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**Pillar 3
Disclosures
2020**

MARCH 2021





This document is a translation from the original Pillar 3 disclosure published in Spanish. In the event of any discrepancies, the original Spanish version prevails.

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01. General information requirements



The purpose of the Pillar 3 disclosures report is to provide information for the market regarding all aspects connected with the financial situation and activity of Cecabank (hereinafter, the “bank”) and, in particular, its risk profile. This ensures compliance with Article 85 of Act 10/2014 on the regulation, supervision, and solvency of credit institutions.

In compliance with the provisions of Articles 431.3 and 434.1 and 2 of Regulation (EU) 575/2013, Cecabank has a Transparency Policy approved by the Board of Directors on 20 February 2017 which compiles the various internal policies on the external disclosure of the information required by the supervisor in different matters and which includes, among other aspects, the content of the information to be published, the frequency, medium and place of publication and the verification of the information. The aforementioned Policy establishes that Pillar 3 disclosures will be subject to the same level of verification and internal control as the data used in its financial statements and is subject to verification by the bank’s Internal Auditing. In accordance with said Transparency Policy, this document was approved by the Board of Directors of Cecabank at its meeting on 23 March 2021, at the proposal of the Risk Committee.

Article 435, paragraph 1, letter f of EU Regulation no. 575/2013 requires that the Board of Directors of credit institutions approve the description of the overall risk profile and the explanation of the comprehensive view of internal risk management, and that this is incorporated into the Pillar 3 disclosures. The approval of this document by the Board, pursuant to

the foregoing, covers this requirement, and all the information requested is found in its different sections.

The information to assess the bank’s risk, market strategy, risk control, internal organisation and solvency situation included in this report has been prepared by Cecabank in line with the provisions of Part Eight of Regulation (EU) 575/2013 and further developments thereof. In accordance with the same regulation, information on remuneration is also included.

The preparation of the Pillar 3 disclosures is based on the different verification and control processes established in each of the three lines of defence defined in Cecabank’s General Control Framework. Certain information required by the regulations in force that must be included in this report is set out, in accordance with this regulation, referring to the 2020 individual financial statements of Cecabank. Along with the annual accounts, these “Pillar 3 Disclosures” can be found at Cecabank’s website (www.cecabank.es).

The bank operates mainly in Spain and opened a branch in Lisbon when, at the end of 2020, the London branch became a representative office. There is also representative office in Frankfurt following the closure of the representative office in Paris at the end of the second quarter of 2020. Furthermore, Cecabank also has a subsidiary, Trionis, which is excluded from the prudential scope of consolidation under Article 19.1 of EU Regulation 575/2013¹. Consequently, all the information contained in this report refers to the bank at an individual level².

¹ The request sent was resolved by the Bank of Spain, stating that it had no objection to subsidiaries being excluded.

² Comparative data included in this report for 2019 also refers to the bank at an individual level.

02. Risk Management



2. Risk Management

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2.1 Policies and Objectives

The Board of Directors of Cecabank establishes the corporate objectives of the bank and has the highest responsibility regarding the risks incurred as a result in the performance of its activities. It is therefore this body that establishes the general policies with regard to the assumption of risks. Similarly, the Board is the driving force in the corporate risk culture, which focuses on guaranteeing efficient internal control systems and rigorous and complete risk management and measurement processes.

To assist the Board of Directors to fulfil its risk responsibilities regarding the maintenance of the risk profile and the implementation of the policies agreed, it has established a supporting structure and a reporting and monitoring system. This structure is described in the following sections.

The risk management philosophy is based on rigorous criteria of prudence, in a manner consistent with commercial strategy, aiming to ensure the efficient use of the capital assigned to the business units. Applying this philosophy results in a highly prudent risk profile with high levels of solvency and a comfortable liquidity position.

The Board establishes the type and intensity of risks which it deems reasonable to assume in order to achieve corporate objectives. The definition and annual updating of this risk appetite are set out in the Risk Tolerance Framework, as well as in the General Risk Management Framework, both of which are subject to approval by the Board itself. It is also the responsibility of the Board to monitor the effective risk profile and to ensure that both are consistent. It is supported in this regard by the work performed by the Risk Committee.

In order to achieve its business objectives the Board of Directors assumes that Cecabank maintains a prudent risk profile at all times; losses produced by the implementation of the risks, even in stress situations, can be withstood within the normal operations of the bank, without permanently affecting the capital and liquidity objectives.

Alongside this quantitative definition of the desired risk profile, the Board establishes tolerance levels with quantitative metrics which determine the risk appetite. These are defined as follows:

- For each relevant risk identified, the maximum losses that the bank is prepared to assume in the course of the business are established. The definition is established in terms of forward-looking measures which serve to anticipate any losses which might be registered, if the risks were to materialise, but also in

terms of the maximum losses tolerated (Annex I to this document provides greater detail as to the metrics employed). These metrics relate to the income statement and the available capital base, for the aforementioned purpose of ensuring that, in the event of losses, they can be withstood within the normal operations of the bank;

- The minimum available liquidity position must allow for ample compliance with all the bank's commitments, incorporating a safety margin to ensure that unexpected situations can be handled at any time.
- The solvency and leverage levels which the Board intends for the bank remain substantially above the regulatory requirements. This surplus of capital is considered essential to achieve the appropriate levels of quantity and quality of solvency and leverage for the wholesale business, and it represents one of the defining elements of the competitive position of Cecabank.

The principles established by the Board and which determine risk management at Cecabank are mainly as follows:

- The business and the management will focus on a stable and recurring results structure and on the conservation of economic value of equity, in order to guarantee the long-term orderly growth of the bank;
- The management will be aligned with good banking practices and the business will be conducted in a way that is ethical, fair, and respectful of the legislation in force;
- Capital planning shall be designed to cover the current capital needs and any arising with the commissioning of the Strategic Plan, taking into account the minimum solvency levels defined by the Board;
- The bank will focus its liquidity management on guaranteeing that it maintains adequate resources to comfortably meet its short- and long-term commitments, taking into account its ability to call upon the markets; diversifying the sources through which it is financed; and maintaining a high-quality unencumbered liquid-asset buffer that covers the position effect of stress-generating events; and
- The corporate governance and internal organisation, and risk admission, control and management systems shall be robust, appropriate to the activities which the bank performs and proportionate to the risks incurred.

Senior management is responsible for the effective implementation of these principles and for maintaining the desired risk profile. It is also responsible for the development of the Risk Tolerance Framework through the adoption of additional metrics and controls, thereby guaranteeing effective implementation of the policies defined.

The Board receives regular information as to the maintenance of the risk profile, and it reviews the risk management policies implemented at the bank. In addition, it is the body responsible for approving the result of the internal capital and liquidity adequacy assessment, which is submitted each year to the Supervisor. In these activities, it has the support and guidance of the Risk Committee. There is a monitoring structure which allows the Board and the Risk Committee to identify potential deviations, so as thereby to adopt the necessary measures and hence adjust the risk profile.

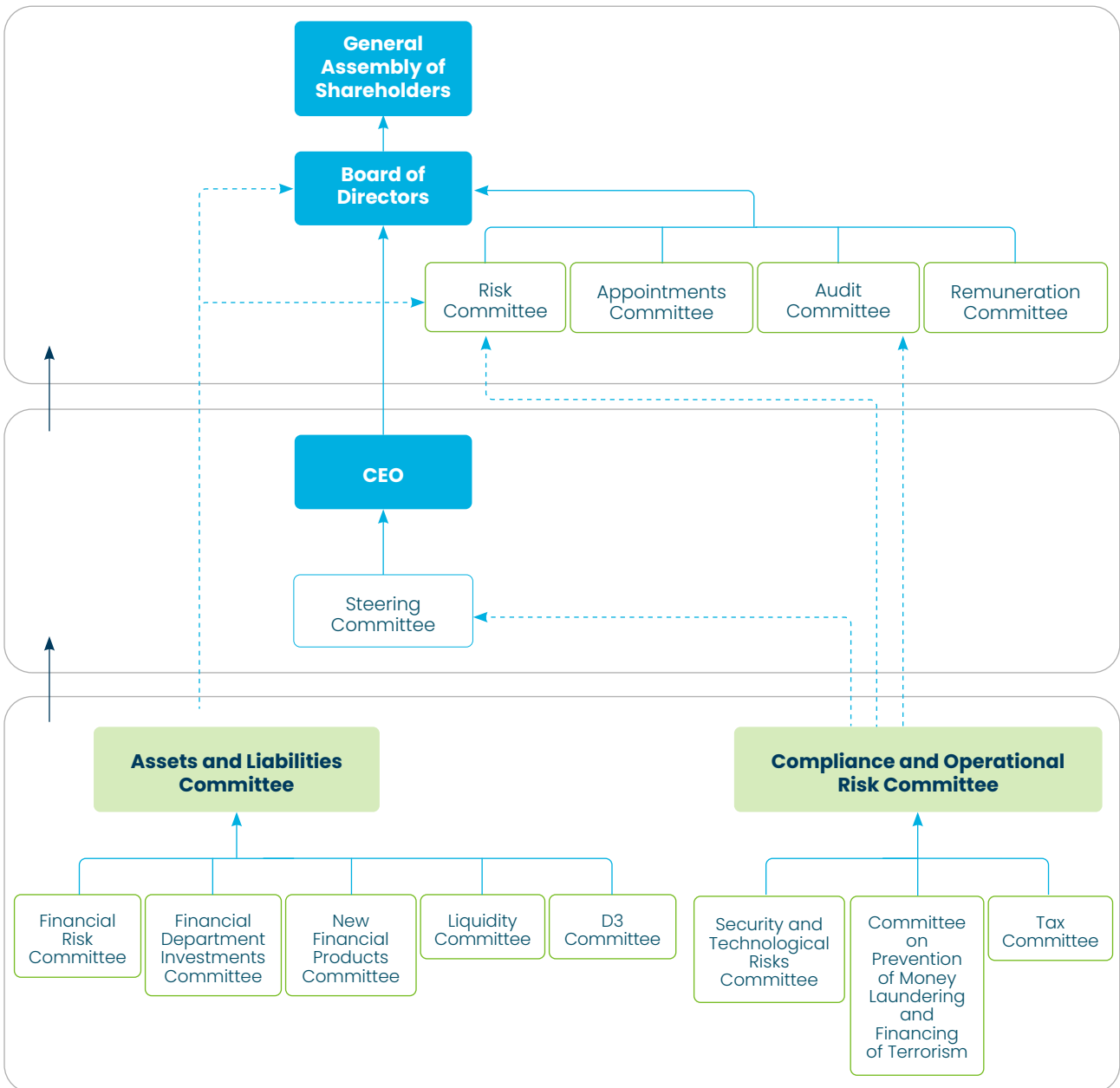
As mentioned at the beginning, this document was approved by the Board of Directors of Cecabank, which performed its review with the assistance of the Risk Committee. As a result, in accordance with the requirements of Article 435, paragraph 1, letter (f) of Regulation (EU) 575/2013, the Board guarantees that, following the analysis performed, the bank qualifies for a prudent risk profile and, therefore, within the accepted tolerance levels, its systems, processes, policies and resources employed for risk management are appropriate. Similarly, no adverse element that could modify this situation in the future is anticipated.

Annex I to this document includes detailed information on Cecabank's risk management, in addition to the specific policies and objectives applied when managing the relevant risks.

2.2 Structure and organisation of the risk management function

The governing bodies of Cecabank are the General Shareholders' Meeting and the Board of Directors, in addition to the specialised committees and delegated bodies designated by the Board. From the perspective of the definition of tolerance to risk, the monitoring of

the implementation of management policies and the monitoring of risk profiles, Cecabank has established a supporting structure and a reporting system as described in the following organisational chart:



- > Hierarchical dependence
- - -> Line of reporting

2.2.1 Responsibilities of the governing bodies

The Board of Directors of Cecabank establishes the bank's business objectives and is the maximum authority responsible for the risks it assumes when carrying out its activities. It is therefore this body which establishes the risk appetite and general policies with regard to the assumption of risks. Similarly, the Board is the driving force in the corporate risk culture, which focuses on guaranteeing efficient internal control systems and rigorous and complete risk management and measurement processes.

The Board of Directors of Cecabank comprises the number of members designated in the General Shareholders' Meeting, which cannot be less than 5 or more than 15. At its meeting held on 26 March 2019, the General Shareholders' Meeting reduced and set the number of directors at twelve (12). Based on the foregoing, at 31 December 2020, the Board has not undergone any changes and contains 12 directors, 7 of which are proprietary directors, 4 independent directors and one executive director. The position of executive director is held by the company's CEO.

This body meets on a monthly basis, having held 12 meetings in 2020.

The committees of the Board of Directors of Cecabank assist it in performing its responsibilities. All details regarding the composition, functions, and operation of these can be found in the Company's bylaws and in its operating regulations, which are available in "corporate information" section of the Cecabank website. Specifically, with regard to risks, these bodies undertake the following activities:

- **Audit Committee:** This Committee supervises and assesses the effectiveness of the internal control structure of the bank, internal auditing and risk management systems; it also oversees the process for preparing and submitting regulated financial information. The Audit Committee held 6 meetings in 2020.
- **Risk Committee:** This Committee advises the Board as to the establishment and monitoring of the risk appetite of the bank, and it evaluates the application of this strategy by senior management and the results thereof. The Risk Committee held 5 meetings in 2020.
- **Remuneration Committee:** This body advises the Board with regard to the bank's remuneration policies and the alignment thereof with the maintenance of risk tolerance levels. The Remuneration Committee met on 2 occasions in 2020.
- **Appointments Committee:** This Committee advises the Board in relation to candidates for vacant

positions on the Board of Directors and compliance with the suitability requirements for the Board's members. The Appointments Committee held 3 meetings in 2020.

To assist the Cecabank Board of Directors to fulfil its risk responsibilities regarding the maintenance of the risk profile and the implementation of the policies agreed, it has established a reporting and monitoring system.

The main objective of this supervisory exercise is to keep the Board abreast, directly and through its supporting bodies, of compliance with the tolerance limits of the evolution of the metrics supporting them; to prospectively identify any source that could result in an infringement of the limits and to raise the alarm in the case of any stress situations; and to enable corrective actions to be taken, when appropriate.

To this end, during 2020, the Risk Committee, with the support of the Risk Department and the Global Risk Control Unit, developed the outline and contents of the reporting received from internal units and that which is sent to the Board. This information includes a scorecard that integrates the main evolutionary indicators relating to risks and capital and monitors the operating results and the annual budget.

Furthermore, the Board and its committees have unrestricted access to the personnel involved in the risk, planning, audit, control and regulatory compliance functions.

2.2.2 Policies regarding the selection of board members and diversity of the Board of Directors

In accordance with regulations applicable to credit institutions, the bank has a policy for selecting directors which considers different diversity criteria and, in particular, has a representation target established for the least represented sex on the Board of Directors.

2.2.2.1 Selection and Suitability Assessment Policy

At its meeting in November 2018, the Board of Directors approved, at the proposal of the Appointments Committee, the Suitability Policy for selecting and evaluating members of the Board of Directors, the CEO or similar members of Cecabank.

The approval of this Suitability Policy came as a result of the entry into force of the EBA-ESMA Guidelines on the assessment of suitability of members of the Board of Directors and key function holders, published in September 2017, and as a result of Cecabank's revision and adaptation of the Suitability Policy that it had in effect since June 2013.

Under this Policy, Cecabank's Board of Directors must be made up of persons whose appointment favours or promotes the good governance of the bank and who, in any case, meet the suitability requirements established by the applicable regulations at any given time as regards the performance of their duties. These requirements relating to their knowledge, honesty and ability to exercise good governance must be assessed, both individually and for the Board of Directors as a whole, applying the principle of proportionality.

Cecabank encourages diversity in the Board of Directors in such a way that its composition reflects a diverse group, taking into account the structure of the CECA - Cecabank group, in which CECA is the majority shareholder. In accordance with the provisions of the Board's Suitability Policy as regards gender diversity, the bank has established a gender diversity target for its Board of Directors whereby at least 50% of the independent directors are female. At 31 December 2020, 75% of independent directors were women. When calculating this percentage, in the event the number of independent directors is uneven, it will be rounded up to the next whole number.

Furthermore, the representation of women on the Board of Directors will be subject to an upward trend, with the ultimate objective being to reach an equal balance of men and women on the Board. In order to reach this objective, when vacancies arise on the Board and its different Committees, the foregoing shall be taken into account.

Regarding the suitability of the members of the steering committee, those responsible for internal control functions and other key positions, the Board of Directors of Cecabank, at its meeting on 30 April 2019, called by the Appointments Committee, approved the Suitability Policy for specific Directors, therefore rendering the Suitability Policy of June 2013 invalid in its entirety.

2.2.3 Supporting structure for the Board of Directors

In addition to the Board and its Commissions as described above, the following committees in which Senior Management is involved also play a key role in governance, policy design and risk monitoring:

Assets and Liabilities Committee (ALCO)

By appointment of the Board of Directors, this is the bank's body responsible for upholding senior management's participation in monitoring and controlling the financial risks and developing and implementing risk policies that ensure the established risk profile is maintained. The ALCO regularly reports to

the Board of Directors on the bank's investments and the performance thereof, and on operations it has authorised on the basis of the powers delegated to it.

The ALCO has the following structure of support committees:

- **Financial Risk Committee.** Decides on proposed operations and credit risk limits that fall within powers delegated to it by the ALCO and submits to the ALCO those operations that exceed its authorisation limits. Ensures that the bank's exposure to risk is within the tolerance levels set by the Board of Directors and the ALCO. Continuously adapts risk management procedures to the increasing sophistication of the financial market and aligns them with capital requirements at each moment in time; as well as assessment methodologies to ensure they are in line with best market practice and the needs of the bank.
- **Financial Department Investments Committee.** This department runs the ordinary management of the Financial Department, especially the Trading Division's activity, in accordance with the policies approved by the Board of Directors and the guidelines issued by the ALCO, raising the information needed to make decisions.
- **New Financial Products Committee.** It assesses and approves, as required, new financial products to be used by the bank's Trading Room.
- **Liquidity Committee.** It evaluates the liquidity situation of the bank and the markets, and, in the event of a liquidity crisis, it defines the measures to be taken and coordinates actions.

Compliance and Operational Risk Committee (CORC)

This is bank's body that upholds senior management's participation in the development and implementation of risk policies and in the management, monitoring and control of non-financial risks (operational and reputational risks). The functions it has been delegated are covered in its Regulations.

To carry out its tasks, this committee has a support structure in place to which to delegate part of its powers:

- **Committee on Prevention of Money Laundering and Financing of Terrorism.** This is the internal control body responsible for applying Cecabank's policies and procedures on PMLFT and, in general, those set out in this PMLFT manual.
- **Tax Committee.** Collaborates in the analysis and interpretation of tax rules that are applicable to Cecabank's activity, to the monitoring of compliance with formal obligations and to the investigation, evaluation, and monitoring of possible tax risks.

- Security and Technological Risks Committee.** Its functions are to establish the initiatives considered appropriate for the proper management of technological risks (logical and physical security risk, outsourcing risk, change risk, data integrity risk and continuity and contingency risk). This Committee aims to monitor all the company projects used to improve the technological service in business processes, or support already existing process, or to provide coverage for new lines of activity.

2.2.4 Risk management departments

Article 38 of Act 10/2014 stipulates that credit institutions must have a unit that assumes the role of risk management in proportion to the nature, scale, and complexity of its activities.

