twelve-month horizon, as well as in the liquidity profile foreseeable for the coming years.

The limits structure authorised by the Executive Committee and reported and monitored by the Board's Risk Committee is again one of the key components of BBVA policy on liquidity management and supervision. It encompasses such aspects as, for example, the concentration degree, the capacity for market access, the future repercussions of the business model and different qualitative elements that underpin the market situation and the perception it has of the entity.

In addition, analyses are made of stress scenarios and payment and collection flow simulations in order to assess the impact of hypothetical scenarios on both assets and liabilities and on book results. These analyses are part of the crisis situation liquidity monitoring model as outlined in the Contingency Plan, which lays down responsibilities and actions to be taken in the

**Liquidity risk. Use of BBVA's total market access limit** (Monthly average)



event of system-wide stress or that specific to liquidity.

Generally speaking, there have been no liquidity stress situations in 2005. Accordingly, the consumption of authorised limits in BBVA has been moderate, with levels averaging between 40% and 65% in the main parameters.

**Structural risk management in the equity portfolio**

The BBVA Group's exposure to structural risk in the equity portfolio stems largely from holdings in industrial and financial companies with medium/long-term investment horizons, reduced by the net short positions held in derivative instruments over the same underlying assets in order to limit the portfolio's sensitivity in the event of possible upsets in share prices or stock market indices.

Regarding the internal structural risk management of the equity portfolio, the Executive Committee sets out the risk policies for the business units and approves the maximum limits for the risk assumed in positions of this nature. The Risks area effectively monitors the levels of risk assumed, assessing it and ensuring compliance with prevailing limits and policies. Regarding discretionary positions, and in addition to stop-loss limits laid down by strategy and by portfolio, establishment is made of an early warning system for results (loss-triggers) which forestall the possible exceeding of those limits.

The internal model for measuring economic capital attributed to the Group's positions in

structural risk in the equity portfolio is based on a statistical analysis of assets, for a horizon determined by the liquidity of the positions and with the confidence level corresponding to the entity's objective rating.

The average consumption of the main economic capital limits has stood at 53% in 2005. The favourable trend in stock market prices over the year has involved a moderate increase in the sensitivity of the Group's positions in structural risk in the equity portfolio on a year-on-year basis, which has been partially offset by the divestments effected and by hands-on management through derivative instruments. The aggregate sensitivity figure for the Group's equity positions in the event of a 1% drop in share prices amounts, at year-end 2005, to €84m, with 75% concentrated in highly liquid equity in the European Union.

● **OPERATIONAL RISK**

**Management model.** BBVA is a pioneering bank in the formulation of a process management model that considers operational risk as a form of risk that is different to credit and market risk. This is reflected in the in-house definition the Group uses: operational risk applies to anything that is not credit or market risk.

This is a highly complex type of risk, due both to the causes that give rise to it and to its consequences. Unlike other credit risk, there is no admission area. In fact, all the processes that

take place in the Group have, to a greater or lesser extent, operational risk.

Given that operational risk is present in all Group processes, it is held responsible when the final outcome of a process does not turn out as planned, if this deviation cannot be attributed to credit or market risk. This definition provides a better meaning of operational risk, as long as it is located within its natural setting, namely, in processes.

In order to facilitate its management, risk needs to be identified, measured, assessed and mitigated. A set of tools has been designed accordingly to help raise awareness on it and which enable it to be gauged over time. These tools are divided into two groups: qualitative and quantitative. The former are used to identify and measure operational risk without there being a need for events to occur. On the other hand, quantitative tools measure operational risk once the events have occurred.

They all share a breakdown of risk into eight major categories:

- 1) Processes: human error, mistakes in operating procedures
- 2) External fraud: criminal activities committed by persons unrelated to the Institution
- 3) Internal fraud: criminal activities committed by Group staff and unauthorised activities
- 4) Technology: computer failures (hardware and software) or breakdowns in communications
- 5) Human resources: failures in human resources policy. Health and safety at work
- 6) Commercial practices: poor sales practices and faulted products
- 7) Disasters: damages to assets caused naturally or intentionally
- 8) Suppliers: non-fulfilment of services arranged.

