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**BBVA** making the difference



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**José Sevilla**

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**General Manager Risk**

***“Risks at BBVA”***

**BBVA** making the difference.



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- **The risk function**
- Credit risk
- Other risks
- Basel II
- Conclusions



## Risk function: global and company wide approach, with local implementation

### Risk function is core at BBVA

- Strong risk culture throughout the Group
- Fully independent function: strict corporate governance standards
- Highly qualified teams

### Company wide approach

- Tools, models and general policies follow corporate standards
- Integrated management of all risks: economic capital used for managing businesses

### Local implementation

- Risk models adapted to local conditions
- Decentralised teams with functional dependence from holding company
- Proximity and knowledge of end-customer is crucial



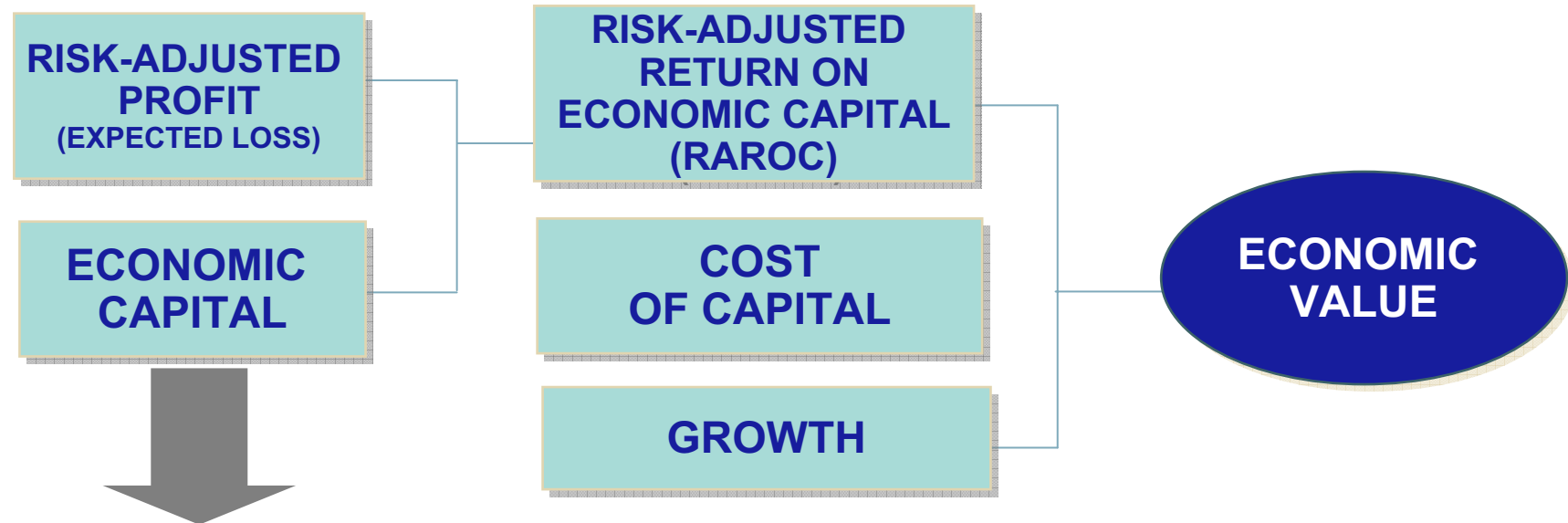
## Economic capital is a key element in our risk management model ...

- We have been working along these lines for **years**...
- ... with the support of robust **internal models** and methodologies, **solid IT support and highly qualified teams**...
- ... consolidating the **forward-looking focus** of risk management, combining economic capital with the analysis of recurrence and scenarios...
- ... and allowing **to compare** between risks and their **integration**:
  - In credit risk: translates into same units exposures of nominally very different profiles
  - Different risk types: translates into same units heterogeneous risk categories





## ... allowing for the integration of risk management with the Group's value-based approach



### *Fully integrated into management...*

- Corporate strategy: management of business portfolio
- Budgets and planning (Group and business units)
- Incentives: based on economic profit
- Business strategy: product design, price setting, customer segmentation