Underpinned by the principles described in section 2.1 on risk management policies and objectives, the structure of the risk function of Cecabank is set up to comply with these requirements. They include its independence with respect to the business units; holding a relevant status, undertaking limited participation in decision-making processes; and having free access to the Board of Directors, with sufficient resources to do so.

This section gives an overview of the structure of the bank’s risk function which, along with the description of the procedures included in Annex I, demonstrates that Cecabank complies with the aforementioned requirements enacted by Royal Decree 84/2015 and the Bank of Spain Circular 2/2016, as well as the Corporate Governance guidelines of the European Banking Authority.

In the first quarter of 2021, the company initiated a process of organisational restructuring with the aim of grouping all the second-level risk control departments under a single division to create the Risk and Compliance Area. This Area acts as a secondary control, whereby the Risk Area, the Control and Compliance Division (which in turn encompasses the departments of Regulatory Compliance, Internal Control and Operational Risk and Information Security and Technology Risks) and the Global Risk Control Unit becoming part thereof, thus extending its status as a second-level control area to both financial and non-financial risks.

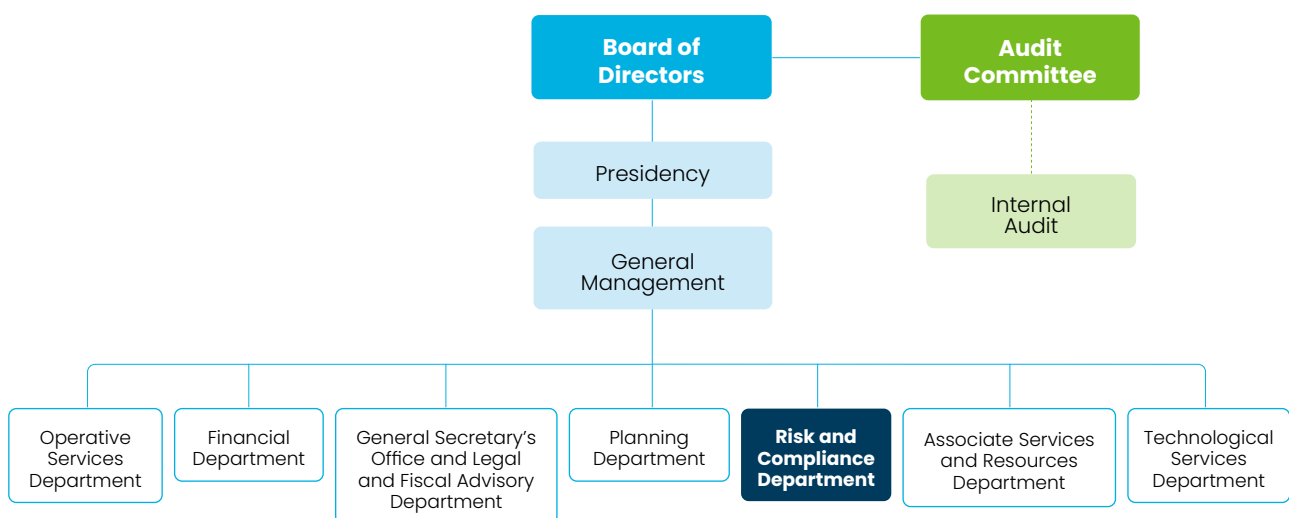
This organisational change, which will be completed throughout the year, will bring about modifications to the current structure of the different risk management areas. The information in this document therefore refers to the structure in 2020.

2.2.4.1 Risk Department

In 2020, the Risk Department was responsible for ensuring that the risk strategy is effectively implemented through the development of policies, procedures, controls and systems which are appropriate and understood by the business areas assuming risks.

The Department is independent of the business areas, in both functional and hierarchical terms. Its manager reports directly to the CEO and is actively involved in the Steering Committee, the Assets and Liabilities Committee and the Compliance and Operational Risk Committee.

Its position within the organisation has been established with the aim of ensuring the independence and autonomy required so as to guarantee compliance with the objectives set.



Specifically, the Risk Department was responsible for the identification, measurement and control of credit risk, market risk and structural balance sheet risks (ALM). It was also responsible for reviewing that the exposure to each of the risks lies within the tolerance limits established by the Board and the Assets and Liabilities Committee, both at an individual level and overall.

The Department was responsible for developing measurement methodologies for all financial risks, and it was involved in their implementation in the control tools in order to ensure that they are permanently updated, aligned with good market practices and are appropriate for the complexity and levels of the risk incurred. Proposals for methodological improvement or modification are approved by the Assets and Liabilities Committee at the proposal of the Financial Risk Committee.

The Department is structured as follows:

- **The Market, Balance and Liquidity Risk Division:** The division responsible for managing and controlling market risk and structural balance sheet risk, and also for monitoring the management results of the Trading Room.
- **Risk Analysis and Control Division:** Responsible for analysing and controlling the credit risk associated with the activities of the various business units. This analysis is the basis for the adoption of decisions at the Financial Risk Committee and the Assets and Liabilities Committee.
- **Pricing and Methodological Control Division:** The division responsible for the valuations and prices used in risk management, accounting, and custody activities, among others, and the extension of the standardisation thereof.

2.2.4.2 Operational Risk Unit

Its key function is to plan, organise and implement the operational risk management system in the bank in accordance with the approved policies and procedures and to ensure that the first line of defence identifies, evaluates, measures, controls, manages and communicates all operational risks as needed.

Its key objective is to align the “operational risk profile” of the bank with the guidelines established by the Board of Directors within the Risk Tolerance Framework.

In order to guarantee its functional independence, in 2020, the Operational Risk Unit formed part of the Associate Services, Control and Resources Department, which is responsible for the bank’s secondary control structure, and, within this, in the Control and Compliance Division.

2.2.4.3 Information Security and Technological Risks

This is the secondary control unit in the field of information and communications technology (ICT) risks. In accordance with the guidelines of the European Banking Authority (EBA) detailed in its document EBA/GL/2017/05, entitled “Guidelines on ICT Risk Assessment under the Supervisory Review and Evaluation process (SREP)”, the unit specifically accounts for security, continuity and data integrity risks, change risk and outsourcing risk, although the latter is analysed jointly with the Operational Risk Unit.

ICT risks are reported to the Compliance and Operational Risk Committee by the Head of the Security and Technological Risks Committee.

2.2.4.4 Regulatory Compliance Department

Its main aim is to ensure efficient management of compliance risk, which is defined as the risk that breaches of legal demands or internal standards could impact on the income statement, either directly, as a result of official sanctions or adverse judgments, or indirectly through a negative impact on the bank’s reputation.

Its main spheres of action are the prevention of money laundering, standards of conduct on the Securities Market (RIC and MiFID), personal data protection, corporate governance, reputational risk, and criminal risk.

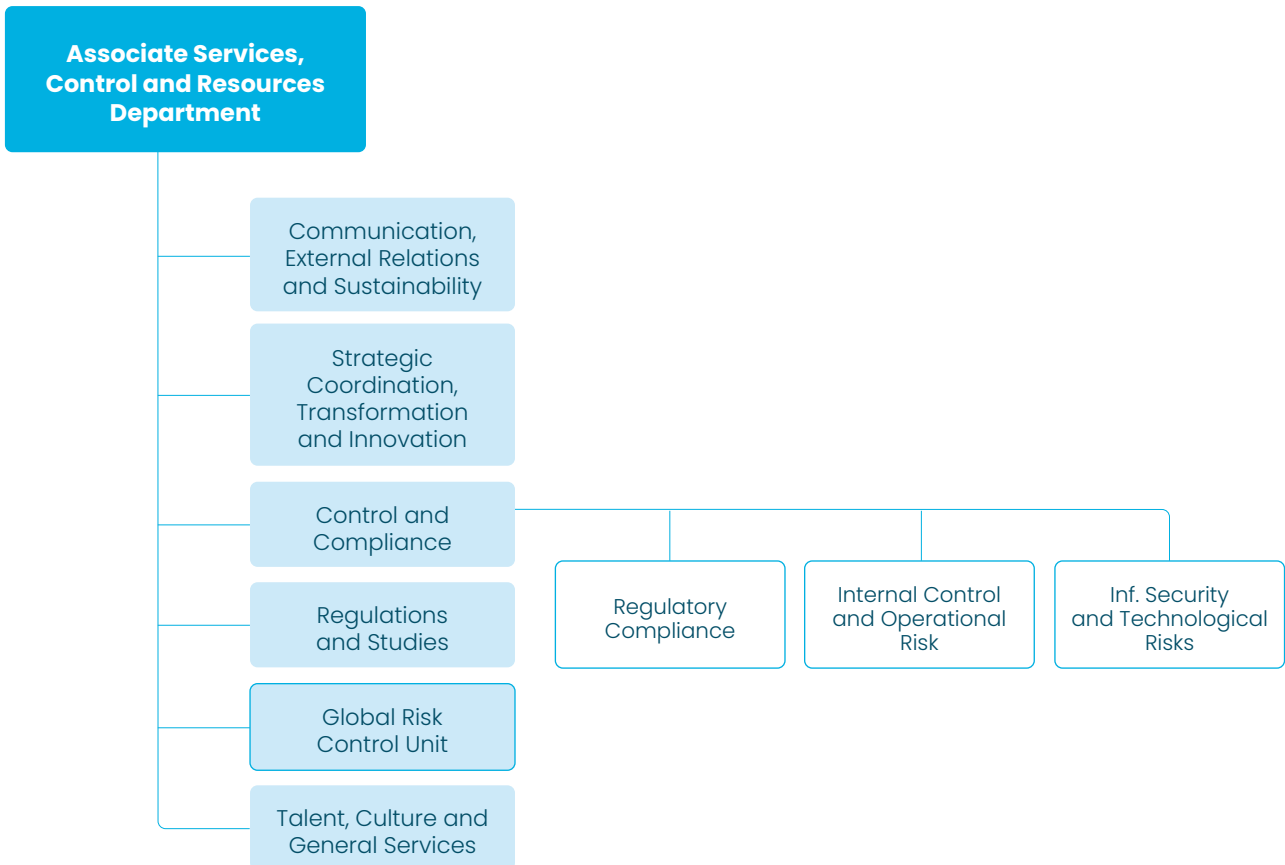
2.2.4.5 Global Risk Control Unit

As it is a second-level control unit, the functions of the GRCU are aimed at guaranteeing proper implementation in the bank’s control framework. This management framework includes policies, procedures, limits and risk controls that ensure the identification, measurement or assessment, monitoring, management, mitigation and notification of the appropriate, timely and continuous risks in the business lines and in the bank.

Likewise, it provides consultancy when defining policies and procedures in proposals for improvements in primary risk control and actively participates in the assessment of the impact that changes in internal control systems could have on the bank. It is also responsible for coordinating different legally required documents when requested by supervisors and the market, specifically the Internal Capital and Liquidity Assessment Report, the Pillar 3 Report, and the Recovery Plan, and for sending information regarding the Resolution Plan.

With regard to reporting to governing bodies, the GRCU offered support to the Board of Directors when developing supervisory functions for risk management and internal control, channelling this activity through the Risk Committee.

The following diagram shows the situation of the Operational Risk Unit, the Information Security and Technological Risks Department, the Regulatory Compliance Department and the Global Risk Control Unit, within the organisation during 2020:



2.2.5 Internal Audit of Risks

Internal Audit is the third line of defence of risk control. One of the general aims of the analysis carried out by this independent team is to verify that the risks the bank is taking on fall within the risk appetite agreed by the Board of Directors.

Internal Audit is located within the organisational structure, and functionally reports to the Audit Committee on a monthly basis through its Chairman. This ensures its independence in the undertaking of its functions, for which it has unrestricted access to all the areas, departments and employees, assets, physical or computer activity records and, in general, all repositories holding physical or digital documentation that are necessary to carry out its activity.

In general, in its area of work, Internal Audit will perform the following functions:

- Communicate and keep the Audit Committee informed of the results of all audit activities.
- Provide an independent and objective assessment of the company's corporate governance system, risks and controls.
- Analyse the reliability, effectiveness and integrity of the information and process management systems (audit of the technological environment and risk applications).
- Monitor compliance with the current regulations, including the requirements stipulated by the supervisor.
- Monitor second-level control units, including Standards Compliance, the Operational Risk Unit, Internal Control, and the Global Risk Control Unit.

- Analyse the accuracy and reliability of risk reports, computer and accounting records and financial reports.
- Analyse the accuracy and reliability of the bank's systems used to assess capital needs in relation to its risk calculation.
- Verify the maintenance of risk levels within those approved by the bank.
- Assess the effectiveness and efficiency of operations.
- Analyse the accuracy and validity of the different risk assessment models established in the bank (credit, market, operational, etc.).
- Assess the accuracy and timely delivery of regulatory information (IACL, IRP, COREP, etc.).
- Verify the implementation of all the corrective measures recommended in the audit reports.
- Verify the proper safeguarding of the bank's assets.
- Carry out, at the proposal of Senior Management or the Audit Committee, consultancy work aimed at adding value and/or increasing the efficiency and effectiveness of operations.

Internal Audit publishes reports including an assessment of the work carried out in these fields, as well as recommendations they consider necessary to resolve any identified incidents and an expected resolution date. Similarly, Internal Audit carries out ongoing monitoring of the recommendations, with the aim of checking that they have been properly implemented.

03. Solvency Position

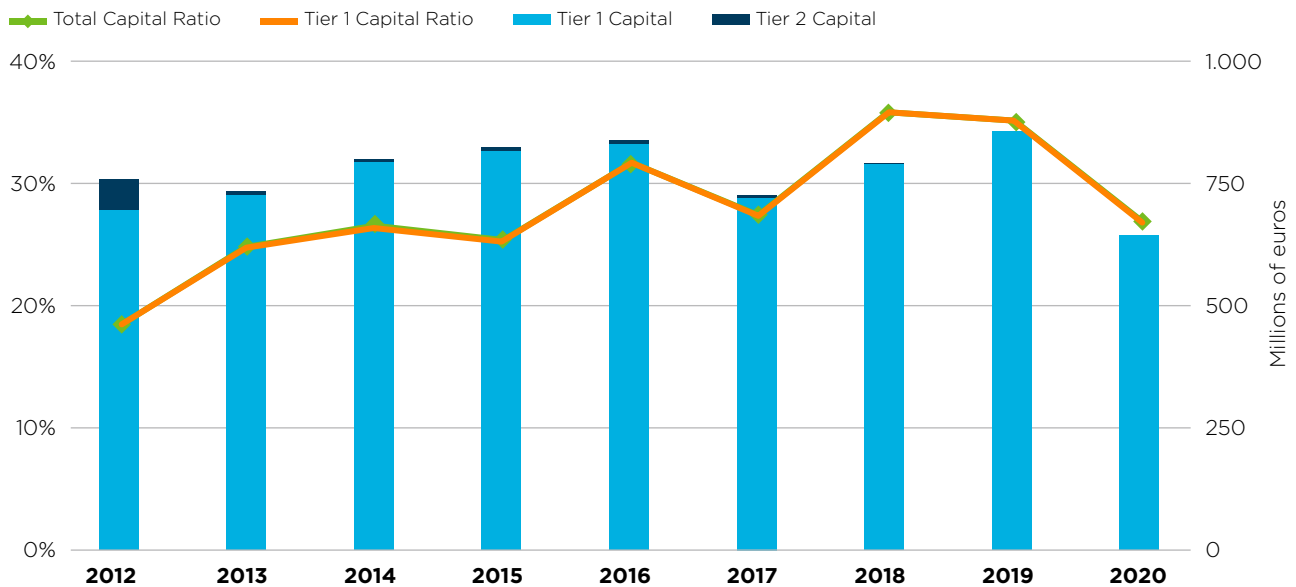


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At the close of 2020, the solvency ratio³ of Cecabank was 26.61%, fully comprised of Common Equity Tier 1 capital (CET1), i.e. the CET1 solvency ratio was also 26.61%. The main factor that has affected the evolution of these ratios has been the increase in the intangible asset resulting from the acquisition of new businesses related to securities services operations carried out during the year. The gradual amortisation of this intangible asset, together with the profit capitalisation policy applied at the bank, will allow

the bank to continue this ratio growth trend in the coming years.

In this regard, a key factor for management is keeping a sound capital structure in terms of quantity and quality. As a result, and as reflected in the graph, in recent years, the Tier 1 capital base has been progressively strengthened through the capitalisation of profits which, together with upholding low risk levels, has enabled the company to maintain elevated capital ratios over time.



In 2020, the Cecabank Board maintained the minimum capital ratio at 4 percentage points above regulatory capital requirements (sum of Pillar 1 and Pillar 2, known as the TSCR), i.e. 13.7%. This ratio is established in terms of Common Equity Tier 1 capital. In addition, the Risk Tolerance Framework establishes a margin of leeway for this ratio above which the bank must operate under normal circumstances. Both levels are amply surpassed at present.

This comfortable solvency situation allows Cecabank to cover current and future capital requirements, and those deriving from additional risks considered when self-assessing capital, that are not included in Basel Pillar 1 requirements.

On 18 December 2020, the Bank of Spain informed Cecabank, S.A. that, as part of the supervisory review and taking into account the provisions of the EBA/GL/2020/10 Guidelines on the pragmatic approach of the Supervisory Review Process (PRS) for 2020 as a result of the COVID-19 crisis, which the Bank of Spain

adopted as its own on 21 September 2020, the additional capital requirements required in the previous PRS cycle remain unchanged. This means that the bank must maintain a CET1 solvency ratio of 9.73%. At the end of the financial year, the own funds classified as CET1 covered this requirement with an excess of 170%.

Cecabank is also subject to a “capital conservation buffer” of 2.5% of CET1 for 2021. At the close of 2020, the exposures held by the bank do not entail any additional requirements for the “bank-specific countercyclical capital buffer”. Taking into account the combined requirements of the buffer, along with the Bank of Spain’s decision on capital mentioned in the previous paragraph, the excess of capital, on top of the actual requirement, stands at 115% at the close of the year.

The result of the internal evaluation of capital requirements is in agreement with the supervisor’s assessment and, as a result, the levels of coverage of these requirements are similar.

³ Unlike 2019, own funds at 2020 year-end reflect the year’s results that the Board of Directors agreed to withhold as reserves for an amount of €49.5 million.

3.1 Eligible capital

The total eligible capital at 31 December 2020 stands at €644.6 million, all of which is Common Equity Tier 1 capital.

The characteristics of the eligible capital and their composition are set out below.

3.1.1 Tier 1 capital

For the purposes of the calculation of minimum capital requirements, Tier 1 capital is understood as the elements defined as such, taking into consideration the corresponding deductions, in Part Two, Title I, Chapters 1, 2 and 3 of Regulation (EU) N° 575/2013.

Common Equity Tier 1 capital components are characterised as equity that can be immediately used without restriction in order to cover risks or losses as soon as they occur, being recorded for their amount free of any foreseeable tax at the time of calculation.

The Common Equity Tier 1 capital of the bank at 31 December 2020 amounts to €644.6 million, predominantly consisting of paid-up equity instruments, the share issue premium and retained earnings. The amounts corresponding to intangible assets incorporated within equity have been deducted from this.