Operational risk management in business and support areas is arranged through an Operational Risk Committee in each area, consisting of those people responsible for process management and with decision-making powers for changing them. Each area has someone in the position of Operational Risk Manager (*GRO*) to coordinate these tasks. Based on the information available in the

different corporate tools implemented in each unit, the Operational Risk Committee meets regularly at the request of the *GRO* and takes the necessary decisions on mitigation, bearing in mind their cost.

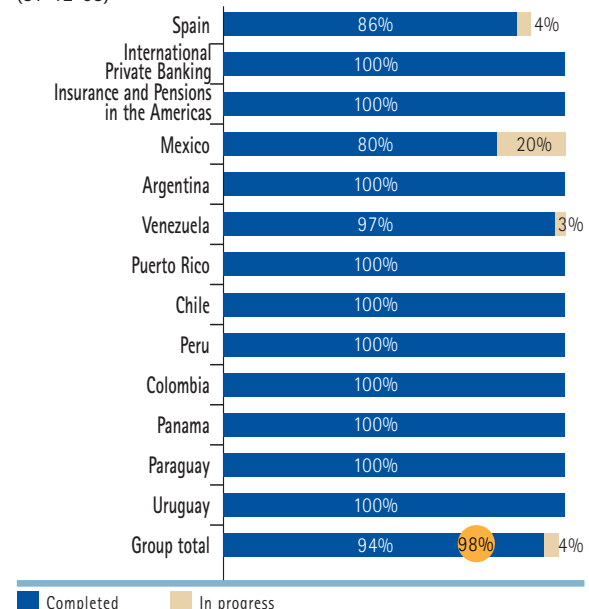
**Implementation of the tools.** In 2005, the Group has pursued a far-reaching implementation scheme with a view to completing the risk map. There follows a detail of the situation at year-end 2005:

**Ev-Ro:** This is the basic qualitative tool for the identification and valuation of operational risk factors by business or shared resources areas. The collated data are used to draw up risk maps (distribution by types of risk and support areas). This Group tool identifies risk factors that lead to losses with a bearing on the books, as well as other factors leading to profit loss, that is, the loss of future revenue.

Amongst those risk factors that have been identified so far, 20% are deemed to be high priority. These risk factors are not all different, as it is quite often the case that some of them are repeated in different areas. At year-end, the implementation degree in the Group stood at 98% (94% completed and 4% underway), as is shown in the accompanying graph.

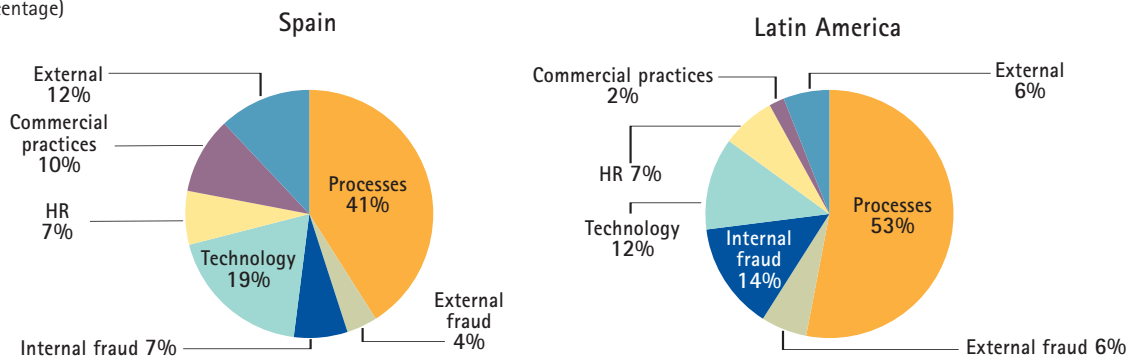
**Ev-Ro implementation degree by countries**

(31-12-05)



**Past distribution of risk assessed by types of risk**

(Percentage)



The above graph shows a display of risk factor distribution, by types of risk, in both Spain and Latin America. The quantification of operational risk factors facilitates the development and implementation of measures for mitigating each risk.