*... and key element to valuing adequacy of provisions and capital*



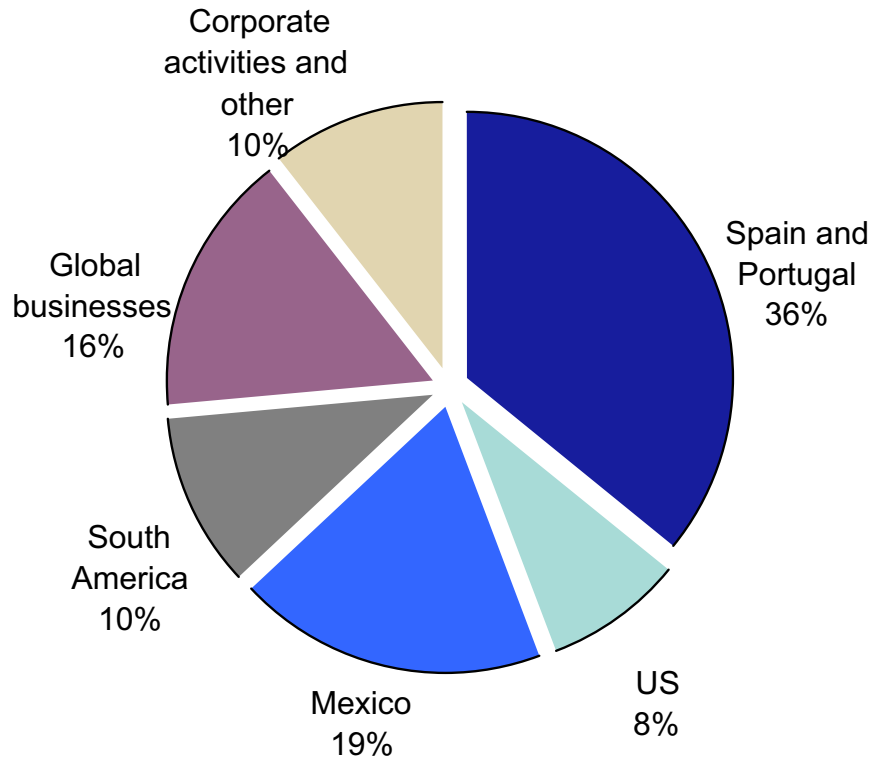
# Risk profile diversified by geographies and products with a considerable retail bias

## Economic Capital

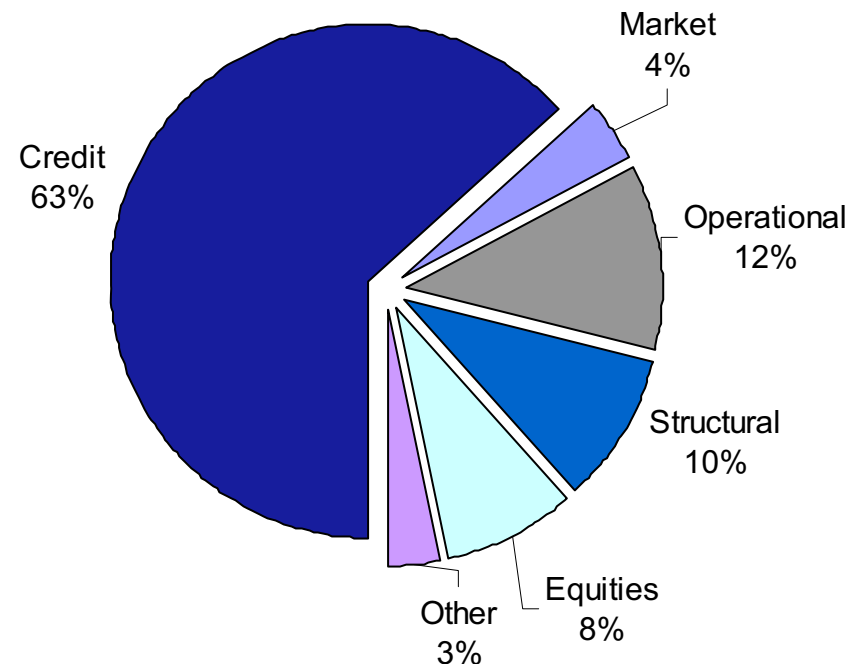
September 2007

Total: €18.78 billion

Business units



Risk types







- The risk function
- **Credit risk**
- Other risks
- Basel II
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# Credit risk: an example of company wide approach + local implementation