As in previous financial years, a reduction in Common Equity Tier 1 capital is carried out due to prudential filters - the result of the application of Commission Delegated Regulation (EU) 2016/101, of 26 October 2015,

with regard to regulatory technical standards for prudent valuation. This completes Regulation (EU) no. 575/2013 and establishes requirements regarding prudent reductions of the value of positions on the investment portfolio, to a fair value. Cecabank calculated a reduction using a simple approach which as at 31 December 2020 resulted in a Tier 1 Capital reduction of €5.6 million.

Additionally, in 2020, Cecabank adhered to Regulation (EU) 2020/873 (COVID or “quick-fix” Regulation) which amends the CRR and CRRII with respect to Article 468, establishing a new transitional timetable to remove—from the calculation of eligible capital—the amount of accumulated unrealised gains and losses as of 31 December 2019, accounted for as “changes in fair value with impact on other comprehensive income” of sovereign debt instruments. The application of this prudential filter, due to the general recovery of portfolios, reduced equity in December 2020, as the accumulated amount of the affected operations during 2020 results in capital gains of €9.8 million, which are deducted from shareholders’ equity.

The following table gives a breakdown of the eligible capital of Cecabank at 31 December 2020.

For 2020, the calculation is shown using the prudential filter of the COVID Regulation in the phase-in column and the amount of eligible capital that would be available at the end of the transitional calendar in the fully-loaded column.

Item	Amount 2020 (phase-in)	Amount 2020 (fully-loaded)	Amount 2019
Tier 1 capital	644,600	654,420	889,032
Common Equity Tier 1 capital	644,600	654,420	889,032
Equity instruments eligible as Common Equity Tier 1 capital	727,750	727,750	727,750
Paid-up equity instruments	112,257	112,257	112,257
Share premium	615,493	615,493	615,493
Accumulated earnings*	388,891	388,891	339,382
Retained earnings from previous years	339,382	339,382	309,108
Eligible profit	49,509	49,509	30,274
Accumulated other comprehensive income	24,310	24,310	19,049
Other reserves (IFRS9)	14,796	14,796	5,592
Common Equity Tier 1 capital reductions due to prudential filters	-5,617	-5,617	-5,134
Other intangible assets (-)	-491,594	-491,594	-195,334
Pension fund assets with defined benefits	-4,116	-4,116	-2,273
Surplus of the elements deducted from additional Tier 1 capital with regard to additional Tier 1 capital (-)	-	-	-
Other transitional adjustments of the Common Equity Tier 1 capital (-) **	-9,820	-	-

Thousands of euros

* Including in the equity figure (Common Equity Tier 1) 67% of the result for the year 2019 applicable to reserves that is not included in the figure reported to Bank of Spain as of 31 December 2019.

** For 2020, the phase-in calculation incorporates accumulated unrealised gains and losses at 31 December 2019 accounted for as "changes in fair value with impact on other comprehensive income" of sovereign debt instruments.

Annex IV includes a conciliation of the own fund items with the audited financial statements.

3.1.2 Tier 2 Capital

Tier 2 capital is understood as the factors defined in Part Two, Title I, Chapter 4 of Regulation (EU) No.

575/2013, with the limits and deductions established in this chapter. These own funds, although they comply with the definition of equity established in the regulations in force, are characterised by having, in principle, greater volatility and a lower degree of permanence than those elements classified as Tier 1 capital. At 31 December 2020, the bank holds no Tier 2 capital.

3.2 Minimum capital requirements

The Pillar 1 capital requirements of Cecabank at 2020 year-end amount to €193.7 million. The distribution by risk is as follows:

Item	2020	2019
Credit Risk requirements	103,587	96,064
Of which counterparty risk	25,846	19,032
Of which securitisation risk	3,560	2,095
Market Risk requirements	48,478	56,035
Of which position risk of the trading book fixed-income portfolio	45,392	51,164
Of which position risk of the trading book equity portfolio	1,926	2,060
Of which exchange rate risk	1,160	2,811
Operational Risk requirements	37,951	39,022
CVA requirements	3,767	4,065
TOTAL PILLAR 1 REQUIREMENTS	193,783	195,186

Thousands of euros

The eligible Common Equity Tier 1 own funds cover these Pillar 1 capital requirements with a surplus of 232.64% over the requirement itself.

3.2.1 Minimum capital requirements for credit risk and counterparty risk

The following table shows the amount of the minimum capital requirements for credit risk and counterparty risk at 31 December 2020. This also includes information

on exposure, the effects of technical mitigation and risk-weighted assets.

Risk Category	Net Exposure*		Value of the Exposure **		RWAs***		
	On-balance-sheet exposures	Off-balance-sheet exposures	On-balance-sheet exposures	Off-balance-sheet exposures	RWAs	RWA Density ****	Capital requirm.
Central administrations or central banks	7,280,851	-	7,280,851	-	228,568	3%	18,285
Regional administrations and local authorities	663,059	64,940	663,059	24,970	-	0%	-
Public sector entities and other non-profit public institutions	21,557	400,000	21,557	200,000	10,779	5%	862
Institutions	1,264,873	86,815	1,222,576	15,546	402,662	33%	32,213
Corporates	699,647	94,224	699,647	43,017	524,472	71%	41,958
Retail	6,613	2,740	6,613	1,340	5,965	75%	477
Exposures secured by mortgages on immovable property	39,084	-	39,084	-	13,679	35%	1,094
Exposures in default	1,058	-	1,058	-	1,135	107%	91
Equity exposures	2,951	-	2,951	-	2,951	100%	236
Other exposures	198,401	-	198,401	-	60,126	30%	4,811
Securitisation exposures	47,813	196	47,813	-	44,499	93%	3,560
Total	10,225,907	648,915	10,183,610	284,873	1,294,836	12%	103,587

Thousands of euros

* Net exposure of corrections and provisions.

** Fully adjusted exposure value following application of credit-risk mitigation techniques and following the adjustment of exposure corresponding to conversion-factor memorandum account entries.

*** Risk-weighted assets.

**** Density of risk-weighted assets: RWAs / Value of exposure.

The distribution of the fully-adjusted exposure according to the corresponding risk weight is shown in the following table:

Risk Category	Exposure classified by the applied risk weight, according to the degree of credit quality of each exposure										Total
	0%	2%	20%	35%	50%	75%	100%	150%	250%	Other	
Central administrations or central banks	7,018,538	-	-	-	202,472	-	14,847	-	44,994	-	7,280,851
Regional administrations and local authorities	688,029	-	-	-	-	-	-	-	-	-	688,029
Public sector entities and other non-profit public institutions	200,000	-	-	-	21,557	-	-	-	-	-	221,557
Institutions	-	59,220	717,108	-	407,476	-	54,318	-	-	-	1,238,122
Corporates	-	204,056	1,183	-	43,454	-	485,059	8,913	-	-	742,665
Retail	-	-	-	-	-	7,953	-	-	-	-	7,953
Exposures secured by mortgages on immovable property	-	-	-	39,084	-	-	-	-	-	-	39,084
Exposures in default	-	-	-	-	-	-	904	153	-	-	1,057
Equity exposures	-	-	-	-	-	-	2,951	-	-	-	2,951
Other exposures	122,057	-	-	-	-	-	54,994	-	-	21,350	198,401
Securitisation exposures	-	-	-	-	-	-	-	-	-	47,813	47,813
Total	8,028,624	263,276	718,291	39,084	674,959	7,953	613,073	9,066	44,994	69,163	10,468,483

Thousands of euros

The comparison of risk-weighted assets and consumption by credit risk and counterparty risk with respect to the previous year are shown below:

Risk Category	2020		2019	
	RWAs	Capital requir.	RWAs	Capital requir.
Central administrations or central banks				
Regional administrations and local authorities	-	-	-	-
Public sector entities and other non-profit public institutions	10,779	862	5,334	427
Institutions	402,662	32,213	389,490	31,159
Corporates	524,472	41,958	450,132	36,011
Retail	5,965	477	6,581	526
Exposures secured by mortgages on immovable property	13,679	1,094	13,934	1,115
Exposures in default	1,135	91	1,600	128
Exposure to institutions and corporates with a short-term credit assessment	-	-	5	-
Equity exposures	2,951	236	14,582	1,166
Other exposures	60,126	4,811	55,629	4,451
Securitisation exposures	44,499	3,560	26,191	2,095
Total	1,294,836	103,587	1,200,807	96,064

Thousands of euros

3.2.2 Capital requirements for trading book price risk

The table below shows the requirements for price risk of positions held in the bank's trading book at 31 December 2020, based on the method applied in its calculation:

Method applied	Capital requirement
Position risk of debt instruments in the trading book calculated in accordance with the terms of Part Three, Title IV, Chapter 2, Section 2 of Regulation (EU) No. 575/2013	45,392
General risk (*)	38,210
Specific risk:	7,182
Position risk in equity instruments calculated in accordance with Part Three, Title IV, Chapter 2, Section 3 of Regulation (EU) No. 575/2013	1,926
Total capital requirements for trading book price risk	47,318

Thousands of euros

(*) Calculated by applying the "maturity-based" method.

3.2.3 Minimum capital requirements for exchange rate risk and gold position risk

The table below shows the amount of the bank's capital requirements at 31 December 2020 for exchange rate risk and gold position risk. The calculation was performed in accordance with the standard method, as defined in Part Three, Title IV, Chapter 3 of Regulation (EU) no. 575/2013.

Capital requirements for exchange rate risk and gold position risk	1,160
Thousands of euros	

3.2.4 Capital requirements for operational risk

The table below shows the amount of capital requirements for operational risk at 31 December 2020. The calculation was performed with the standard method, as defined in Part Three, Title III, Chapter 3 of Regulation (EU) No. 575/2013.

Capital requirements for operational risk	37,951
Thousands of euros	

3.2.5 Procedures applied in order to assess internal capital adequacy

The Cecabank Group has implemented an internal assessment process which comprises a quantitative and qualitative assessment of its internal governance structure, its systems of identification, measurement and aggregation of risks incurred in the pursuit of its activities and the control environment. The fundamental aim of this review is to assess the adequacy of the available capital, taking into consideration the control framework and risk management, the economic environment and its strategic business plan.

The procedure also serves to ensure that risks lie within the limits which the Board and senior management establish in order to define the risk profile.

This procedure is aligned with the "Guidelines on Internal Capital Adequacy Assessment Process" (hereinafter ICAAP Guidelines) published by the Bank of Spain, providing the basis for drafting the "Internal Capital and Liquidity Assessment Report" (hereinafter, the ICLAR), which is presented each year to the supervisory authority.

For the purposes of this Report, it was decided to generally employ the simplified options proposed by the supervisor in the aforementioned ICAAP Guidelines, which generate prudent additional capital requirements and facilitate the supervisory review process. Nonetheless, the bank has complemented those additional needs for the case of operational risk and concentration risk. In such cases, the application of a more rigorous model that is aligned with the business of the bank produces more demanding capital needs than those defined by the supervisor.

Following this process of internal analysis, the conclusion reached regarding all the risks is that the bank maintains low levels of risk, for which it has ample capital coverage. Throughout this document and in Annex I there is information about the aforementioned risk profile and control and management framework.

The outcome of the capital needs and the stress exercises incorporated to the capital self-assessment process anticipates the previously described situation, in which the quality and quantity of capital available will have appropriate margins in order to be able to guarantee that current or future capital requirements will be maintained in the future.

04. Information on credit risk and dilution risk

4. Information on Credit Risk and Dilution Risk

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4.1 Credit risk exposure as at 31 December 2020

As of 31 December 2020, the value of the bank's exposures and its annual average credit risk, following the adjustments indicated in Part Three, Title II, Chapter 1 of Regulation (EU) N° 575/2013, of the corresponding impairment value corrections of assets⁴, as applicable,

of the effects of credit risk mitigation techniques and the application of conversion factors for the entries included in memorandum accounts is presented below, disclosed by risk category:

Risk Category	31 December 2020	2020 Annual Average	2019 Annual Average
Central administrations or central banks	7,280,851	5,951,675	4,486,638
Regional administrations and local authorities	688,029	811,472	635,432
Public sector entities and other non-profit public institutions	221,557	182,664	45,288
Institutions	1,238,122	1,399,461	1,262,010
Corporates	742,664	727,311	601,396
Retail	7,953	8,223	8,796
Exposures secured by mortgages on immovable property	39,084	39,259	40,843
Exposures in default	1,058	784	946
Exposure to institutions and corporates with a short-term credit assessment	-	626	1,266
Equity exposures	2,951	5,911	12,367
Other exposures	198,401	204,918	190,226
Securitisation exposures	47,813	53,138	51,203
Total	10,468,483	9,385,442	7,336,411

Thousands of euros

A more detailed breakdown of this exposure may be found in section 3.2.1.

⁴ Annex II of this report includes the definition of "delinquency" and "impaired positions" that are used in different sections of this report, as well as the definition of the methods used in the determination of provisions for deterioration of the credit risk.

4.2 Geographical and counterparty distribution of exposures

The following table gives an overview of the exposures defined in the above subsection, with a breakdown by geographical area:

Geographic region	Amount the exposure
Spain	8,303,910
Other countries in the EU	1,662,902
Other	501,671
Exposure as at 31 December 2020	10,468,483

Thousands of euros

4.3 Residual maturity of the exposures

The following table sets out the distribution by residual maturity term of the exposures referred to in section 4.1:

Risk Category	Residual maturity as at 31 December 2020				
	On demand	Up to 3 months	Between 3 months and a year	Between 1 and 5 years	More than 5 years
Central administrations or central banks	5,072,675	100,136	987,937	1,011,607	108,496
Regional administrations and local authorities	16,204	20,042	90,519	503,860	57,404
Public sector entities and other non-profit public institutions	-	-	-	221,557	-
Institutions	724,067	-	2	107,466	406,587
Corporates	228,736	2,112	39,883	145,401	326,532
Retail	1,359	2	165	1,182	5,245
Exposures secured by mortgages on immovable property	-	-	31	962	38,091
Exposures in default	354	-	-	-	704
Equity exposures	2,951	-	-	-	-
Other exposures	193,474	-	-	4,927	-
Securitisation exposures	-	-	-	29,077	18,736
Exposure as at 31 December 2020	6,239,820	122,292	1,118,537	2,026,039	961,795

Thousands of euros

4.4 Counterparty credit risk

Counterparty credit risk is understood as the credit risk arising from derivatives, repurchase operations, securities or commodities lending, margin lending transactions or long settlement transactions carried out by the bank.

The details of the exposure to counterparty credit risk through derivative and securities financing operations at 31 December 2020, are set out below:

Medidas

Positive fair value of the contracts	1,958,425
Minus: Effect of netting agreements	1,389,850
Credit exposure after netting	568,575
Minus: Effect of the guarantees received	-
Credit exposure after netting and guarantees	568,575

Thousands of euros

For the calculation of the minimum capital required associated with counterparty credit risk at 31 December 2020, the bank applied the market price valuation method in accordance with the terms of the standards set out in Part Three, Title II, Chapter 6 of Regulation (EU) No. 575/2013. By way of summary, it can be stated that, for derivatives operations, the value of the exposure is determined by adding the cost of replacement of all contracts with a positive value (established by means of attribution of a market price to the contracts and operations) and the amount of the potential future exposure of each instrument or operation, calculated in accordance with the terms of Article 274 of Regulation (EU) No. 575/2013. In the calculation of the amount of the potential risk, the scales contained in Table 1 of the aforementioned article were applied.

4.4.1 Credit derivatives

At the close of 2020, the bank had coverage for five positions in its portfolio, through credit derivatives, totalling €120 million. These derivatives are offset through a central counterparty clearing house.

4.4.2 Impact in collateral in the case of a reduction in the bank's credit rating

The impact is extremely low in view of the fact that practically all the collateral agreements currently in force do not have an agency rating as a factor that conditions the elements contained therein. Of the five contracts that have the Minimum Transfer Amount linked to the rating, three would be amended in the event the bank is at levels Baa1/BBB+ or lower, and two if the investment grade is lost. The impact on liquidity would not be considered relevant in any of these cases.

4.5 Concentration risk

Cecabank's activity as a wholesale bank means the management of risks associated with concentration is particularly relevant. At the close of 2020, two positions exceeded the threshold set to qualify as major risk. Furthermore, the 10 greatest exposures, without taking into account public debt and other exposures not included in the large exposure calculation, according to solvency standards, represent around 38.9% of the total.

This exposure corresponds to some of the main Spanish banking groups and large Spanish corporations. The distribution according to credit agency ratings is presented below:

Level	Rating	% 2020
1 and 2	AAA/AA/A	35.9%
3	BBB	35.2%
Lower than 3	BB-B	9.3%
Not rated	-	19.6%
Total		100.0%

Cecabank's level of specialisation can be seen at both sectoral and geographical levels. In terms of the relevant exposure for the purpose of determining large exposures, financial institutions account for 66.6% and those located in the Eurozone, including Spain, stood at 67.5%.

In the assessment of the degree of sector concentration the exposure is considered to be maintained within a highly regulated and supervised sector. This aspect is explained as the level of sectoral specialisation. Irrespective of this, and as shown in section 3.2.5, the bank applies prudent criteria to cover these risks under the Pillar 2 framework, with the appropriate levels of capital.

4.6 Impaired exposures

Exposures impaired by counterparty

The following table shows the value of impaired exposures at 31 December 2020, with a breakdown by counterparty type, together with the coverage for credit-risk losses due to insolvency and country risk established at year end, and the amount of provisions accounted for, in net terms, in the 2020 financial year:

Counterparty	Original Impaired Losses	Coverage for non-performing assets	Provisions for the year to cover non-performing assets
Institutions	665	312	-37
Corporates	-	-	-
Retail	429	113	26
Securitisation exposures	-	-	-
Amounts as at 31 December 2020	1,094	425	-11

Thousands of euros

Impaired exposures by geographical area

The following table indicates the above exposures depending on their location:

Counterparty	Original Impaired Losses	Coverage for non-performing assets	Provisions for the year to cover non-performing assets
Spain	454	137	19
Other countries in the EU	-	-	-
Other	640	288	-30
Amounts as at 31 December 2020	1,094	425	-11

Thousands of euros

At 31 December 2020 the value of non-performing exposures, net of provisions, stands at €669 thousand.

Credit quality of restructured or refinanced exposures

As of 31 December 2020, the bank had the following restructured or refinanced operations:

Categoría de Riesgo	Gross book value/nominal amount of restructured or refinanced exposures			Accumulated impairment loss, accumulated negative changes at fair value due to credit risk and provisions		Collateral and financial guarantees received on restructured or refinanced exposures	
	Restructured or refinanced non-performing exposures		Of which: with impairment of value	On restructured or refinanced performing exposures	On restructured or refinanced non-performing exposures	Of which: collateral and financial guarantees received on restructured or refinanced exposures	
	Restructured or refinanced performing exposures	Of which: in default					
Loans and advances	342	342	342		-96	245	245
Central banks							
Public administrations							
Credit institutions							
Other financial companies							
Non-financial companies							
Households	342	342	342		-96	245	245
Debt securities							
Loan commitments given							
Total	342	342	342		-96	245	245

Credit quality of performing and non-performing exposures according to the number of days elapsed since maturity

The following table represents the gross book value of the exposures broken down by maturity and product tranches:

	Gross book value/nominal amount									
	Performing exposures					Non-performing exposures				
	Not matured or matured ≤ 30 days	Matured > 30 days ≤ 90 days	Payment unlikely not matured or matured ≤ 90 days	Matured > 90 days ≤ 180 days	Matured > 180 days ≤ 1 year	Matured > 1 year ≤ 2 years	Matured > 2 years ≤ 5 years	Matured > 5 years ≤ 7 years	Matured > 7 years	Of which: in default status
Loans and advances	8,815,016	8,814,942	74	1,094	990	2	77	25		1,094
Central banks	5,071,475	5,071,475								
Public administrations	511,602	511,602								
Credit institutions	2,652,299	2,652,299	665	640				25		665
Other financial companies	531,864	531,864								
Non-financial companies	2,080	2,080								
Of which: SMEs	1,167	1,167								
Households	45,696	45,622	74	429	350	2	77			429
Debt securities	2,789,468	2,789,468								
Central banks										
Public administrations	2,309,295	2,309,295								
Credit institutions	129,726	129,726								
Other financial companies	131,760	131,760								
Non-financial companies	218,687	218,687								
Off-balance-sheet exposures	1,630,865									
Central banks										
Public administrations	464,940									
Credit institutions	1,057,271									
Other financial companies	16,481									
Non-financial companies	89,433.00									
Households	2,740									
Total	13,235,349	11,604,410	74	1,094	990	2	77	25		1,094

Thousands of euros

Of the total number of non-performing exposures, 10% have been due for more than a year, while 90% have been due for less than 90 days.