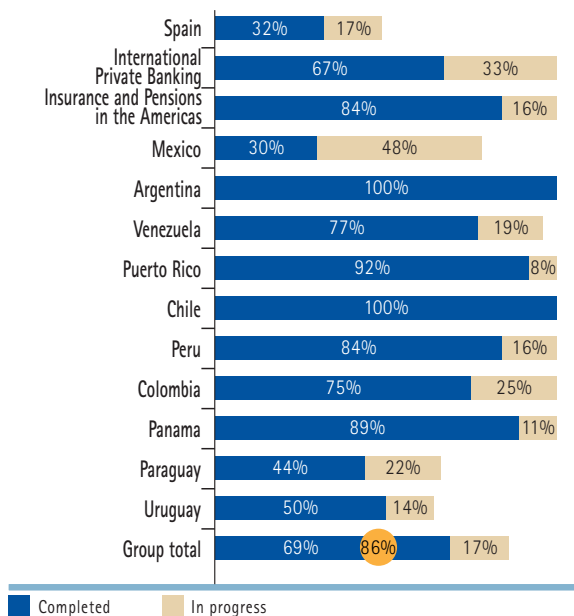
**TransVaR:** This is an operational risk management tool that uses indicators. It is a hybrid tool, as it has both qualitative and quantitative aspects. The data input takes place within the units that manage the processes by gathering basic indicators that provide data on 22 generic indicators common to the entire Group. It has been noted that the level of operational risk clearly diminishes in those

units that have implemented this tool. Its implementation degree at the end of 2005 stood at 86%, as shown in the accompanying graph.

**SIRO:** This is the key quantitative tool. It is a corporate database that, since January 2002, contains all those operational risk events that constitute a heavy loss or cost for the organisation. Events are classified by types of risk and business lines. There is a local Siro in each country that uploads its data each month into a Global Siro, where they are consolidated.

External databases are also used in the Group. Thus, BBVA is one of the founding members of the world's first database created for such purposes: Operational Risk Exchange (ORX), a non-profit organisation located in Zurich whose purpose is to disclose, on an anonymous basis, operational risk events exceeding €20,000. This information serves a dual purpose: on the one hand, it completes the data held when calculating capital and, on the other, it is used as a benchmark. ORX was set up in 2002 with 12 members, and it currently consists of 23 of the world's major banks.

**TransVaR implementation degree by countries** (31-12-05)

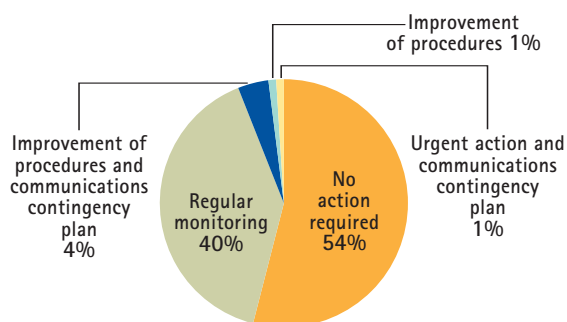


**Reputational risk.** RepTool is the tool for the qualitative management of reputational risk in the Group. Corporate reputation is an intangible asset that each company projects onto its investors, customers and employees (both current and potential), resulting in attraction, rejection or indifference. BBVA understands reputational risk to be what exposes us to uncertainty as a result of the

perception that different groups may have of our entity. The stakeholders most affected are customers, shareholders and employees. Reputational risk is a consequence of the materialisation of other kinds of risk, mainly operational risk.