1

## Rating for companies and institutions

- Corporates
- SMEs
- Real-estate
- Public sector
- Financial entities
- Country risk

2

## Scoring for retail exposures

- Behavioural and reactive
- Segmented by product
  - Consumer
  - Cards
  - Mortgages
  - Business

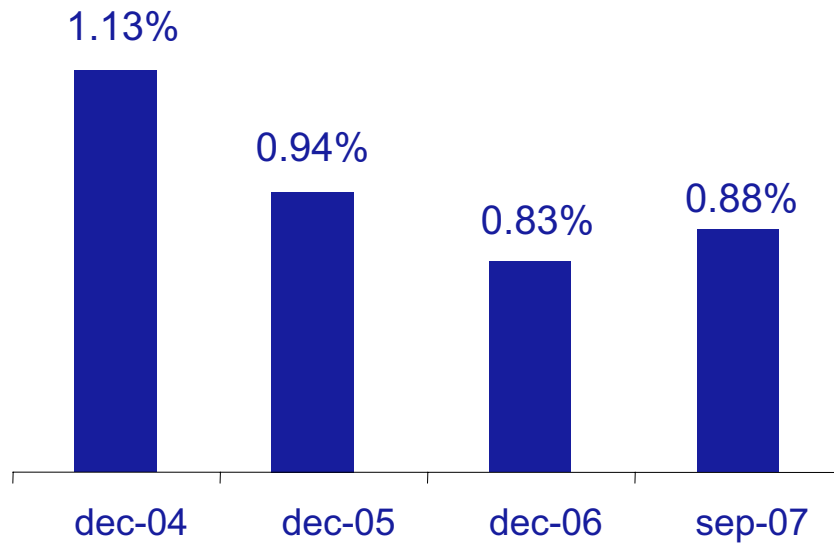
- Implemented throughout the group and integrated in processes and schemes of risk acceptance
- Uniform corporate policy tailored to local market conditions
- Global tools and database facilities
- Centralised calibration of economic capital and expected loss
- Cross view of Group credit risk profile