Performing and non-performing exposures and related provisions

	Gross book value/nominal amount				Accumulated impairment loss, accumulated negative changes at fair value due to credit risk and provisions						Collateral and financial guarantees		
	Performing exposures		Non-performing exposures		Performing exposures - impairment of accumulated value and provisions			Non-performing exposures - Accumulated impairment losses, accumulated negative changes at fair value due to the risk of credit and provisions			Accumulated partial defaults	On performing exposures	On non-performing exposures
	Of which: in phase 1	Of which: in phase 2	Of which: in phase 2	Of which: in phase 3	Of which: in phase 1	Of which: in phase 2	Of which: in phase 2	Of which: in phase 3					
Loans and advances	8,815,016	8,814,936	80	1,094	-517	-517	-1	-426	-426		1,888,429	314	
Central banks	5,071,475	5,071,475											
Public Administrations	511,602	511,602											
Credit institutions	2,652,299	2,652,299	665	665	-122	-122	-313	-313	-313		1,542,021		
Other financial companies	531,864	531,864			-306	-306					305,888		
Non-financial companies	2,080	2,080			-4	-4							
of which SMEs	1,167	1,167			-4	-4							
Households	45,696	45,616	80	429	-85	-85	-1	-113	-113		40,520	314	
Debt securities	2,789,468	2,754,938	34,529		-8,461	-1,363	-7,097						
Central banks													
Public Administrations	2,309,295	2,309,295											
Credit institutions	129,726	129,726											
Other financial companies	131,760	108,593	23,167		-5,083	-434	-4,648						
Non-financial companies	218,687	207,324	11,362		-3,378	-929	-2,449						
Off-balance-sheet exposures	1,630,865	1,630,865			-288	-288					31,122		
Central banks													
Public Administrations	464,940	464,940											
Credit institutions	1,057,271	1,057,271									25,857		
Other financial companies	16,481	16,481			-40	-40					196		
Non-financial companies	89,433	89,433			-228	-228					5,069		
Households	2,740	2,740			-20	-20							
Total	13,235,349	13,200,739	34,609	1,094	-9,266	-2,168	-7,098	-426	-426		1,919,551	314	

Thousands of euros

Of the total exposures at the close of 2020, non-performing exposures represent 0.01%.

Collateral obtained through takeover and enforcement processes

During 2020, no collateral was obtained through takeover or enforcement processes.

4.7 Changes during the 2020 financial year in losses through credit risk impairment and provisions for risks and contingent commitments for credit risk and country risk

The changes during the 2020 financial year in coverage of losses from credit risk due to insolvency and country risk comply with the terms of Regulation (EU) no. 575/2013, both in the type of coverage and the methodology applied to the calculation thereof (see Annex II).

The detail of the changes in non-performing assets in 2020 is as follows:

Coverage of non-performing assets

Balance at 31 December 2019	436
Provisions charged to income statement	39
Recovery credited to results	-50
Balance at 31 December 2020	425

Thousands of euros

With regard to coverage of standard risk and risk under special monitoring, the summary of changes in 2020 is shown in the following table:

Cobertura de activos dudosos

Balance at 31 December 2019	4,375
Provisions charged to income statement	6,352
Recovery credited to results	-593
Uses	-732
Effect of the differences in foreign currency exchange	-135
Balance at 31 December 2020	9,267

Thousands of euros

4.8 Credit rating agencies used

Cecabank uses Moody's and S&P as credit ratings agencies when determining the risk weights applicable to its exposures. These ratings agencies are used consistently and on a long-term basis for all the assets for which they are available, including securitisation exposure. Given the wholesale nature of the bank's activity, these ratings are usually available for assets from the different categories, except for those related to individuals.

4.8.1 General description of the process of assigning public security issue credit ratings to comparable assets

When there is a credit rating for a particular issue programme or for an exposure to which the element comprising the risk belongs, this rating is used in order to establish the risk weight applicable to that element.

In cases in which there is no credit rating directly applicable to a specific exposure, but there is a general credit rating for the issuer, the latter is used, in accordance with the ratings assignment criteria described in the solvency regulations.

The credit ratings corresponding to the issuers of a particular economic group are not used to classify the credits of other issuers of the same group. Likewise, short-term credit ratings are applied only to those exposures which may be considered to be short-term and are not extended to other entries.

In cases in which the external credit rating corresponds to an exposure in the local currency of a debtor, this will not be used to determine the risk weight of another exposure of the same debtor in foreign currency.

4.8.2 Risk-weighted exposure determined by the risk assessment of external rating agencies

The following table shows all risk-weighted exposures for different categories of credit risk, separating weighted exposure based on the credit rating awarded by an ECAI, from those whose credit rating comes from a central administration:

Risk Category	Risk-weighted exposure		
	TOTAL	Of which: with credit rating awarded by an ECAI	Of which: with credit rating from central administrations
Central administrations or central banks	228,568	-	101,236
Regional administrations and local authorities	-	-	-
Public sector entities and other non-profit public institutions	10,779	10,779	-
Institutions	402,662	334,486	62,894
Corporates	524,472	269,205	-
Retail	5,965	-	-
Exposures secured by mortgages on immovable property	13,679	-	-
Exposures in default	1,135	-	352
Equity exposures	2,951	-	-
Other exposures	60,126	-	-
Securitisation exposures	44,499	44,499	-
TOTAL	1,294,836	658,969	164,482

Thousands of euros

4.9 Securitisation transactions

The following breakdown shows the securitisation positions held on 31st December 2020, classified by the risk-weighting bands to which they are assigned:

	Original exposure	Net exposure *	Value of the Exposure **	Level 4	Level 5	Level 7	Level 12	Weight Risk-weighted exposure
On-balance-sheet items	52,243	47,813	47,813	20,078	8,999	16,911	1,825	44,499
Derivatives and off-balance-sheet items	196	196	-	-	-	-	-	-
Total investor position exposure	52,439	48,009	47,813	20,078	8,999	16,911	1,825	44,499

Thousands of euros

* Net corrections and provisions.

** Fully adjusted exposure value following application of credit-risk mitigation techniques and following distribution of the fully adjusted value corresponding to conversion-factor memorandum account entries.

On 31 December 2020 all Cecabank's securitisation operations correspond to investment positions, are traditional securitisations (no re-securitisations or synthetic securitisations).

Cecabank has no share in securitisation programmes other than in its own position as an investor. This includes, in addition to investment in securitisation bonds, acting as a counterparty in interest-rate swap contracts and, residually, providing liquidity facilities to securitisation funds.

These positions are incorporated in the usual monitoring channels corresponding to the portfolios in which they are held. As well as the information published by external credit ratings agencies, monitoring of the behaviour of underlying assets and the structure of securitisation funds is carried out based on available public information, and market prices of positions are followed.

4.10 Credit-risk mitigation techniques

Cecabank requires compliance with the following requirements using any of the recognised credit-risk mitigation techniques:

- Ensuring there is always the option to legally enforce the settlement of guarantees.
- Checking that there is never any significant positive correlation between the counterparty and the value of collateral.
- Requiring the proper documentation of guarantees.
- Undertaking the regular monitoring and control of the mitigation techniques used.

Cecabank acknowledges the following credit-risk mitigation techniques:

Contractual netting agreements

Contractual netting agreements (ISDA and CMOF – Spanish Financial Transactions Framework Agreement) are employed as a credit-risk mitigation technique. Furthermore, in order to reduce credit risk, CSA Annexes are signed for ISDA contracts and Annex III for the CMOF agreement for the collateralisation of the net outstanding risk in this type of operations.

The Global Master Repurchase Agreement (GMRA) is also used as a credit-risk mitigation technique for repo-style operations, and securities lending agreements (EMA and GMSLA).

These agreements are specified in further detail in Annex I: Risk Management Policies and Objectives. Section I: Credit Risk.

Collateral

Collateral refers to assets that remain subject to the guaranteed obligation.

At Cecabank collateral assets are basically cash in euros, and Spanish public debt securities. In the case of collateral that is a financial asset, the potential volatility of the value of the securities is taken into account, in line with provisions in current solvency regulations.

A particularly important case of financial collateral is the collateral (usually cash) linked with OTC derivatives, repos, or sell/buy-backs, and securities lending subject to contractual netting and financial guarantee contracts, mentioned in the previous section.

Personal guarantees and credit derivatives

These types of guarantees correspond to a third party's obligation to pay an amount in the event of a borrower's non-payment or when other specific events occur. An example of such types of guarantees are bonds and warranties.

In terms of their capacity to mitigate credit risk, only those guarantees provided by third parties that meet the minimum requirements established by the current solvency regulations will be recognised.

The purchase and sale of protection through credit derivatives, generally Credit Default Swaps (CDS) and Total Return Swaps, is carried out with first-rate financial institutions or Central Counterparty Clearing Houses.

The following details indicate the distribution of credit risk exposure on 31 December 2020, disclosed in accordance with the application or otherwise of credit risk reduction techniques and, where applicable, the mitigation technique applied (the exposure data refer to exposures prior to application of the risk mitigation applied):

Exposure type	Value of the original exposure
A) Exposures to which no credit-risk mitigation technique is applied	10,240,587
B) Exposures to which a credit-risk mitigation technique is applied	634,235
Netting agreements for off-balance sheet transactions	-
Netting master agreements regarding operations with a repurchase commitment, securities or commodities lending operations or other operations tied to the capital market	565,885
Collateral	68,154
Other collateral	-
Hedging based on personal guarantees	196
Hedging through credit derivatives	-

Thousands of euros

Central Clearing Houses and Organised Markets

In an effort to reduce the credit risk and as required by regulations, the bank settles and clears OTC derivatives in central counterparty clearing houses. It also clears and settles part of its operations with a repurchase agreement in clearing houses.

In the case of OTC derivatives operations (including credit derivatives), access to central counterparty

entities are carried out indirectly through a clearing member. On the contrary, for operations with a repurchase agreement, the bank accesses directly, as it is a clearing member in various houses.

With regard to organised markets, the bank carries out operations directly with central counterparty clearing houses on national markets and indirectly in international markets through a clearing member.

4.11 Encumbered assets

Assets which, as at 31 December 2020, are committed (contributed as collateral or guarantee against certain

liabilities) and any unencumbered assets are detailed below:

	Book value of encumbered assets	Fair value of the encumbered assets	Book value of unencumbered assets	Fair value of the unencumbered assets
Assets of the declaring bank	1,737,796	-	12,529,992	-
Loans on demand	-	-	5,226,851	-
Equity instruments	10,088	10,088	145,993	145,933
Debt securities	1,202,277	1,203,124	2,328,672	2,304,842
Loans and advances other than loans on demand	525,429	-	3,062,888	-
Other assets	2	-	1,765,588	-

Thousands of euros

Encumbered assets mostly correspond to collateral pledged to guarantee derivatives operations, and debt securities that are handed over in reverse repurchase agreement operations.

Outlined below are the guarantees received which are used in collateral taken for derivatives operations and in guarantees taken from reverse purchase lending operations and securities lending:

Exposure type	Fair value of collateral received or of own encumbered debt securities issued	Fair value of collateral received or of own debt securities issued available for encumbrance
Collateral received by the declaring bank	958,084	2,232,921
Equity instruments	-	87,734
Debt securities	958,084	1,862,224
Other collateral received	-	282,963
Own debt securities issued other than covered bonds or securitisation bonds for own assets	-	-

Thousands of euros

Guarantees received in the form of the reverse repurchase lending operations or securities lending are committed through their use in reverse repurchase agreement operations, as is the case with debt securities.

At 31 December 2020, the total financial liabilities associated with different assets/guarantees committed in financial operations is shown below:

Exposure type	Corresponding liabilities, contingent liabilities, or securities loaned	Assets, collateral received, and own debt securities issued other than secured bonds and securitisation bonds for encumbered assets
Book value of selected financial liabilities	2,642,429	2,480,158
Other sources of encumbrance	205,632	215,722
TOTAL SOURCES OF ENCUMBRANCE	2,848,061	2,695,880

Thousands of euros

05. Market risk in the trading book



For the purposes of calculating the capital requirements associated with the trading book, it should be indicated that the bank classifies as such any positions in financial instruments and commodities which are held with the trading intent, in other words, the portfolio of financial assets held for trading ("trading intent" being understood as holding positions for the purpose of disposing of them in the short term or benefiting in the short term from real or expected differences between the purchase price and the sale price, or variations in other prices or interest rates), or which are measured at fair value through profit or loss (portfolio of financial assets not held for trading at fair value through profit or loss). Lastly, the trading book includes positions that provide coverage to the elements of this portfolio.

The bank uses an internal model for managing and controlling market risk. A description of the risk management and control model can be found in point 2 of Annex I.

The details of financial assets included in the trading book are set out below as defined previously, classified by accounting portfolio and type of instrument at 31 December 2020.

Financial assets for trading

Held-for-trading financial assets	1,857,991
Derivatives	961,056
Equity instruments	146,992
Debt securities	749,943
Financial assets not held for trading at fair value through profit or loss	28,791
Equity instruments	6,451
Debt securities	21,720
Loans and advances	620
Total financial assets in the trading book	1,886,782

Thousands of euros

The following table shows the amount of the capital requirements associated with the trading portfolio on 31st December 2020:

Capital requirements in the trading book

Position risk requirements	47,318
Counterparty credit risk requirements	4,880
Total capital requirements	52,198

Thousands of euros

Details of capital requirements for position risk, according to the instrument, are as follows:

Requerimientos por riesgo de posición

Requirements for position risk in equity instruments	1,926
General Risk	573
Specific Risk	1,353
Requirements for position risk in fixed-income instruments	45,392
General Risk	38,210
Specific Risk	7,182
Own funds requirements for securitisation instruments	348
Total capital requirements	47,318

Thousands of euros

As mentioned previously, within the positions of the trading book fixed-income portfolio, there are securitisation positions with capital consumption requirements of €348,000.

06. Equity instruments not included in the trading book



Equity instruments not included in the trading book include participations in the permanent portfolio ("strategic investments") which have been held at fair value through changes in other comprehensive income. Notes 2 and 7 of the 2020 Individual Report include a description of the accounting portfolios into which these equity investments and instruments owned by the bank are classified, together with the accounting criteria for the registration and measurement applied to each of them. These notes also indicate the models and assumptions applied for determination of the value of instruments included in this portfolio.

The permanent portfolio is made up of the holdings in other entities in which, to a greater or lesser extent, it is involved in the administration and decision-making processes. The holdings in this portfolio, in addition to maintaining a permanent relationship with its shareholders, aim to achieve the purposes that are part of the bank's strategy and objectives. At 31 December 2020, strategic investments totalled €2,638 thousand euros.

The following table shows a breakdown of these exposures:

	Amount the exposure
Equity instruments listed on organised markets	-
Equity instruments not listed on organised markets	2,638
Total	2,638

Thousands of euros

Gains, net of the tax impact, without impairment, at 31 December 2020 and associated with the various investments in equity instruments included in the trading book and those which are consolidated amounted to €1,430 thousand.

The cost of exposures and their unrealised capital gains and losses are as follows:

	Amount the exposure	Cost	Unrealised capital losses	Unrealised capital gains*
Equity instruments listed on organised markets	-	-	-	-
Equity instruments not listed on organised markets	2,638	595	-11,539	13,582
Total	2,638	595	-11,539	13,582

Thousands of euros

*The amount corresponds to the unrealised capital gains in the portfolio, which include €152,084 corresponding to outstanding payments, and are therefore not included in equity.

The following is a breakdown of exposures based on the issuer's sector:

Classification by issuer

Credit institutions	-
Other financial companies	957
Non-financial companies	1,681
Total	2,638

Thousands of euros

07. Capital requirements for operational risk



Calculation of the Pillar 1 Regulatory Capital for operational risk is performed by applying the percentages established in the standard method to the relevant revenue. The procedure includes the following aspects:

- Determination of relevant revenue.
- Assignment of relevant revenue to business lines.
- Application of weight to the business lines.
- Calculation of capital consumption.

The following table indicates the capital consumptions at the close of 2020 for each business line:

Line of business	Weight	Requirements
Trading and sales	18%	8,157
Commercial banking	15%	13,597
Retail banking	12%	55
Asset management	12%	-
Payment and settlement	18%	3,841
Agency services	15%	12,198
Retail brokerage	12%	-
Business funding	18%	103
Total		37,951

Thousands of euros

Additionally, as mentioned in section 3.2.5, the bank applies a more stringent methodology than that required by regulations, under the Pillar 2 framework.

**08.
Interest-
rate risk in
positions not
included in the
trading book**



Interest-rate risk is the risk affecting or potentially affecting results or capital as a result of adverse changes in interest rates in the trading book. The measurement and analysis of this risk is performed by taking into consideration the following aspects in accordance with the premises described below:

- It is conducted on a permanent basis.
- An analysis is performed of the effects on the Net Interest Margin and Economic Value which could result from changes in interest rates in the various currencies in which significant exposures are maintained.
- The analysis includes all positions that are sensitive to interest-rate risk, including interest-rate derivatives,

both implicit and explicit, and excluding positions that form a part of the trading book.

Based on these analyses, measures are adopted as required in order to guarantee the optimal management of this risk.