The scheme for implementing RepTool has continued in 2005, and by year-end 2005 it had been completed in the following units: Global Markets and Distribution, International Private Banking, Global Corporate Banking, Products and Businesses and Special Financial Services. A total of 334 factors have been identified for reputational risks, which are circumstances that have the potential to become reputational events. RepTool classifies these risk functions in terms of the type of action required to mitigate them. The accompanying graph shows risk distribution in terms of action plan.

**Reputational risk factors by type of action**



**Basel II.** The BBVA Group has informed the Bank of Spain of its intention to rate operational risk in AMA (advanced management approaches). This is the most demanding methodology in terms of information gathering and management. Accordingly, successful completion requires a two-year transition period, beginning in January 2006. During this time, implementation is to be made of qualitative and quantitative tools, risk capital is to be calculated and the Group is to prove it has management mechanisms capable of mitigating risk, wherever this is important.

**Operational risk capital.** The first estimates have been made in 2005 for operational risk capital as per AMA models. Within the range of possible approaches, use has been made of the LDA (Loss Distribution Approach) method, which estimates the distribution of losses in accordance with the operational events an entity has to face, by adjusting accordingly two factors that, in turn, determine it: the frequency of events and their impact.

The calculations made use SIRO as their main source of information. In order to enrich the data provided by this in-house database and consider the impact of possible events not yet included in it, use has been made of the ORX external database and scenario simulation has also been included, with information provided by the Ev-Ro tool.

## ● RISK MANAGEMENT IN NON-BANKING ACTIVITIES

**Insurance.** BBVA operates in the insurance sector in different countries and with multiple products. Given that the main business of insurance companies is to provide risk coverage for third parties, risk management serves a threefold purpose:

- 1) To continuously improve risk assessment and management techniques in order to ensure that current products are increasingly competitive and, therefore, generate more value for both customers and company alike.
- 2) To permit the launch of products that cover new risks, with a joint perspective of risk control and value creation.
- 3) To introduce those controls and metrics that at all times ensure companies uphold the solvency the Group requires.

In the insurance business, and in addition to credit and market risk companies are exposed to, there are technical risks, such as those related to the performance of risks they insure for third parties. Concerning technical risks, an analysis is made of: a) mortality rates, which affect life assurance and accident insurance; b) life-expectancy rates, which affect endowment policies and annuities; c) other technical risks involving “general risks” (cars, homes, etc.).

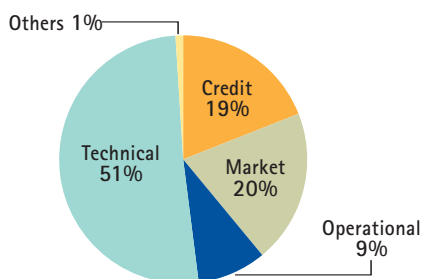
Furthermore, operational risk control is very important, as several processes coexist in the company: a) investment management, in which the business activity is akin to an asset management firm; b) customer management, due to product marketing through the Group's networks or those pertaining to its companies or third parties; c) claim management, through the treatment of events that had been previously covered by the company.

An analysis has been undertaken throughout the year of companies' core products and a review has been made of the calculation of economic capital, fine-tuning methodologies in accordance with central BBVA criteria.

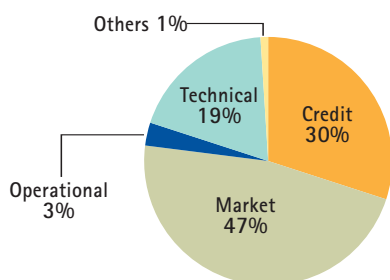
Insofar as new products, each launch involves an analysis of the embedded value and its risk-adjusted return, as well as the economic capital consumed.

Limits have likewise been laid down for credit and market risk as approved by the Group's Executive Committee and supervised by Risk units (both centrally and in each business area).