# Favourable NPL evolution in recent years

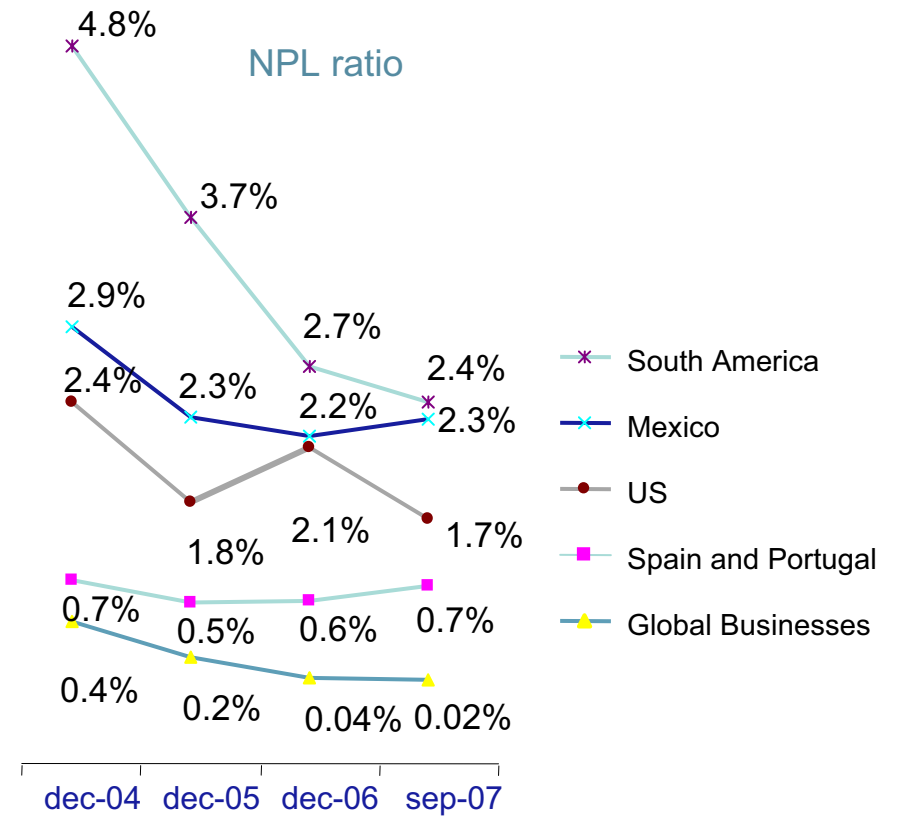
## Group

NPL ratio



## Business Units

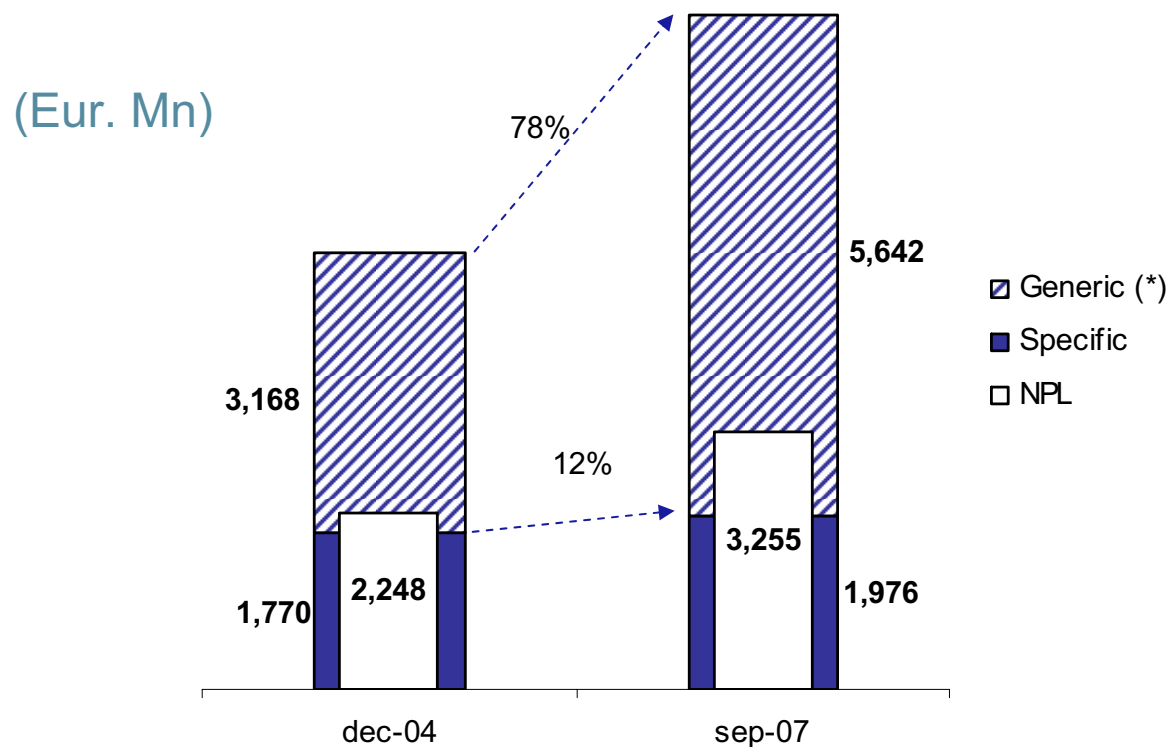
NPL ratio





## And very substantial coverage ratio

**GROUP COVERAGE RATIO = 234.1%**  
**€5.6 billion generic provisions vs**  
**€2.3 billion expected loss**  
**(Cyclically adjusted)**