Gap analysis indicates the exposure to interest-rate risk on the basis of the maturity structure and/or repricing of positions. This analysis enables the distribution of interest risk along different terms, and also aims to ascertain where potential impacts may affect the financial margin and equity. Management data at 2020 year-end are set out in the following table:

	0<=1M	1<=2M	2<=3M	3<=4M	4<=5M	5<=6M	6<=12M	1<=2Y	2<=5Y	5<=10Y	10<=20Y	20<=30Y
ASSETS	9,961	70	140	411	149	80	578	658	935	259		3
1. Cash and balances with central banks	5,309											
2. Available-for-sale financial assets	1,671	63	115	388	115	50	302	580	639	191		
2.1 Debt securities	1,671	63	115	388	115	50	302	580	639	191		
2.2 Equity instruments												
3. Loans and receivables	1,444	3	5	13	24	30	76	78	269	22		
3.1 Debt securities	45		2	10	2	28	69	78	267	22		
3.2 Customer credit	29	3	2	3	23	2	7					
3.3 Credit institution deposits	1,370		1						2			
4. Amortised cost							200		28	46		
5. Hedging derivatives	1,536	5	20	10	10							
6. Investments												3
LIABILITIES	10,839	20	3	109	59	6	77	353	880	172		
1. Fin liabilities amortised cost and FV thr. P&L	3,014	3	3	1	1	1	2					
1.1 Credit institution deposits	1,434	3	3	1	1	1	2					
1.2 Temporary assignment of assets	1,581											
2. Customer deposits	7,816								96			
3. Hedging derivatives	8	17		108	58	5	76	353	784	172		
GAP	-878	51	138	302	90	74	501	305	56	87		3
ACCUMULATED GAP	-878	-828	-690	-388	-298	-224	277	582	638	725	725	727

Data in millions of euros

As mentioned above, the most representative indicators employed internally for management identify the levels of structural interest-rate risk

based on sensitivities to interest-rate changes. The values of these indicators are set out below:

Indicator	Indicator description	
Economic Value	The relationship between the economic value and the highest quality eligible capital.	141.87%
Sensitivity to Economic Value with respect to Tier I and II	Percentage of eligible capital that would be represented by the loss in Economic Value caused by a sudden change of 200 b.p. on the yield curves.	3.44%
Sensitivity to Economic Value with respect to EVC	Percentage of economic value that would be represented by the loss caused by a sudden change of 200 b.p. on the yield curves.	2.20%
Net Interest Margin Sensitivity	Sensitivity of the one-year financial margin projections to sudden changes of 100 b.p. on the yield curves.	10.93%
VaR – Banking Book	Percentage of Tier I capital committed to the VaR of the Banking Book.	0.95%

Average data for the year

09. Structural liquidity risk



9. Structural Liquidity Risk

52

9.1 Procedures applied for the assessment of liquidity adequacy

54

This is the risk affecting or potentially affecting results or capital as a result of the bank being incapable of meeting its payment obligations upon maturity, without incurring unacceptable losses.

This risk reflects the probability of incurring losses or having to give up new business or an increase in current business through an inability to fulfil commitments upon maturity in a normal manner or being unable to fund additional needs at market costs. In order to mitigate this risk, the liquidity situation is regularly monitored together with potential actions to be performed, and measures are put in place in order to be able to re-establish the overall financial balance of the bank in the event of a potential liquidity shortfall.

The measurement and analysis of this risk is performed by taking into consideration the following aspects in accordance with the premises described below:

- It is conducted on a daily basis.
- Liquidity situations are analysed over different time frames.
- Compliance with the regulatory ratios is ensured.
- They are accompanied by market indices and data affecting liquidity.
- The analyses include all those positions which generate or could generate cash movements.

The bank maintains a high degree of stability in terms of liquidity sources, adequate capacity for wholesale market calls and the availability of sellable assets. All of this results in a comfortable liquidity situation.

Indicators

LCR (Liquidity Coverage Ratio)	Year-end data	148%
Average LCR for the year	Average monthly LCR values	164%
Average total liquid assets for the year	Average monthly total liquid assets (millions of euros)	6,790
Average net liquidity outflows for the year	Average net monthly liquidity outflows (millions of euros)	4,159
NSFR (Net Stable Funding Ratio)	Year-end data	270%
Available stable funding	Year-end data (millions of euros)	4,361
Required stable funding	Year-end data (millions of euros)	1,613

A key factor that demonstrates Cecabank's comfortable liquidity status is the reserve of the set of highly-liquid assets that it holds for the purpose of acting as a last resort in situations of maximum market stress. A balanced liquidity structure is maintained due to the high amount of stable deposits from clients and the investment in short-term assets with a high credit rating that are also very liquid in nature.

At the end of 2020, the balance of this reserve of liquid assets to deal with potential liquidity needs was €8.484 billion, predominantly comprised of the cash balance and assets eligible for financing operations with the European Central Bank (88%).

The following table shows the balance of liquid assets eligible for financing operations with the European Central Bank and arranged according to the levels that affect the haircuts applicable when being discounted. The values below already include these adjustments.

Liquidity categories by asset type

Central Bank + Cash-in-Hand + Other Cash	5,302,666
Level I	1,630,182
Level II	122,518
Level III	271,290
Level IV	171,222
Level V	-
Other liquid assets	986,247
TOTAL	8,484,125

Thousands of euros

Cecabank regularly conducts stress tests on the liquidity ratios, as indicated in section 7 of Annex I. Among other factors, these stress scenarios take into account a prolonged closure of the capital and interbank markets, the activation of contingent lines and deposit flight. The result of these exercises is that the bank has a sufficient buffer of liquid assets in place to withstand a situation of prolonged stress.

9.1 Procedures applied for the assessment of liquidity adequacy

As is the case in the internal capital adequacy assessment process, Cecabank quantitatively and qualitatively assesses the adequacy of its processes for managing liquidity, and funding and liquidity risks, for the nature of its activities, its dimension and complexity.

This procedure is aligned with the ICAAP Guidelines published by the Bank of Spain, providing the basis for drafting the ICLAR, which is presented each year to the supervisory authority.

The evaluation of the liquidity position, as previously described, concludes that the bank has sufficient resources to guarantee its liquidity position, as well as a suitable framework in place to control and manage the liquidity risk, as shown in Annex I.

The projection of future funding needs and the stress tests conducted anticipate that the comfortable liquidity position will continue.

10. Leverage



Another factor that demonstrates Cecabank's level of solvency is the leverage ratio. As shown below, the calculation made for December 2020 was 9.91%.

This ratio was established in Basel III as a not-sensitive-to-risk measure, aiming to limit the possibility of excessively increasing companies' balance sheets in relation to their available capital. Its calculation is defined as the ratio between the eligible Tier 1 capital and a non-risk weighted measurement of exposure calculated in accordance with the definition established in the EU Delegated Regulation 62/2015.

The following table shows the elements taken into consideration in the leverage ratio calculated at 31 December 2020.

	2020	2019
CET1 (full-loaded)	654,420	858,758
CET1 (phase-in)	644,600	-
Total exposure (fully-loaded)	6,601,652	7,736,673
Total exposure (phase-in)	6,591,833	-
Derivatives	377,336	412,427
Securities lending and financing	736,820	719,023
Off-balance sheet items	290,045	329,979
Other assets	10,113,621	6,482,051
Regulatory adjustments* (fully-loaded)	-501,328	-206,807
Regulatory adjustments (phase-in)	-511,147	-
Excluded exposures (**)	-4,414,842	-
Leverage ratio (fully-loaded)	9.91%	11.10%
Leverage ratio (phase in)	9.78%	-

Thousands of euros

* Assets deducted from Tier 1 Capital

** At the close of 2020, excluding certain exposures to Eurosystem Central Banks from the total exposure (denominator) of the leverage ratio, based on the decision of the Executive Committee of the Bank of Spain, which at its meeting of 2 October 2020 determined the existence of exceptional macroeconomic circumstances referred to in article 500 ter of Regulation 575/2013 (CRR), added by EU Regulation 2020/873, known as the COVID Regulation or "quick-fix".

Controlling the risk of leverage is incorporated within the standard monitoring of risk parameters. There is a limit that is monitored based on the information received by the Risk Committee and the Assets and Liabilities Committee in order to guarantee that the ratio comfortably exceeds the level that is taken as the reference value (3%) in the solvency regulations, whose entry into force has been delayed until 2023 according to EU Regulation 2020/873 (COVID Regulation).

Monitoring is performed alongside the supervision of solvency levels and it includes an assessment of both the bank's exposure and available own funds.

11. Information on remuneration



11. Information on Remuneration

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With regard to reporting remunerations to the market, and in line with the Bank of Spain Circular 2/2016 of 2 February, which clarifies the adjustment of the Spanish legal ruling to EU Directive 2013/36 and EU Regulation no. 575/2013, Cecabank herein outlines its remunerations policies and practices relating to

managers, senior management, employees performing control functions in risk, employees carrying out duties relating to control systems, and any other worker whose overall remuneration may be similar to that already mentioned.

11.1 Remuneration of Cecabank personnel

11.1.1 Remuneration Committee

The Board of Directors of Cecabank has a Remuneration Committee, in accordance with the provisions of the regulation, supervision, and solvency of credit institutions Act 10/2014, of 26 June, and its enacting regulation, as well as Act 31/2014 of 3 December, amending the Corporation Act for the improvement of corporate governance.

The Remuneration Committee has regulations specifying the following:

1. In accordance with the provisions of Royal Decree 84/2015, of 13th February, implementing Act 10/2014, of 26 June, on the regulation, supervision, and solvency of credit institutions, the Remuneration Committee has the following functions:
 - a) Preparing decisions in relation to remuneration, including decisions that have repercussions for the bank's risk and risk management, that must be adopted by the Board of Directors.
 - b) Reporting information on the General Remuneration Policy of the members of the Board of Directors, CEOs, or similar positions, as well as the individual remuneration and other contractual conditions of the members of the Board of Directors who perform executive duties, and ensuring compliance therewith.
 - c) Reporting information on the Remuneration Policy of senior executives, employees that take on risk, employees performing control functions and any employee that receives an overall remuneration that falls within the same scale of remuneration as applies to senior executives and employees that take on risk, whose professional activities significantly coincide with their risk profile.
 - d) Directly supervise the remuneration of senior executives responsible for risk management and in charge of the bank's compliance functions.
 - e) Reporting information on the incentive plans for directors or employees linked to the bank's profit and/or other variable indices/components.
2. The Remuneration Committee may also report on any issues assigned to it in relation to the remuneration and compensation system, amounts and raises, of the Board of Directors, executive directors, and executive personnel.
3. When preparing the decisions, the Remuneration Committee takes into consideration the long-term

interests of the bank's shareholders, investors, and other stakeholders, as well as the public interest.

4. The Committee reports its activity and the work conducted to the Board of Directors in an appropriate and timely manner.
5. The Committee drafts an annual report on its activities over the course of the financial year.

The composition of the Remuneration Committee can be consulted in Annex III of this document.

In 2020 the Remuneration Committee held two meetings.

At its meeting of 28 April 2020, at the proposal of the Remuneration Committee, the Board of Directors approved the General Remuneration Policy applicable to the entire workforce.

11.1.2 General principles of the remuneration policy

The remuneration policy must be understood as an instrument of internal governance and risk management at the bank, and as a result, the main objective in this regard is to align the objectives of the employees themselves with the long-term interests of the bank. To this end, the valuation of the components of performance-based remuneration focuses on long-term results and takes into consideration all outstanding risks associated with these results.

In this regard, the principles governing this remuneration policy are as follows:

- Multiplicity of elements
- Prudent and effective risk management
- Alignment with long-term interests
- Suitable ratio between the fixed and variable components
- Internal equality and external competitiveness
- Supervision and effectiveness
- Flexibility and transparency
- Simplicity and individualisation

Cecabank commissioned the services of an external consultant, Ernst&Young Abogados, S.L.P., to evaluate the remuneration policy, as well as to review the procedure for determining the identified group.

11.1.3 Risk-adjusted identified group

A distinction is made between four groups (hereinafter, in aggregate terms, the Identified Group) that may have a material impact on the risk profile of the bank, and which would be affected by the requirements in terms of remunerations:

- Group 0: Members of the Board of Directors without executive roles.
- Group 1: Members of the Steering Committee, including the CEO.
- Group 2: Employees belonging to the Trading and Equity Sales Divisions.
- Group 3: Heads of key control functions and members of key Cecabank committees not included in the previous groups.

Situation as at 31/12/2020	Number of people
Group 0	11
Group 1	8
Group 2	34
Group 3	9

11.1.4 Relationship with the bank's profit

The objective of Cecabank's annual variable remuneration system is to establish a relationship between the profit obtained and the amount of remuneration, which must furthermore compensate the level of achievement, performance, effort and responsibility, as well as be aligned with the long-term interests of the bank, without involving any excessive risk-taking.

The potential variable remuneration is established taking into account the achievement of objectives and the performance evaluation, based on certain reference scales that are set out for each functional level, taking into account the competitiveness criteria.

The payment of variable remuneration is also determined by whether the budget is attained.

With regard to the control units, the method for establishing the remuneration of the key figures does not compromise their objectivity and independence, nor create conflicts of interest in their function of monitoring and advising.

Trading and Equity Sales Divisions

The variable remuneration model for the Cecabank Trading and Equity Sales Divisions comprises the distribution of a percentage of the profit obtained by the Divisions, after expenses. In addition, corrective elements are applied that enable the final amounts paid to be adjusted (upwards or downwards). These reductions are made according to: (i) the computable performance of the division to which the member of the identified group is assigned, taking into account his or her responsibilities and departmental objectives, (ii) an evaluation of any exceptional situations which may have occurred during the process, as set out in the Performance Assessment, at both the quantitative and qualitative levels.

Therefore, variable remuneration for the Trading and Equity Sales Divisions is determined by profits obtained and by obtaining at least 80% of the computable result. Distribution by departments, panels, and individuals is carried out based on the contribution each has made to the profits.

11.1.5 Characteristics of the remuneration system of the identified group

Risk tolerance as defined by the Board determines that remuneration policies have to reinforce the control environment and incorporate incentives to keep the risk profile within the defined tolerance levels, and, in this way, they help align the bank's objectives with the assumed risk levels, without incurring in inadequate levels of risk and promote their rigorous management.

These are the strategies employed to comply with the aforementioned objectives:

Risk adjustments prior to accrual

Identified group 0

Members of the Board of Directors without executive roles do not receive any variable remuneration, so no corresponding adjustments are made.

Identified groups 1 and 3

The accrual of variable remuneration for these groups is conditioned upon compliance with the tolerance levels defined by the main indicators determining the risk profile of the bank; specifically, maintaining the market risk limits and solvency targets defined by the Board of Directors. Profitability thresholds are also fixed for the capital involved in activities undertaken.

Group 2

Remuneration for this group is determined by compliance with risk levels allocated to activities carried out by the Trading and Equity Sales Divisions. Thus, the total amount of variable remuneration is determined by the division remaining within market risk limits, and the profit obtained by unit of risk, the profitability of capital used for activities undertaken, and maintaining the desired liquidity profile.

Risk adjustments after accrual

Regardless of the identified group, the approaches to be employed as techniques for application of ex-post risk adjustment will be the malus and clawback methods.

Malus. This is understood as any technique preventing the total or partial maturity of deferred remuneration. In specific terms, this maturity is prevented in the following cases:

- (i) Evidence of disloyal behaviour or serious error (for example, breach of internal regulations, such as the Securities Market Internal Conduct Regulation or the Manual on the Prevention of Money Laundering and Financing of Terrorism).
- (ii) Evidence of the implementation of personal hedging or insurance strategies intended to reduce risk adjustment effects in variable remuneration.
- (iii) A significant decline in the financial performance of the bank or the corresponding business unit.
- (iv) A significant failure in risk management by the bank or the corresponding business unit.
- (v) Situations that jeopardise the fulfilment of the bank's solvency objectives.
- (vi) The existence of firm administrative penalties of legal convictions that may be attributable to the unit or to the personnel responsible for the same.
- (vii) The increase in the capital requirements of the bank or its unit that is not foreseen when generating exposures.

Clawback. The variable remuneration already paid to the members of the identified group, whether deferred or otherwise, shall be partially or totally recovered by Cecabank during the deferral and withholding periods applied to the variable remuneration plus one additional year, when it is demonstrated that the payment and, as such, the non-application of the adjustment mechanisms, has been partially or totally made based on information that has been proven to be false or seriously inaccurate, a posteriori, or that risks arise that were assumed during the period in

question, or other circumstances that are unforeseen and unaccepted by the bank that have a significant negative impact on the income statement of any of the financial years in which the variable remuneration was applied.

In particular, the circumstances under which a member of the identified group in Cecabank must repay part or all of the variable remuneration received to the bank are as follows:

1. In the event that Cecabank reformulates its financial statements on the condition that, in accordance with this reformulation, a resulting lower variable remuneration is due to be paid than the amount actually paid, or that no variable remuneration would be due in accordance with the system of variable incentives implemented by the bank.
2. In the event that the payment of the variable remuneration was based on objectives which were achieved as a direct or indirect consequence of:
 - (i) A fraudulent activity by the individual;
 - (ii) The occurrence of circumstances that lead to the lawful disciplinary dismissal of the employee in accordance with the applicable employment legislation or, in the case of a board member, the occurrence of circumstances that lead to the termination of their role as director due to breach of their duties, an act or omission that causes damages to the bank, or the combined occurrence of the circumstances required to entitle the bank to bring a derivative suit against the individual in question;
 - (iii) In the event that, by their action or omission, the individual has caused damages to Cecabank through fault or negligence.
 - (iv) In the event that the individual has been penalised for a serious and intentional breach of any of Cecabank's internal regulations that may be applicable.
 - (v) In the event that the individual has been penalised for a breach of the rules on order and discipline contained in Title IV of Act 10/2014, of 26 June, on the regulation, supervision, and solvency of credit institutions, classified as serious or extremely serious. The sanction imposed must be confirmed and accredited by a senior competent body.
 - (vi) The increase in the capital requirements of the bank or its unit that is not foreseen when generating exposures.

Remuneration system deferral clauses

Identified groups 1 and 3

Considering the regulations applicable to credit institutions, the deferral requirement will be applied in all cases.

The deferred amount of the variable remuneration accrued shall be 40%, being paid in equal parts, over a period of three financial years.

In the case of the CEO, a deferral of 60% of the amount payable is applied, in equal parts, over the 5 years following accrual.

Group 2

There is a deferral of the variable remuneration accrued in accordance with the following: 50% will be paid in cash upon conclusion and evaluation of the result for the financial year, with the remaining 50% to be paid in equal parts over the next 3 financial years after deferral.

For the accrual of variable remuneration for this group, at least 80% of the computable result must be reached, and in no case may the amount of variable remuneration accrued exceed, in total, 150% of the fixed remuneration accrued by the personnel assigned to the Treasury and Equity Sales Divisions.

In accordance with directives 237 et seq. of the EBA Guidelines on sound remuneration policies, Cecabank has established specific deferral systems for variable remunerations of particularly high amounts for all groups.

11.1.6 Ratio between fixed and variable remuneration

In general terms, for Cecabank personnel, the amount of variable remuneration per employee must not exceed, as a rule, 40% of fixed remuneration, with the final variable being adjusted in all cases to individual achievement of objectives and performance.

This percentage can be exceeded depending on the assigned responsibilities, achievement of set objectives and performance of the employee, without exceeding 100% of fixed remuneration and upon justification by the corresponding Area Director.

As regards the identified group, the variable remuneration is limited to a maximum of 100% with respect to fixed remuneration, unless authorised by the General Shareholders' Meeting, in which case it may reach 200%.

The General Shareholders' Meeting of 24 March 2020 approved a level of variable remuneration of up to 200% of fixed remuneration for certain positions.

11.1.7 Payment of variable remuneration in non-pecuniary instruments and withholding periods

During 2017, according to the provisions of the EBA Guidelines on Sound Remuneration Policies by virtue of articles 74.3, and 75.2 of Directive 2013/36/EU and the disclosure of information by virtue of article 450 of Regulation (EU) no. 575/2013, the Remuneration Policy was amended to include remuneration mechanisms based on non-pecuniary instruments.

In this sense, in 2020, all members of the identified group that accrue variable remuneration will receive 50% of their accrued variable remuneration in non-pecuniary instruments, which will be subject to a withholding period of one year, except for the CEO, whose withholding period will be two years.