**Insurance in Europe. Economic capital distribution by type of risk**



**Insurance in the Americas. Economic capital distribution by type of risk**



**Asset Management.** BBVA is present in various facets of the asset management business: mutual funds, pension funds, UDI trusts, investment companies and discretionary portfolios.

The Group has entities dedicated to third-part asset management (trust management) in numerous countries, whose aim, in return for a fee, is to manage risks to the account of third parties with two possible investment mandates: maximise returns for an expected level of risk or optimise risk for an expected level of returns.

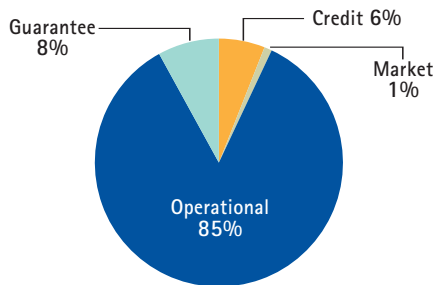
Therefore, from the perspective of risks, the duty of trusteeship undertaken with the customer involves the following: use of the finest technology available in order to assess how risk and returns are best combined for each investor profile and remit; ensure the ability to identify, measure and assess the risks assumed by the investor; identify and address possible conflicts of interest that might arise; and inform the investor in a clear manner about the risks assumed and the returns obtained.

In view of the fact that, generally speaking, here it is the customer who assumes the credit and market risks, the most important risk is the operational one, which stems from two basic sources (through selection, performance of transactions, monitoring, etc.) and customer management (through the process of calculation and assessment, information, subscriptions and reimbursements, etc.).

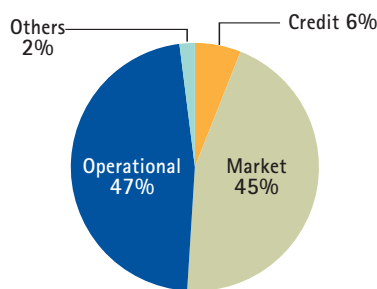
The Group is currently developing the process of adapting customers to their risk profile, as well as providing clear information on the results obtained in terms of risk and returns. The inclusion of volatility metrics, index-backed returns, value at risk, etc., have yet to become standard practice in the market, and the focus is on reporting what best suits each type of product and what the investor more readily understands.

Regarding guaranteed funds, the provision of the guarantee is assessed and monitored by the Bank, in terms of embedded options and taking into account both market and credit risk. This assessment is complemented by an admission procedure for each new guaranteed fund.

**Asset Management and Private Banking in Spain and Portugal. Economic capital distribution by type of risk**



**Pensions in the Americas. Economic capital distribution by type of risk**



Credit and market risk limits have been introduced for the investment in equity approved by the Group's Executive Committee and supervised by Risk units.

**The management model.** The Group has two aims in risk management in the Insurance and Asset Management units: a) the use of homogenous methods and processes applying a

company-wide standard; b) assessment through the risk departments in each company.

The achievement of this dual objective implies a two-tier organisation:

- 1) A dedicated Non-banking Central Risk unit in the Group, whose mission it is to provide companies with all collective experience and shared methodology in terms of risks, as well as ensure that each company undertakes the proper identification, measurement, assessment and supervision of risks. The Group, therefore, is the one to define the methods to be used in all business activities, guaranteeing homogeneity in the treatment of each type of risk and thereby enabling aggregation.
- 2) Risk units in the business areas, focusing on risk identification, measurement and assessment, applying Group methods and reporting to the Central Unit. Accordingly, they implement methods and procedures that are established for the Group as a whole and carry out all those duties required for proper risk monitoring to facilitate business development.

This arrangement allows for centralised supervision with decentralised assessment, thereby streamlining the process.

A key component in the risk management model in these areas is the New Products Committee where, convened by Risk units in the business areas, all departments adopt a multidisciplinary approach to the review and validation of the new products to be offered to customers, new assets for portfolios and new activities to be undertaken.