(\*) Includes country-risk



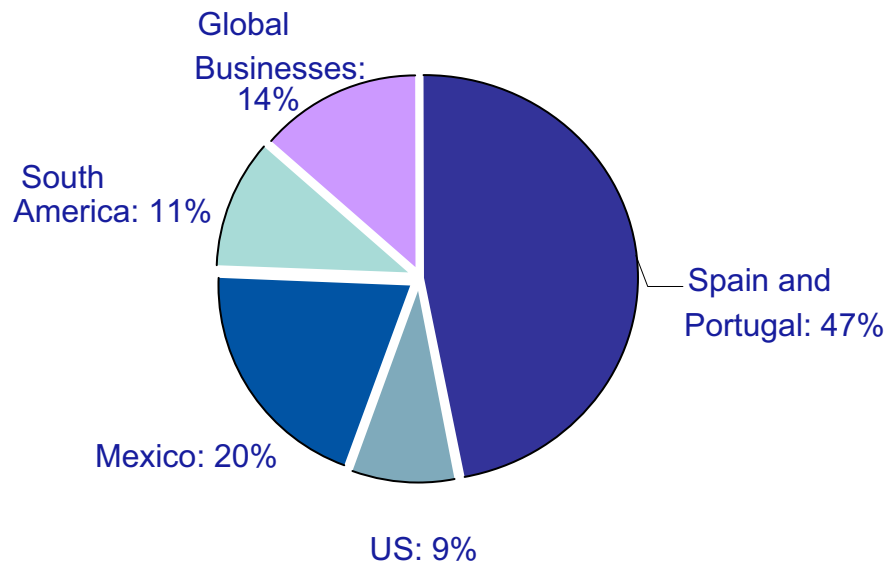
# Distribution of economic capital by credit risk