Given that Cecabank is not a listed company, the Board of Directors, at the proposal of the Remuneration Committee, has decided to implement a system of phantom shares, the value of which will depend on the evolution of the bank's own funds.

11.1.8 Main parameters and purpose of the variable remuneration plans

Cecabank believes that its professionals are a key factor in achieving the bank's objectives and it is aware of the impact of remuneration on motivation and talent retention.

Each year, Cecabank evaluates individual and group performance in order to establish overall performance management.

For these purposes, the bank has implemented a performance management system that, based on the competences identified for Cecabank and the functions performed in the job position by the employee, facilitates the assessment and observation of behaviour or conduct with respect to which there may be an opportunity for each professional to grow and improve.

The assessment measures a series of competences with a specific requirement level set for each functional level, with the aim of identifying strengths and areas for improvement. Moreover, an analysis of the Functional Job Execution is conducted in order to ascertain how the professional under assessment performs the duties corresponding to their position.

Once the final rating is obtained from the performance management system, the following actions may be taken:

- Remunerative: an input that facilitates each individual's position within their remuneration scale.

It is also an element involved in the determination of the percentage of variable remuneration to be received, as a complement to the level of achievement with respect to objectives.

- **Competence-based:** by comparing the evaluation conducted and the competence profile of the functional level, the profile's strengths and points for improvement are obtained.
- **Developmental:** drafting an improvement plan that, having obtained the result of the assessment, sets out the future plans of the professional under assessment, with the aim of the areas identified as requiring improvement.

In this regard, when assessing the individual performance of employees, Cecabank takes into consideration both financial and non-financial criteria. The appropriate combination of the two depends on the tasks and responsibilities of the employee.

Financial criteria must cover a sufficiently long time period in order to reflect the risk of the employee's actions, and incorporate risk adjustment and economic efficiency measures.

Negative performance from the non-financial perspective, in particular unethical behaviour and those in violation of regulatory compliance, cancels out any positive financial performance.

Conversion of the measurement of performance into a variable remuneration component for each employee includes an adjustment for present and future risks, including quantitative and qualitative measures. The final risk adjustment depends on the specific group to which the employee belongs, as outlined above.

In addition, and in the case of functional levels corresponding to directors, managers and technicians with an assigned team, the Remuneration Policy establishes the settlement of variable remuneration for achieving certain objectives, distinguishing between business units, support units related to incremental initiatives covered under the 2017-2020 Strategic Plan and other support units.

The Steering Committee members have been assigned a series of individual objectives and part of their remuneration is aligned with the achievement of the objectives of the 2017-2020 Strategic Plan.

11.1.9 Aggregate quantitative information on remuneration by area of activity of the identified group

	Investment banking	Commercial banking	Asset management	Other	Total
Number of employees in the identified group	34	-	-	28	62
Total remuneration for the identified group	5,506,894	-	-	3,552,230	9,059,123

Figures in euros

11.1.10 Aggregate quantitative information on remuneration of the identified group and members of the Board of Directors

Type of remuneration

	Executive directors	Non-executive directors	Senior managers	Other employees
No. of beneficiaries	1	11	7	43
Remuneration Main Company	525,560	378,622	1,639,769	6,515,173
Allowances	24,828	378,622	-	-
Fixed	265,320	-	997,067	3,806,796
Variable	118,994	-	588,266	2,462,625
Pecuniary	85,760	-	358,422	1,465,494
Shares	-	-	-	-
Instruments related to shares	33,234	-	229,844	997,130
Other Benefits (in kind, health insurance)	418	-	19,660	146,717
Supplementary social provision	116,000	-	34,775	99,036

Figures in euros

The above table does not include €27,000 corresponding to the allowances for a proprietary

director, since it was directly paid to the bank that said director represents.

	Executive directors	Non-executive directors	Senior managers	Other employees
Remuneration at other entities	-	-	33,275	-
Allowances (euros)	-	-	33,275	-
No. of beneficiaries	-	-	2	-

Figures in euros

Cumulative deferred remuneration, pending payment at close of the financial year

	Executive directors	Non-executive directors	Senior managers	Other employees
Deferred remuneration pending payment	366,932	-	745,885	2,518,128
Vested part	-	-	-	-
In cash	-	-	-	-
Other than cash	-	-	-	-
Non-vested part	366,932	-	745,885	2,518,128
In cash	165,840	-	314,479	1,198,782
Other than cash	201,092	-	431,406	1,319,346

Figures in euros

Deferred remuneration from previous financial years paid out during the financial year

	Executive directors	Non-executive directors	Senior managers	Other employees
Remuneración diferida pagada durante el ejercicio	88.194	-	501.441	2.377.397
Pagadas	88.194	-	501.441	2.377.397
Reducción por ajustes derivados de los resultados del desempeño	-	-	-	-

Figures in euros

Payments for new recruitment included in the identified group

	Executive directors	Non-executive directors	Senior managers	Other employees
No. of beneficiaries	-	-	-	-
Remuneration Main Company	-	-	-	-
Allowances	-	-	-	-
Fixed	-	-	-	-
Variable	-	-	-	-
Pecuniary	-	-	-	-
Shares	-	-	-	-
Instruments related to shares	-	-	-	-
Other Benefits (in kind, health insurance)	-	-	-	-
Supplementary social provision	-	-	-	-

Figures in euros

Possible payments due to early termination of a contract

At the close of 2020, there is no member of the identified group whose employment contract provides for the payment of any amount corresponding to remuneration above that established by labour law.

Severance pay granted to personnel from the identified group during the financial year

During 2020, there were no terminations of employment contracts for personnel considered as a Cecabank identified group.

Number of individuals that receive remuneration of €1 million or more during the financial year

No employee received remuneration of €1 million or more for the financial year.

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ANNEX I: Risk Management Policies and Objectives

Below, in accordance with the information advanced in Title 2 of this document, this Annex includes detailed information on the management objectives and policies connected with each of the risks having a significant impact:

1. Credit risk

Objectives, general policies with regard to assumption and management of risks

The General Risk Management Framework approved by the Board, implementing the Risk Tolerance Framework, contains the policies regarding the assumption and management of credit risk.

This document is the foundation upon which the management of internal risk is based and determines the governance and monitoring structure. It also determines the internal limit structure, and processes for risk admission, assessment, mitigation, and coverage, as well as pricing.

The policy highlights that the portfolio is made up of, primarily, exposures with a low level of risk and shows that other risks with a worse credit rating are rare, exceptional and few in number.

Credit Risk Processes and Management

This is one of the basic risks to which Cecabank is exposed through its various business units.

Credit Risk is defined as the risk which affects or could affect results or capital as a result of a breach by a borrower of the commitments set out in any contract, or the possibility that it might not act as agreed. This category includes:

1. **Principal risk.** Resulting from a failure to repay the principal.
2. **Substitution or counterparty risk.** This refers to the capacity and intention of the counterparty to comply with its contractual responsibilities at the time of maturity. Credit risk exists throughout the lifespan of the operation, however it may vary from one day to another because of settlement mechanisms and changes in the market valuation of operations.
3. **Wrong-way risk.** As counterparty risk, depending on the nature of the specific transactions, OTC derivative instruments can also have adverse effects from correlation between exposure to risk with a specific counterparty and credit quality, in such a way that when it decreases, exposure to the

counterparty increases. This risk is called wrong-way risk.

4. **Issuer risk.** This risk arises when trading financial assets of an issuer on primary and/or secondary markets, and it is defined as the risk that a loss in their value could occur as a result of a change in the market perception of the economic and financial strength of the issuer.
5. **Settlement or handover risk.** This is the risk that one of the parties settles the transaction and that the agreed consideration is not received.
6. **Country risk.** This is the credit risk which applies to the debts of borrowers in another country because of circumstances beyond the standard commercial risk. It may take the form of a transfer risk or sovereign risk, and other risks derived from international financial activity.
7. **Concentration risk.** This measures the degree of concentration of credit risk portfolios under different relevant dimensions: geographical areas and countries, economic sectors, products, and client groups.
8. **Residual risk.** This incorporates risks derived from strategies for dynamic hedging, credit risk mitigation techniques, securitisations, etc..

In order to manage credit risk properly, a number of procedures are established, the key elements of which are described below.

Credit Risk Analysis

The process of assessing the credit rating of counterparties and the assignment of limits are closely connected. As a result, an internal rating is granted to the various counterparties with which operations are desired. This internal rating contributes to the establishment of the maximum amount of risk allowed with each entity. It also constitutes the baseline for the admission and monitoring of the risk.

The rating is the result of the analysis of various quantitative and qualitative factors, which are assessed independently and are given a specific weight for the calculation of the final rating. The result is an independent analyst valuation, which combines the perception of the credit rating of those counterparties with which operations are intended.

Credit Risk Control and Monitoring

The monitoring of credit risk is performed by means of active portfolio management. The fundamental aim is

to detect sufficiently in advance any counterparties which may register some impairment in their credit quality or weakening of guarantees. As an integral part of the monitoring process, a list is kept of all counterparties requiring special monitoring. They are identified and kept on so-called FEVE (signings under special monitoring) or FRO (signings with operating restrictions) lists.

As in the analysis process, ratings are an additional strand in the risk monitoring process, in addition to the country and business type, among other variables.

In addition, and as a part of the monitoring of credit risks incurred by market operations, in collaboration with Legal Consultancy active management is performed, and the adequacy of the contractual documentation on which the operations are based is monitored.

The control process comprises all activities connected with the permanent verification of compliance with all settlement, counterparty and credit risk limits established, the management and reporting of surpluses, and the maintenance and updating of the parametrisation of products, clients, countries, economic groups, ratings, contractual netting agreements and financial guarantees in the control tools.

Risk limit structure

The general credit risk limit structure (lying within the Risk Tolerance Framework and the General Risk Management Framework) is divided into two major groups.

On the one hand, there are the limits granted individually to a counterparty. On the other, there is a series of limits associated with certain activities: country risk limits and operational limits for private fixed income and for equities activities, among others.

Credit risk measurement methodology

The methodology applied for the calculation of credit risk exposure is, generally speaking, the standard set out in the Solvency Regulation. In addition, in the case of products subject to counterparty risk, the bank applies the position valuation method to the market prices of the various operations, with the addition of certain add-ons or coefficients which, when applied to the notional value, incorporate the measurement of the potential risk of each operation until maturity. Management tools provide information on the consumption of limits in real time for each counterparty and economic group, allowing for the application of ongoing monitoring of any modification and/or excess in the limits.

The existence of guarantees and collateral is taken into consideration with regard to reduced credit risk consumption in operations covered thereby, and also

in accordance with the criteria established in the applicable regulations.

Counterparty risk

It is the risk that the counterparty could default upon payment before the final cash flow settlement of any of this operation. It includes the following types of operations, among others: derivative instruments, operations with a buy-back commitment, security loan operations.

Depending on the nature of the specific transactions, derivative instruments can also have adverse effects from correlation between exposure to risk with a specific counterparty and credit quality, in such a way that when it decreases, exposure to the counterparty increases.

Managing wrong-way risk forms part of the process of accepting and monitoring risk. Given Cecabank's activities, these cases are exceptional, which means they can be treated on an individual basis; usually through a reduction of the exposure to the operation in question.

With respect to correlation between the guarantee and the guarantor, because cash is mainly received as collateral in the world of derivatives, there is almost no risk of adverse effects due to the existence of correlation. Any potential adverse effects due to correlations in non-cash collateral are not significant.

Concentration risk

Concentration risk, within the scope of credit risk, represents an essential element for management. The degree of concentration of credit risk is continuously monitored in accordance with various relevant classifications: countries, ratings, sectors, economic groups, etc.

For the management of concentration risk, prudent criteria are applied so as to be able to manage the limits available with sufficient leeway with regard to the legal concentration limits established.

As for the level of sector concentration, this is the consequence of Cecabank's specialisation in the execution of all manner of activities, operations, and services inherent in the banking business in general, or directly or indirectly associated with this. Nevertheless, when evaluating this degree of sector concentration, a significant part of the exposure is taken on by the financial sector, a highly regulated and supervised segment.

Contractual netting and financial guarantee contracts or "collateral"

The general policy regarding trading of financial derivatives, and repo, sell/buy-back and securities

lending operations is to sign netting agreements prepared by national or international associations. In the event of a breach by the counterparty, these contracts allow for the foreclosure of the operations covered by them and offsetting, which means that the parties will only be able to demand the net balance of the product of the settlement of such operations.

For financial derivatives, ISDA Master Agreements are formalised, subject to UK law or that of the State of New York, or otherwise the CMOF (Spanish Financial Transactions Framework Agreement), subject to Spanish law, depending on the counterparty. Meanwhile, for hedging derivative financial instruments beyond a certain risk level, financial guarantee agreements are formalised, namely the Credit Support Annex for the ISDA Master Agreements and Annex III for CMOF.

In the case of repo and sell/buy-back operations, the Global Master Repurchase Agreements (GMRA) are signed, while for securities lending, the European Master Agreement (EMA) or the Global Master Securities Lending Agreements (GMSLA) are formalised. In this type of contractual netting agreement, the clauses incorporate the regulation of the financial guarantees or "margins" for the operations.

At present, most collateral (to be handed over or received) in derivatives takes the form of cash, although market practices are demonstrating that non-cash collateral usage is increasing, a trend which Cecabank is taking into consideration in its active collateral management.

Credit risk exposure in accordance with the credit ratings

At 31 December 2020, some 80.4% of exposure (without taking into consideration investments in the public sector, nor central counterparties (CCP) with direct or indirect access) has been given a rating granted by one of the credit rating agencies recognised by the Bank of Spain.

The distribution by rating level of the rated exposure is as follows:

Level	Rating	Percentage
1	AAA-AA	4.5%
2	To	40.1%
3	BBB	43.8%
4	BB	10.8%
5	B	0.8%
6	CCC and lower	0.0%
	Total	100%

2. Risks associated with the portfolio at fair value through profit or loss

The General Risk Management Framework approved by the Board, implementing the Risk Tolerance Framework, contains the policies regarding the assumption and management of market risk.

Market risk management objectives, policies, and processes

Market risk is defined as the risk affecting results or capital and resulting from adverse changes in the prices of bonds, securities, commodities, and exchange rates in operations registered in the trading book. This risk arises from market-making activities, trading, adoption of positions in bonds, securities, currencies, commodities, and derivatives (based on bonds, securities, currencies, and commodities). This risk includes foreign currency risk, defined as the current or potential risk affecting results or capital and resulting from adverse changes in exchange rates in the trading book.

The exposure of the bank to this type of risk is derived from various financial factors affecting market prices. These factors include, but are not limited to, the following:

- Levels of interest rates in each country and product type.
- Spread levels above the risk-free curve with which each instrument is quoted (including the credit and liquidity spreads).
- Market liquidity levels.
- Pricing levels.
- Exchange rates.
- Levels of volatility in the above factors.

The concept of Value at Risk (VaR) provides an integrated measurement of market risk, covering the fundamental aspects of the risk: interest-rate risk, exchange rate risk, equities risk, credit spread risk and volatility risk in the preceding factors.

Interest-rate risk

Interest-rate risk is the exposure to market fluctuations as a result of changes in the general level of interest rates. Exposure to interest rates can be separated into the two following elements:

Directional, slope and basis risk in the curve

Directional risk is the sensitivity of revenue to parallel changes in the yield curve, while the yield curve risk is the sensitivity of gains to a change in the structure of the rate curve, either through a change in the slope or in the form of the curve.

Basis risk is the potential risk caused by unexpected changes in the margins between the different yield curves with regard to those maintaining portfolio positions. Market liquidity conditions, and also the perception of the specific risk, are typically the triggers for this type of change (although other factors may also exert an influence).

All interest-rate risks described are tracked by means of the VaR, in which all relevant factors are included for their measurement, including all the different curve time frames and all the relevant curves (including specific sector curves for each level of credit rating).

Spread and illiquidity risk

Spread risk is derived from holding positions in private fixed income and credit derivatives, and it is defined as the exposure to the specific risk of each issuer.

Certain circumstances in the market and/or the issue itself could increase these spreads because of the liquidity premium.

Currencies

Given its activities in FX and international capital markets, the bank is exposed to the two following currency risk elements.

Exchange rate risk

Exchange rate risk is derived from the net positions of a currency against the euro or of one currency against another. As a result, exchange rate risk is the potential changes of cash exchange rates affecting the value of the positions.

Interest-rate margin risk

The risk regarding the net interest-rate margin is derived from the difference between the interest rates of two different currencies, and its effect on term positions in foreign currencies.

Both risks are measured by the VaR, incorporating the foreign currency rate curves and exchange rates as risk factors.

Equity

This represents the risk of incurring losses as a result of the variation in share prices.

Volatility risk

Operations on options based on different underlying assets are typically performed in portfolio management.

The most immediate way of measuring the risk of these options is through their Delta, a parameter which approximates the risk of an option as an equivalent position in another simpler (linear) instrument.

However, the non-linear nature of the value of options makes it advisable, particularly in complex options, to perform the additional monitoring of other parameters which affect the value of the option, which are also described below:

Delta risk

The Delta parameter measures the variation in the value of the option which occurs when the price of the underlying asset varies by one point. Delta risk thus refers to the exposure to unexpected changes in the value of the options portfolio as a result of changes in the prices of the underlying instruments.

Gamma risk

The Gamma of an option measures the sensitivity of its Delta to a variation of one point in the price of the underlying asset. It represents the risk that the Delta position of an options portfolio might vary as a result of a change in the prices of the underlying instruments.

Vega risk

Vega is a measurement of the sensitivity of the value of the option as a result of a change of one percentage point in the volatility of the price of the underlying asset.

Theta risk

The Theta risk is related to a reduction in the value of positions in options as a consequence of the passage of time.

The Delta and Vega risks are measured by means of the parametric VaR while, in order to measure the options risk, the Historical Simulation VaR is used, as this methodology performs complete re-evaluations thereof.

For operations in certain types of exotic and complex options, for which management and measurement of the risk proves overly complex, the general policy is to eliminate this risk from the portfolio by means of the arrangement of back-to-back operations in the marketplace.

Measurement of market risk

The following is a description of the methodology employed for the measurement of market risk.

For the portfolio of financial assets at fair value through changes in other comprehensive income, the VaR is also calculated and tracked in the same way as for the trading book.

Value at risk

As mentioned previously, the VaR is the indicator used to establish the monitoring of limits on the exposure to

market risk. It provides one single market risk measurement, integrating the fundamental aspects of the risk:

- Interest-rate risk.
- Credit spread risk.
- Exchange-rate risk.
- Equities risk.
- Volatility risk (for options).
- Liquidity risk.

VaR by historical simulation

The VaR measurement used for monitoring the aforementioned limits is a VaR by Historical Simulation with the following characteristics:

- Time horizon: 1 day.
- Confidence level: 99%.
- Decay factor of 0.97.
- Depth of series of 255 business days.

Calculation is performed daily, with the base currency being the euro.

In addition to the total VaR for the Trading Room, the measurement is obtained for the various levels and operational units of the Financial Department.

The mean distribution of the Trading Book VaR by desk for 2020 and 2019:

	2020	2019
Funding Desk and DPV	283	1,263
Forex Desk	319	254
Debt Desk	44	730
Equity Desk	286	247
Derivatives Desk	220	130
Credit Desk	319	147
Banknotes	36	19

Thousands of euros

In addition, an analytical measurement derived from the VaR, known as the market risk Component VaR is calculated and reported daily, serving to establish the contribution to the total risk of each position and market risk factor (risk concentration), approximating the sensitivity of the VaR to variations in the portfolio positions.

The component VaR can be obtained at a greater level of breakdown and reported by:

- Product.
- Risk level.

Parametric VaR

With the aim of increasing the control over the VaR historical simulation model, the parametric VaR is calculated and reported daily to provide a point of comparison for the risk estimate.

This methodology is based on statistical hypotheses of normality in the distribution of probability of changes in the risk factors. Using the historical series of market prices (provided by the Market Data Service), we calculate (in the market risk measurement tool) the volatility and correlation between assets, which together with the hypothesis of the distribution of probability of changes provide an estimate of the potential change of a position.

Expected shortfall

Another more advanced method supplementing market risk measurements is the Expected Shortfall. The aim in this case is to measure the expected loss in the event that the VaR levels were to be exceeded. It therefore quantifies the risk within the loss zone. This is an asymmetric measurement which, unlike the VaR, not only takes into consideration the frequency of losses but also their magnitude in the event that the VaR were exceeded.

Back-testing

Monitoring tests to check the goodness-of-fit of the market risk model are carried out; for this purpose, clean and dirty back-testing studies are performed, which help us demonstrate the suitability of this model in the daily activity.

Contrast statistics

With the purpose of completing the models in further detail and more effectively and complementing back-testing, stricter goodness-of-fit tests are performed to help identify possible inefficiencies in their calculation.

These tests are an essential tool to manage market risk, especially when a part of it lies on the use of models and systems that stem from a series of hypotheses that require practical confirmation.

The metrics used are carried out on 2 levels:

- General metrics applicable to all methodologies of VaR calculation.
- Specific normality metrics applicable to parametric methodologies.

Management results

On the basis of the risk tools, the management results for the trading books are calculated on a daily basis.

The criterion followed is mark-to-market for positions with directly observable market prices (funds, bills, futures, options on organised markets) and mark-to-model (theoretical valuation) with market inputs for operations without a quoted price (deposits, OTC derivatives, etc.).

Sensitivity measurements

Although the limits are structured with regard to the VaR measurement, which summarises all types of risks and portfolios in a single indicator, there is a series of supplementary measurements for the monitoring of market risk exposure, which are quantified and reported daily. The sensitivity measurements performed are as follows:

- Total Delta: Sensitivity of the Net Present Value (NPV) to parallel changes in the yield curve.
- Curve risk: Sensitivity of the NPV to changes in the structure of the yield curve terms resulting from changes in the slope or the form of the curve in any section.
- Spread risk: Measurement of the specific risk incurred with debt instrument issuers. In addition, liquidity risk is quantified by taking into consideration the nature of the portfolio positions and the situation of the financial markets.
- Exchange rate sensitivity: Sensitivity of the NPV of foreign currency positions in the portfolio to changes in exchange rates.
- Price sensitivity: Sensitivity of the NPV of equities positions in the portfolio to changes in the prices of the portfolio securities.
- Volatility sensitivity: Sensitivity of the NPV of options positions in the portfolio to changes in the volatility of the underlying factors (Vega risk).

Stress testing

The purpose of stress tests is to estimate the effects in terms of losses of an extreme change in the market on the current portfolio. To this end, one or several "worst-case scenarios" are defined for the evolution of prices and rates, based on actual situations that have been observed in the past, or others that may be generated.

The inclusion of the results of the stress tests in reporting systems provides information to operators and persons responsible on the level of losses which could be suffered in positions in extreme cases, and it helps to identify the risk profile of the portfolios in such situations.

The stages to be assessed are approved at the Financial Risk Committee and ratified by the ALCO. The specific risk impact is added to these (via the spread).

Two types of calculations are made to obtain the impacts of stress. This first one employs a static methodology in which the market conditions are altered without considering any type of correlation between the different assets. The second calculation uses a stochastic methodology (Stress-VaR) that applies the correlations and volatilities occurred in a historical period of high volatility in the market.

Limits on market risk

The measurement of market risk for the trading book is performed by means of the VaR, both by the Parametric and Historical Simulation methodology (for the purposes of the consumption of limits, the former is currently used), incorporating criteria of diversification and correlation between risks (diversification benefit).

The general structure of limits is determined by the following guidelines:

- The Board of Directors, within the Risk Tolerance Framework, establishes global limits and, at the proposal of the ALCO, approves implementation plans and management procedures.
- The Assets and Liabilities Committee establishes a general framework of limits for market risk management and the distribution of limits across the desks.
- The Board of Directors approves and reviews, in the ALCO Manual, modifications to these limits at the proposal of the Assets and Liabilities Committee.
- The head of the Financial Department is responsible for consumption of the global limit, along with the delegated limits, with any possible excesses requiring authorisation from the ALCO.
- The Risk Department is responsible for the monitoring of and compliance with the limits and reporting of consumption to the Assets and Liabilities Committee.

There are two limit structures to control market risk in trading activity:

- VaR limits that measure the maximum one-day potential loss authorised in accordance with the size and composition of the portfolio risk exposure at the close of day.
- Stop-loss limits that measure the maximum real loss authorised both for the Trading Room and for its various constituent desks, incorporating the result of intraday operations. There is one monthly and another annual limit, along with a weekly and 22-calendar-day references.

The Stop-Loss limits are reviewed periodically, with this review coinciding with the corresponding process applied to the VaR limits.

In addition, in order to have a greater degree of control, monitoring of a VaR reference in situations already affecting stress has been put in place.

Any excess over the total limit of the Financial Department, both monthly and annually, must be analysed in an extraordinary ALCO, where the actions to be taken are decided.

3. Operational risk

The General Risk Management Framework approved by the Board, implementing the Risk Tolerance Framework, contains the policies regarding the assumption and management of operational risk.

The objective of Cecabank with regard to operational risks is management and control, so as to align the operational risk "profile" of the bank with the guidelines established by the governance bodies.

Cecabank adopts the policy of comprehensive management of operational risk, applied in a uniform and systematic manner to all structural units of the organisation, whether they are business or support units, and to the foreign branches. It will also apply to subsidiaries under the principle of proportionality, depending on their relative importance for the bank; in any case, the comprehensive management policy will include subsidiaries whose ordinary margins, total assets and number of employees represent a percentage exceeding 5% of the group.

In accordance with Regulation (EU) no. 575/2013, the Operational risk is the risk of suffering losses due to inadequacy or flaws in the processes, people, or internal systems, or due to external events. The operational risk scope covers the management of the different types of operational risk affecting the bank as a whole.

Operational risk is managed through the Operational Risk Unit (ORU). ORU is responsible for preparing the bank's non-financial risk maps, and planning, organising, and coordinating the implementation of the operational risk management system at the bank. It implements operational risk management procedures and verifies that the first line of defence adequately identifies, assesses, measures, controls, manages and communicates all operational risks and applies the approved policies and procedures related to the identification and collection of operational events that have produced losses in the bank. It also coordinates the development and implementation of action plans aimed at mitigating operational risk and proposes the establishment of measurement methodologies and indicators.

The Operational Risk Unit carries out its tasks under the principle of functional collaboration with the various areas. Each Corporate Director designates one or more people in charge of managing the operational risk for their department, whose functions are to develop the principles of operational risk management in the terms established by the Compliance and Operational Risk Committee. Specifically, it identifies and reports all the actual or potential risk situations that may arise within processes and events that are subject to operational losses and the causes thereof.

As regards legal risks and the like, the Operational Risk Unit will oversee its functions in coordination with the Regulatory Compliance Function.

Operational Risk Management Policies

As previously stated, the General Risk Management Framework approved by the Board, implementing the Risk Tolerance Framework, contains the policies regarding the assumption and management of operational risk.

Below is an overview of the policies connected with managing this risk.

3.1 Identification of operational risk

All activities, products and services of the bank are subjected to a periodic analytical process in order to identify inherent operational risks and control points aimed at their mitigation.

The risk identification processes will be carried out through a permanent working group which, in addition to the risk control units, will feature the participation of Internal Audit, Organisation, and the person responsible for the activity or service to analyse. It will also systematically identify the relevant risks that may arise as a result of external or internal changes and it will include risk indicators that enable the risk to be assessed, directly reflecting the quality of operational environments and effective control.

A rigorous and systematic record is kept of all events which have generated operational losses at the bank. This record is maintained separate from accounting information records and integrated with all other operational risk management procedures.

Any losses due to operational risk shall be classified, according to the categories established in Regulation (EU) no. 575/2013, as internal fraud, external fraud, sales practices, labour relations, damage to physical assets, technological faults and process errors. The events will be stored in a database for losses, identifying their source, occurrence, posting date and recoveries, where applicable, among other aspects.

The development of new activities, products or systems requires the identification and assessment of the inherent risks associated with them.

The risk control units will inform the Compliance and Operational Risk Committee when it is deemed that an excessive inherent risk is incurred, in order for this Committee to issue specific preventive measures to be taken or to advise against the launch of the new activity or product.

3.2 Self-assessment and measurement of operational risk

The Operational Risk Unit will develop an internal model for qualitative assessment. Said model must be well documented and integrated within the established operational risk management processes, and its results will be an integral part of the operational risk profile control and monitoring process of the bank.

The risks and mitigation control points shall be subject to systematic assessments in order to obtain the existing residual operational risk in activities, systems, and products, employing quantitative techniques for this purpose. A residual risk is understood to be the part of the risk not covered by means of the internal control structure of the bank or insurance arranged with third parties. In other words, the part of the risk which with a certain degree of probability could have a negative impact. The profile obtained is compared against the desired profile, in order to initiate the appropriate corrective actions.

Quantitative assessment will check that the basic internal control factors of the bank that have been identified reflect the quality of internal control and contribute to immediately acknowledging improvements and deteriorations observed in the operational risk profile. The assessment process identifies potential increases in risk attributable to internal or external sources.

The assessments will be subject to frequent comparison processes based on the results of the controls conducted by the second and third-level control units.

The results obtained in the assessment are binding. The persons responsible for each activity, product or service will take part in the assessment procedure, and the Area Managers will validate the assessment provided by the headship under their responsibility.

3.3 Monitoring operational risk

In the monitoring phase, all the variables defined for the identification and assessment of risks will be reviewed, with the aim of ensuring and supporting consistency in the assessment/measurement process in the various areas; assessing the quality and appropriateness of the mitigation techniques applied; and guaranteeing that

the premises established in the initial identification/assessment model are kept constant.

Parameters will be set for the risk indicators within certain thresholds, generating alerts that warn about changes in the evolution of the risk. These alerts will be analysed by comparing their values during the last three measurement periods to the thresholds established in their configuration. Depending on the result of said analysis, the corresponding Area shall be approached, where applicable, to justify the increased exposure to the risk, and the decision will be reached on whether any additional controls will be required for their mitigation or whether the current situation of the business leads to the conclusion of modifying of the defined thresholds.

The implementation of the Action Plans arising out of the control weaknesses observed in previous assessment processes will be checked, contrasting the resolution of the control incidents observed, and the Operational Risk Unit will ascertain that the improvements performed have been incorporated into the following assessment process.

The Operational Risk Unit must analyse events that have given rise to losses and re-assess the processes affected both positively (reduction in losses) and negatively (increase in losses), and propose any improvements deemed necessary to those in charge of the activities/processes that have produced losses.

In addition, any events that affect the bank's reputation shall be reported to the Regulatory Compliance Department so it can adopt any preventive measures it deems appropriate.

3.4 Mitigation of operational risk

The Compliance and Operational Risk Committee will approve the strategies proposed by the Operational Risk Unit in order to mitigate those risk levels deemed unacceptable. These strategies may be of the following kinds:

- Improvement actions, which aim to reduce the potential impact on the bank of the risks assumed. These actions may consist in the development of new controls, redesign of processes and development of contingency and continuity plans.
- Actions to transfer the risks to other banks, for example by means of insurance of any risks which the bank may face over a period of time.
- Coverage or insurance of the risks, for example by means of the use of provisions to cover the impacts of the risks or financial hedging at the point of impact.
- Acceptance of the current situation, having deemed that the risk profile is aligned with the situation desired by senior management.

The Control/Mitigation Strategies must be agreed with the supervisors of the areas affected if these processes entail increased allocations of human or technical resources or significant restructuring of the processes.

4. Risk in equity instruments not included in the trading book

The bank maintains positions in equity instruments not included in its trading book. These positions are investments in entities that are held, generally, for strategic purposes.

Monitoring of these positions is integrated into ordinary risk management circuits.

Section 6 of this document includes information on these instruments and the capital requirements deriving from them.

5. Interest-rate risk in the banking book

The structural interest-rate risk in the balance sheet may be defined as the exposure of the financial and economic situation and, thus, changes in interest rates as a result of the differing time frames of maturities and repricing of the overall balance sheet entries. This risk comprises a substantial part of the banking business and could have a major impact on the financial margin and economic value of capital. As a result, interest-rate risk management maintaining this at prudent levels is essential for the security and strength of the bank.

Objectives, policies, and processes for the management of interest-rate risk in the banking book

The objectives set for the management of balance sheet risks are as follows:

- Establishing appropriate mechanisms in order to prevent unexpected losses through the impact of interest-rate changes, through protection of the financial margin and economic value of capital.
- Adopting investment and hedging strategies which achieve a short-term (financial margin) and long-term (economic value of capital) balance in the financial impact deriving from changes in interest rates.
- Executing hedging and investment strategies which strengthen the generation of profit under the risk levels approved.
- Ensuring adequate liquidity levels that facilitate adequate business growth with optimum financing costs, ensuring an adequate level of liquid assets and managing changes in liquidity in the medium/

long term through own debt issuances or through any other means.

In order to achieve the aforementioned objectives, a structure of structural balance-sheet risk limits has been devised, guaranteeing that levels of exposure to risk lie within the tolerance level established by senior management.

The Board of Directors defines the general operational framework and approves risk limits in accordance with its risk tolerance level. Structural risk is managed for both the short term and the medium and long terms and takes the form of limits which are approved by the Board itself, and for which monthly monitoring is performed.

Senior management is actively involved in the risk management through the Assets and Liabilities Committee (ALCO). This committee is responsible for performing the actions required in order to redress any possible balance-sheet risk imbalances.

Ensuring that exposure to interest-rate changes is kept within the levels approved by the Board, along with the measurement, analysis and control of the structural balance-sheet risk incurred by the Financial Division operations, is the responsibility of the Market, Balance Sheet and Liquidity Risk Division.

Measurement of interest-rate risk in the banking book

Repricing gap analysis

The purpose of gap analysis is to measure any surplus or shortfall in the volume of sensitive assets with respect to sensitive liabilities, and the volume not matched (and so not hedged), and subject to possible variations in interest rates. Thus, the risk exposure is identified through a study of the concentration of volumes of repricing risk over significant time frames.

It illustrates the exposure to interest-rate risk on the basis of the structure of maturities and/or repricing of positions. This analysis enables the distribution of interest risk along different terms, and also aims to ascertain where potential impacts may affect the financial margin and equity.

The interest-rate gap is built up by distributing – into time bands – the positions and balances of the sensitive entries on and off the balance sheet, in the part corresponding to the banking book. In the case of entries with no maturity or repricing date, they are distributed in accordance with a historical performance hypothesis.

Simulation of the financial margin

In order to incorporate a dynamic balance-sheet analysis to address various rate scenarios, financial margin simulations are performed over a time horizon

of one year. This enables the analysis of the impact of changes through a movement in interest rates in accordance with the repricing periods of the various balance sheet entries.

The scenarios analysed are not only the implicit market forward rates, but also include other anticipated changes in the stress scenarios and curves.

Sensitivity of the Economic Value of Capital

In order to analyse the sensitivity of economic value, the impact of the usage of a number of stressed rate curves on the net present value (NPV) is analysed, calculated on the basis of the zero-coupon curve data.

In order to supplement the sensitivity measurements, a methodology similar to the market VaR is applied, which enables the calculation of the Economic Value of Capital at Risk over a period of one month, and with a confidence level of 99%, taking into consideration all risk factors affecting the balance sheet.

Interest-rate risk limits

The Board of Directors, as part of its monitoring function, establishes limits for interest-rate risk in terms of sensitivity to variations in market interest rates. These changes are performed both for the net interest margin and the economic value.

6. Liquidity risk

Liquidity risk is defined as:

- The uncertainty of succeeding in financing at a fair price the commitments assumed, at times when recourse to external financing would be problematic for a given period.
- The maintenance or generation of the liquidity levels required to finance the future growth of the business.

In other words, this risk reflects the probability of incurring losses or being required to abandon new businesses or growth of current businesses through an inability to meet maturity commitments on a normal basis, or inability to finance additional needs at market costs. In order to mitigate this risk, the liquidity situation is periodically tracked, along with possible actions to be taken, with measures established in order to be able to re-establish the overall financial balance of the bank, in the event of a potential liquidity shortfall.

Objectives, policies, and management processes for liquidity risk

The objective with regard to liquidity risk is to have instruments and processes in place at all times to enable payment commitments to be met in a timely

manner, through access to instruments serving to maintain sufficient levels of liquidity in order to meet payments without significantly compromising profit, and the maintenance of mechanisms which, in the event of various eventualities, would serve to fulfil payment commitments.

In general and traditional terms, various forms of acquiring liquidity are available, including the capture of customer deposits, the availability of various funding facilities through official bodies and the capture of liquidity through the interbank market.

Liquidity Risk Measurement

There follows an overview of the measurements employed by the Market, Balance Sheet and Liquidity Risk Division to measure Liquidity Risk.

Liquidity gap

The liquidity gap measures the maturity and settlement profile by risk line (assets and liabilities classified in accordance with their residual maturity term plus the interest flows derived from these volumes) and reveals the balance mismatch structure in terms of cash flow incomings and outgoings.

It reflects the level of liquidity maintained under normal market conditions and provides information on cash incomings and outgoings, both contractual and non-contractual, in accordance with performance hypotheses for a given period.

This is reported on a monthly basis.

Liquidity Inventory

A list is drawn up in order to monitor available liquid assets so as to identify potential sources available in the event of a liquidity contingency.

Liquidity ratios

As part of monitoring the liquidity position, the regulatory ratios are calculated:

- **LCR (Liquidity Coverage Ratio):** This is the statutory ratio used to measure whether adequate funds are available in terms of unencumbered high-quality liquid assets (HQLA), which can easily and immediately be converted into cash on the markets, in order to cover liquidity requirements in the event of liquidity problems of 30 calendar days.
- **NSFR (Net Stable Funding Ratio):** This ratio is defined as the amount of available stable funding relative to the amount of required stable funding and aims to ensure the balance sheet is kept balanced and stable funding requirements are financed by stable liabilities. In other words, the aim is for banks to finance their assets in the medium and long term with stable long-term resources

(such as equity, stable current accounts, etc.) and reduce the excessive dependence on financing from capital markets.

In addition, other liquidity ratios are used for the purpose of evaluating and measuring liquidity in the balance sheet, monitoring the following on a daily basis:

- **Short-term liquidity ratios.** These ratios estimate the potential capacity to generate liquidity within a period of 7, 15 and 30 days in order to meet a liquidity eventuality, and they assess the adequacy of the proportion of sight deposits captured and maintained in liquid assets.