## Credit risk economic capital

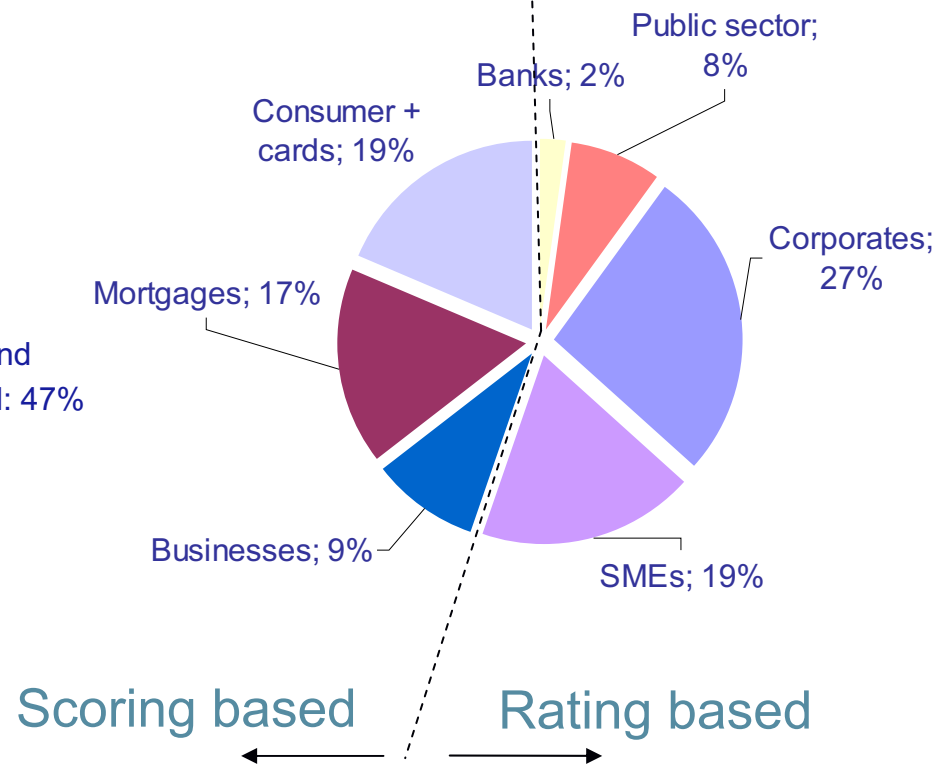
September 2007

Total €11.89 billion

### Business units



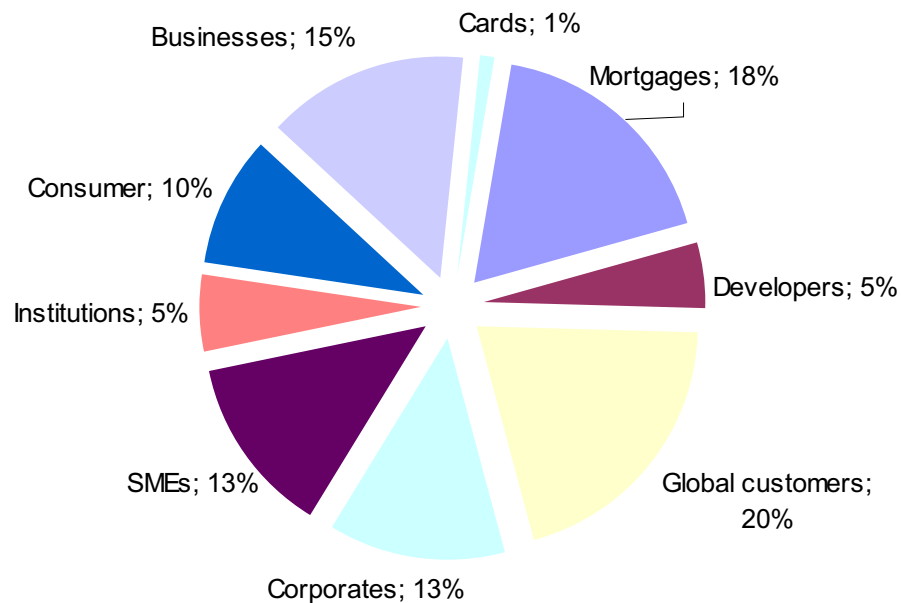
### Risk segments





# Credit risk in Spain and Global Businesses: broad diversification of customer and product portfolio

## Economic capital distribution Credit risk



Focus on 3 key portfolios:

- **Mortgages**
- **Developers**
- **Global Customers**



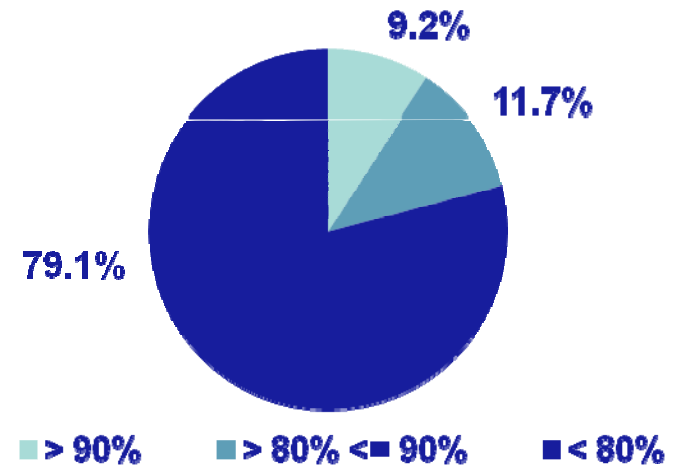


# Spain: Prudent risk profile in residential mortgages (I)

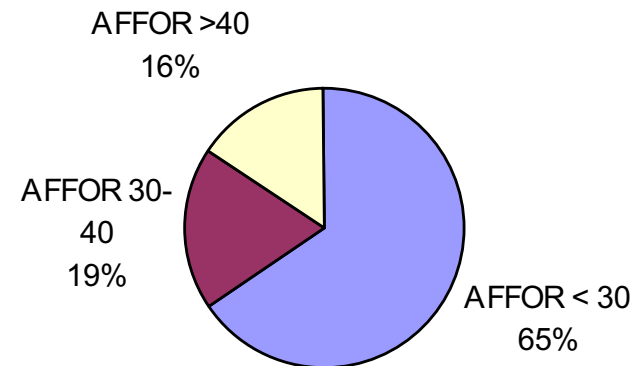
| Residential mortgages (€ m) |         | % Group  |
|-----------------------------|---------|----------|
| No of loans                 | 890,525 |          |
| Lending                     | 71,040  | 23.0%    |
| % second home               | 5.0%    |          |
| NPLs                        | 279.6   | 8.6%     |
| NPL ratio                   | 0.39%   |          |
| Coverage ratio              | 275%    |          |
| Provisions                  | 768     | 10.1%    |
| Economic capital            | 1,152   | 9.7% (*) |

(\*) % of credit risk economic capital

% LENDING BY LTV (av 53.3%)



AFFORDABILITY (av 26.3%)



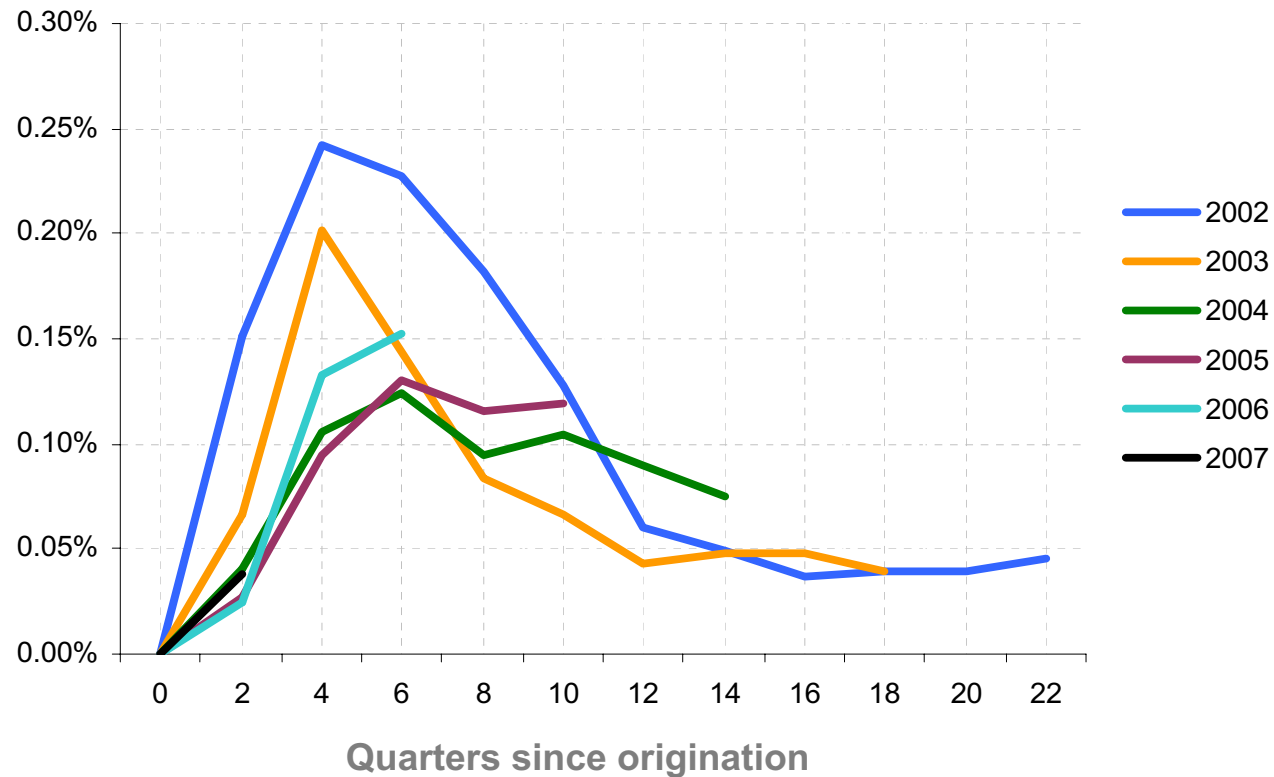
LTV calculated on historical appraisals



# Spain: Prudent risk profile in residential mortgages (II)

## Residential mortgages by vintage

Quarterly NPL entries





## Developers: prudent and consistent policies in recent years

- Specialised analyst team with cyclical view.
- Diversified portfolio, good asset quality and limited exposure relative to Group.
- Solid customers, experts in market.
- Land financing policy: rigorous approval conditions.
- Reduced and selective second home development exposure.