The short-term liquidity ratio is calculated as follows:

- Numerator, sum of the following concepts:
 - Collection flows (dynamic, with renewed maturities of temporary asset acquisitions) for the determined period.
 - Total amount of the inventory of liquefiable assets (impact of immediate sale and/or discount of the entire inventory of liquefiable assets).
- Denominator:
 - Payment flows (dynamic, with renewed maturities of temporary liability disposal) for the determined period (with a normal impact on current accounts).

This ratio measures Cecabank's capacity to generate sufficient liquidity to meet the committed payments without the need to appeal to the interbank market. The risk level of the proposed limit means that, taking into account the collection and payment structure in the analysis period, with the discount facility in the ECB of eligible assets and the sale of other liquefiable assets, the bank has sufficient resources to cover payments in the limit reference period without having to resort to the interbank market or to take periods longer than those used to calculate the ratio.

- **Structural liquidity ratio.** The purpose of this ratio is to identify the funding mismatch, indicating the structure of liquidity generation and financing/investment by term.
- **Survival ratio.** This ratio estimates the term over which liquidity commitments can be met in the event of a lack of access to the interbank market or alternative sources of funding, for a period of 30 days. Various scenarios are combined for non-availability of access to the sources of funding covered by this calculation, along with the immediate withdrawal of customer positions classified as stable.

Stress ratios are also applied, combining different restrictions such as the inaccessibility of capital markets, a mass withdrawal of deposits, the activation of contingent liquidity commitments and other external market conditions.

In addition, daily monitoring is also performed on a series of leading alert and intensity indicators with regard to a liquidity crisis, and a detailed and permanently updated inventory is maintained of the "liquidation" capacity of balance sheet assets.

Liquidity risk limits

The Board of Directors, as part of its monitoring function, establishes a framework of limits for liquidity risk, based on the monitoring of the short-term liquidity situation.

Specifically, limits have been established for the LCR (Liquidity Coverage Ratio), the NSFR (Net Stable Funding Ratio) and the short-term liquidity ratio previously defined, and for the 1-month liquidity gap with respect to stable funding, which compares the net refinancing needs at 1 month, together with the capacity to liquidate positions in the portfolio, with respect to stable funding.

Any excess beyond these limits must always be authorised by the Assets and Liabilities Committee whenever deemed necessary and must be reported to the Board of Directors together with the action plan in order to redress the situation.

7. Other risks

7.1 Compliance risk

Compliance risk is defined as the potential impact that failure to comply with legal demands or internal standards could have on the income statement, either directly, as a result of official sanctions or adverse judgments, or indirectly, through a negative impact on the bank's reputation.

The Regulatory Compliance Department has devised a comprehensive compliance risk management system comprising three levels:

- **Risk maps,** identifying obligations for which compliance is controlled with an incorporated methodology to assess risks on the basis of objective criteria (possible penalty applied by the supervisory authority, and probability of reputation impact as a result of publication of the penalty).
- **Control map,** setting out the controls to cover the risks identified on the risk map.
- **Design of an information or reporting system,** by means of which the results obtained from the

controls are reported to the PMLFT Committee and the Compliance and Operational Risk Committee, in order for appropriate corrective measures to be adopted. The annual reports on compliance activities are also presented to the Audit Committee.

7.2 Reputational risk

EBA/GL/2014/13 defines reputational risk as the current or future risk to the bank's profits, own funds or liquidity arising from damage caused to its reputation. This risk comes from a wide variety of sources, including economic and financial, strategic, operational and liability related, and its understanding is highly variable depending on the interest group. This causes it to have an approach, management model and control that is different from other risks, even if it is integrated in a coordinated manner with respect to other financial and non-financial risks through Cecabank's Global Risk Control Unit.

The reputational risk control function has a Reputational Risk Procedure Manual in place, which was approved by the Compliance and Operational Risk Committee. This establishes the methodology for measuring this risk and the monitoring and reporting procedure. Work is currently being done on drawing up a scorecard that will allow for closer and more frequent monitoring of the bank's reputational risk.

In addition, in 2016 the Compliance and Operational Risk Committee approved a new system to assess reputational risk of new counterparties/customers, which meant all legal entities (falling within the predefined subjective field) requesting the provision of services would be assessed. According to this new procedure, if the final assessment of the qualitative report (overall risk assessment and assessment of product/service sensitivity) is Medium-High or High, as well as when there is not enough public information available to perform an evaluation, the result would be put forward to the Compliance and Operational Risk Committee to make a decision on the counterparty as a prerequisite for admission. Reports produced over the year have also served for reference in the process of the bank's measuring of general reputational risk.

7.3 Criminal risk

The drafting of the Code of Criminal Procedure governed by Organic Law 1/2015 entailed a substantial change in the way in which the criminal liability of legal persons is articulated, as it redefined the requirements that give rise to such liability (Art. 31 bis, section 1, of the Code of Criminal Procedure):

- "The offences committed in their name or on their behalf, and for their direct or indirect benefit, by their legal representatives or those that, acting individually or as members of a legal entity's body,

are authorised to make decisions on behalf of the legal person or have the authority to organise and control them".

- "The offences committed, in the exercise of social activities and on behalf of and for the direct or indirect benefit thereof, by those who, being subject to the authority of the natural persons mentioned in the previous paragraph, have been able to carry out the events because they have seriously failed to perform the duties of supervision, surveillance and control of their activity, given the specific circumstances of the case".

In view of the risk of possible criminal conduct, and for its prevention, the bank has implemented and maintains a Criminal Risk Organisation and Management System. This system has specific internal regulations, comprising a Criminal Compliance Policy, a Structural Document and a Roles and Responsibilities Document. The System has been certified by AENOR in accordance with the UNE 19601 Standard on criminal compliance.

7.4 Business risk

Business risk is understood as the possibility of suffering losses arising from hypothetical downturns (internal or external) that negatively affect the bank's capacity to achieve its objectives and, as a result, negatively affect its profits (income statement) and, thus, its solvency.

The Risk Tolerance Framework approved by the Board of Directors establishes the pursuit of long-term revenue stability as a priority for the management of this risk. This is the principle which must prevail in relationships with customers, including contractual relationships.

The risk assessment does not focus solely on those elements which could result in a particular strategy proving unsuccessful, but rather an analysis of the elements that may affect long-term performance and positioning.

All these risks are taken into account when the Board of Directors sets the bank's strategy, focusing on the competition and structural elements of the markets that could influence the competitive position and customer base, affecting the company's value.

The pillars on which this risk is addressed, which are qualitative, which may take time to present itself and for which a quantitative approach is not valid, are as follows:

- A framework of ongoing monitoring for the markets in which the bank is exposed, from various perspectives (economic, regulatory, competition, business at risk, etc.).
- Monitoring at various levels of the evolution of businesses and the comparison of these results with the strategic planning suppositions.

- Diversification by business type and by customer.
- Maintenance of a stable and recurrent profit structure. In addition to ensuring that, in terms of individual businesses and for the bank as a whole, the profitability of businesses is, over time, predictable, sufficient and in line with the strategic planning budgets.
- Specialisation in businesses where the establishment of stable, long-term relationships with customers is a key element.
- Management of the relationship with customers in a transparent and transversal manner, with dialogue at various levels of the bank, in order to reduce "key person" risk.

The monitoring structure established is based on three levels:

- The Units with business responsibilities are given the task of monitoring the objectives set out in the Strategic Plan and reporting on any aspect or contingency which could jeopardise the achievement of these objectives.

- Senior management oversees the evolution of the business lines, the levels of concentration and distribution of revenue, the assessment of risks which could prevent the achievement of strategic objectives, and the volatility of the income statement.

It is also responsible for adopting any mitigation measures which might be required, and for identifying those elements and scenarios which could jeopardise the achievement of the specific objectives of each business line.

- The Board, with the support of the Risk Committee, receives information on compliance with of the Strategic Plan, as a cornerstone of establishing the focus of the bank's business and the objectives for each of the business lines.

The monitoring performed is focused on early identification of any potential impairment which could result from changes in the competitive environment, and which jeopardises profit and requires a review of the bank's strategy. Perception of the brand and the quality of services provided is also assessed, to the extent that these could affect customer decisions.

ANNEX II: Definitions of Default and “Impaired Positions” and Criteria Applied to establish the amount of Impairment Losses

The classification of operations based on credit risk due to insolvency is as follows:

- A) Standard risk:** considers all operations that do not comply with the requirements to be classified in other categories.
- B) Standard risk under special monitoring:** this category is composed of all operations that, without complying with the criteria to be classified as non-performing risk or write-offs, show significant credit risk increases from the initial recognition.
- C) Non-performing risk (deteriorated) due to non-payment by the holder:** this comprises the amount of the debt instruments, whatever their holder and guarantee, that have any overdue amount of principal, interest or contractually agreed expenses that are over 90 days old, unless they should be classified as write-offs. This category also includes guarantees granted when a guaranteed operation has entered into non-payment due to the party guaranteed.

This category also includes all of a holder's operations when the sums that are more than 90 days overdue are higher than 20% of the amount outstanding. Solely for the purposes of determining the percentage outlined, the numerator is considered the gross book value of the operations deemed non-performing due to default with the sums overdue. The denominator is considered the gross carrying amount for the total of all debt instruments granted to the holder. If this percentage exceeds 20% both the debt instruments and the off-balance exposures involving credit risk will be transferred to non-performing due to default.

- D) Non-performing risk other than due to non-performing loans of the holder:** this comprises debt instruments, whether subject to late payment or not, although the circumstances for them to be considered write-offs or non-performing due to late payment on the part of the holder have not occurred, in which there are reasonable doubts about whether they will be fully repaid (principal and interest) within the contractually agreed period; as well as off-balance exposures not classified as non-performing due to holder default where it is probable that they will be paid by the bank and doubtful that this will be recovered.

This category will include, among others, operations whose full recovery is doubtful and which do not have any amounts overdue for more than 90 days.

In addition, if any of the following factors used for automatic classification are observed they will be necessarily included in this category:

- i. Operations with reclaimed balances or operations which it has been decided will be repaid through legal means by the bank, although they are guaranteed, as well as operations on which the debtor has raised a dispute, the resolution of which depends on its payment.
 - ii. Transactions in which the collateral enforcement process has begun, including financial lease operations and operations with a purchase with subsequent lease in which the seller-lessee has the control of the leased asset for which the bank has decided to terminate the contract to recover possession of the asset.
 - iii. Operations of holders who have sought or have signalled that they wish to seek bankruptcy proceedings without any settlement request.
 - iv. The guarantees granted to guarantors declared bankrupt at a creditors' meeting who have declared or are going to declare themselves in the winding-up stages or suffer a noticeable impairment in their solvency which is unlikely to recover, although the beneficiary of the guarantee has not reclaimed their payment.
 - v. Refinancing or restructuring which is refinanced or restructured during the test period, or where overdue amounts are more than 30 days late.
- E) Write-off risk:** this category includes debt instruments, in arrears or not, which, for which after individual analysis it is considered that there is a remote chance of recovery due to a noticeable impairment or unrecoverable impairment of the solvency of the operation or holder. Classification in this category will entail the recording in the results of losses for the amount in gross book value of the operation and the total write-off of the asset.

Loss coverage by credit risk due to insolvency:

- A) Coverage for non-performing risk (impaired):**
- a. Non-performing risk due to non-performing loans of the holder:
- Banks will evaluate assets classified as non-performing due to holder default in order to

estimate loss coverage for credit risk, taking into account the age of the overdue amounts, the collateral and personal warranties received and the financial situation of the holder and guarantors. Coverage for non-performing operations will be subject to an individual or collective estimate.

The coverage for the following non-performing operations must be subject to an individual estimate.

- i. Coverage for non-performing operations due to default deemed significant by the bank.
- ii. Coverage for non-performing operations that were identified as low credit risk.
- iii. Coverage for non-performing operations that do not belong to a homogeneous risk group and, therefore, for which the bank cannot develop internal methodologies to give a collective estimate of credit losses of these operations.

- b. Non-performing risk other than due to non-performing loans of the holder:

Coverage for operations that are non-performing for reasons other than default should be assessed on an individual basis. However, when the classification has been done exclusively by considering automatic factors, coverage for operations classified in this category should be assessed as a group. As an alternative solution to these group coverage estimates, coverage percentages for risk that is non-performing for reasons of default, from the same risk segment, but for younger debts, can be used

- B) Coverage for standard risk (includes special monitoring): Coverage for operations classified as standard risk will be subject to collective estimates and operations classified as standard risk under special monitoring will be subject to an individual estimation or collective estimation. The coverage for the following standard operations under special monitoring must be subject to individualised estimates:

- i. Coverage for standard operations under special monitoring that the bank deems significant.
- ii. Coverage for operations classified as standard under special monitoring as a result of an individual analysis of the operation in which a factor other than the automatic factors has had a critical influence.
- iii. Coverage for standard operations under special monitoring that do not belong to a homogeneous risk group and, therefore, for which the bank cannot develop internal methodologies to give a collective estimate of the credit losses of these operations.

Coverage for all operations for which an individual estimate is not required will be subject to a collective estimate. Therefore, the following operations will be subject to a collective estimate:

- i. Those classified as non-performing due to default (other than those identified as low credit risk) not considered significant, including those classified as non-performing due to default caused by the accumulation of overdue amounts in other operations with the same account holder.
- ii. Operations classified as non-performing for reasons other than default (other than those identified as low credit risk) and only automatic classification factors are considered.
- iii. Those classified as standard operations under special monitoring that the bank does not deem significant.
- iv. Operations classified as standard under special monitoring as a result of an individual analysis of the operation in which only automatic classification factors are considered, or in which no factor other than the automatic factors has had a critical influence. This is the case, among others, for operations classified in this category because the account holder has outstanding amounts over thirty days old.
- v. Those classified as standard operations under special monitoring due to belonging to a group of operations with similar credit risk characteristics ("homogeneous risk group"). This is the case, among others, for groups of operations classified in this category due to the account holder belonging to groups, such as geographical areas or economic activity sectors in which weaknesses are observed.
- vi. Those classified as standard risk.

Credit risk due to country risk

Classification of operations according to credit risk due to country risk: Debt instruments not valued at fair value through profit or loss, as well as off-balance exposures, with non-resident holders, will be analysed to determine credit risk due to country risk. To this effect, country risk comprises risk where holders are resident in a particular country due to circumstances other than usual business risk. Country risk comprises sovereign risk, transfer risk and other risks derived from international financial activity.

Operations will be grouped according to the following:

- a) Group 1. This group will include operations where the parties bound reside in:
 - i) Countries in the European Economic Area.

- ii) Switzerland, the United States, Canada, Japan, Australia, New Zealand and the United Kingdom, aside from in the event of a significant deterioration of the country's country risk profile, in which case they will be classified according to that.
- b) Group 2. This group will include operations where the parties bound reside in low risk countries, in terms of their strong ability and commitment to pay.
- c) Group 3. This group will include, at least, operations where the parties bound reside in countries showing significant macroeconomic deterioration, which it is believed could affect the country's payment capacity.
- d) Group 4. This group will include, at least, operations where the parties bound reside in countries showing far-reaching macroeconomic deterioration, which it is believed could affect the country's payment capacity. This group will include operations charged to countries in group 3 which are experiencing a worsening of the indicators mentioned in the previous group.
- e) Group 5. This group will include, at least, operations where the parties bound reside in countries showing prolonged issues with resolving their debt, with the possibility of repayment considered to be doubtful.
- f) Group 6. This group will include operations for which it is considered there is a remote chance the sums will be recovered, due to circumstances attributable to the country. In all cases, this group will include operations where the parties bound reside in countries that have renounced their debts or who have not attended to depreciation and amortisation nor interest payments for a period of four years.

At 31 December 2020 the bank applies the estimation percentages and criteria established in Annex IX of Bank of Spain Circular 4/2017, of 27 November, of the Bank of Spain (which came into force on 1 January 2018).

ANNEX III: Composition of Cecabank's Committees

There follows a list of the members of each of the Committees mentioned in section 2.2.1. as of 31 December 2020:

- **Members of the Audit Committee**

Chairman: Mr. SANTIAGO CARBÓ VALVERDE

Members:

Mrs. MARÍA DEL MAR SARRO ÁLVAREZ

Mr. FRANCISCO BOTAS RATERA

Mrs. CARMEN MOTELLÓN GARCÍA

Mr. JESÚS RUANO MOCHALES

Secretary (non-member):

Mr. FERNANDO CONLLEDO LANTERO

- **Members of the Risk Committee**

Chairman: Mrs. CARMEN MOTELLÓN GARCÍA

Members:

Mr. VÍCTOR MANUEL IGLESIAS RUIZ

Mrs. JULIA SALAVERRÍA MONFORT

Mr. FRANCISCO JAVIER GARCÍA LURUEÑA

Mrs. MARÍA DEL MAR SARRO ÁLVAREZ

Secretary (non-member):

Mr. FERNANDO CONLLEDO LANTERO

- **Members of the Appointments Committee**

Chair: Mrs. JULIA SALAVERRÍA MONFORT

Members:

Mr. ANTONIO ORTEGA PARRA

Mr. JAVIER PANO RIERA

Mr. SANTIAGO CARBÓ VALVERDE

Secretary (non-member):

Mr. FERNANDO CONLLEDO LANTERO

- **Members of the Remuneration Committee**

Chair: Mrs. MARÍA DEL MAR SARRO ÁLVAREZ

Members:

Mr. JESÚS RUANO MOCHALES

Mr. SANTIAGO CARBÓ VALVERDE

Secretary (non-member):

Mr. FERNANDO CONLLEDO LANTERO

ANNEX IV: Conciliation of the own fund items with the audited financial statements

Item	Amount (phase-in)	Amount (fully loaded)	Accounting matching
Tier 1 capital	644,600	654,420	
Common Equity Tier 1 capital	644,600	654,420	
Equity instruments eligible as Common Equity Tier 1 capital	727,750	727,750	
Paid-up equity instruments	112,257	112,257	Individual Public Balance Sheet-Equity PI.1.3.a Heading "Paid-Up Capital"
Share premium	615,493	615,493	Individual Public Balance Sheet-Equity PI.1.3a. Heading "Share Premium"
Retained earnings	388,891	388,891	
Retained earnings from previous years	339,382	339,382	Individual Public Balance Sheet-Equity PI.1.3a. Heading "Retained Earnings"
Eligible profit	49,509	49,509	
Accumulated other comprehensive income	24,310	24,310	Individual Public Balance Sheet-Equity PI.1.3.a Heading "Accumulated other comprehensive income"
Other reserves (application of IFRS9)	14,796	14,796	Individual Public Balance Sheet-Equity PI.1.3.a Heading "Other reserves"
Common Equity Tier 1 capital adjustments due to prudential filters*	-5,617	-5,617	
Other intangible assets (-)	-491,594	-491,594	Note 13.1 of the Cecabank Individual Report "Intangible assets"
Pension fund assets with defined benefits (net of related liabilities)	-4,116	-4,116	
Pension fund assets with defined benefits	-5,880	-5,880	Note 14.1 of the Cecabank Individual Report "Net assets in pension plans"
Liabilities related to defined benefit pension fund assets	1,764	1,764	
Other transitional adjustments of the Common Equity Tier 1 capital (-) (**)	-9,820	-	

Thousands of euros

* Value adjustments due to reductions for prudent assessment requirements

** Amount of accumulated unrealised gains and losses as of 31 December 2019, accounted for as "changes in fair value with impact on other comprehensive income" of sovereign debt instruments in accordance with Regulation (EU) 2020/873, amending CRR and CRRII as regards Article 468.

cecabank