| Developers (€ m) |        | % Group  |
|------------------|--------|----------|
| No loans         | 12,043 |          |
| Lending          | 14,798 | 4.8%     |
| NPLs             | 12.5   | 0.4%     |
| NPL ratio        | 0.08%  |          |
| Coverage ratio   | 1,961% |          |
| Provisions       | 245    | 3.2%     |
| Economic capital | 277    | 2.3% (*) |

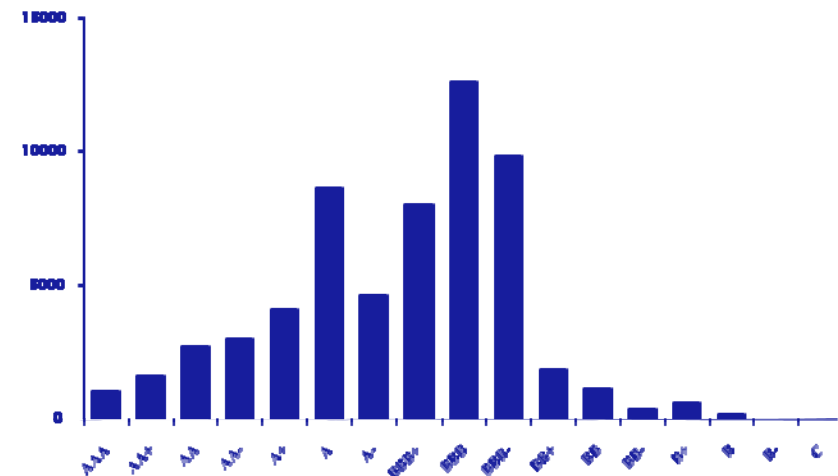
(\*) % of credit risk economic capital



# Global Businesses: diversified, high-quality portfolio

| Global businesses (€ m) |        | % Group  |
|-------------------------|--------|----------|
| Lending                 | 32,179 | 10.4%    |
| NPLs                    | 16.2   | 0.5%     |
| NPL ratio               | 0.02%  |          |
| Coverage ratio          | 5,043% |          |
| Provisions              | 818    | 10.7%    |
| Economic capital        | 1,622  | 13.6%(*) |

Distribution by ratings



- 93.5% investment grade
- Little exposure to leverage finance
- No commitments pending syndication

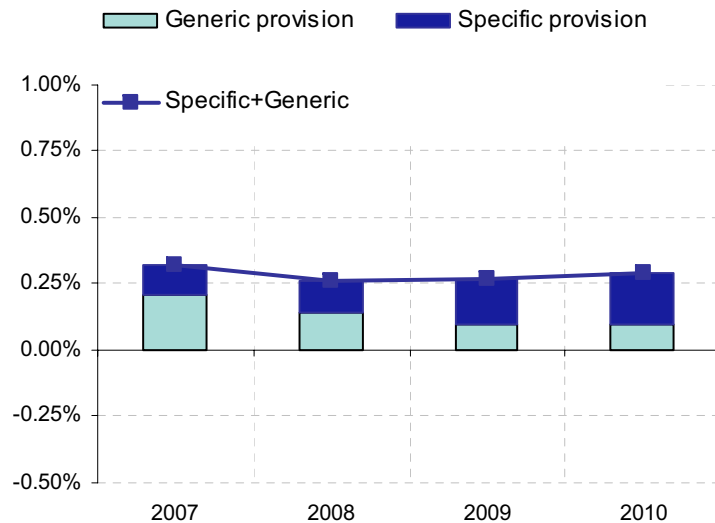
(\*) % of credit risk economic capital



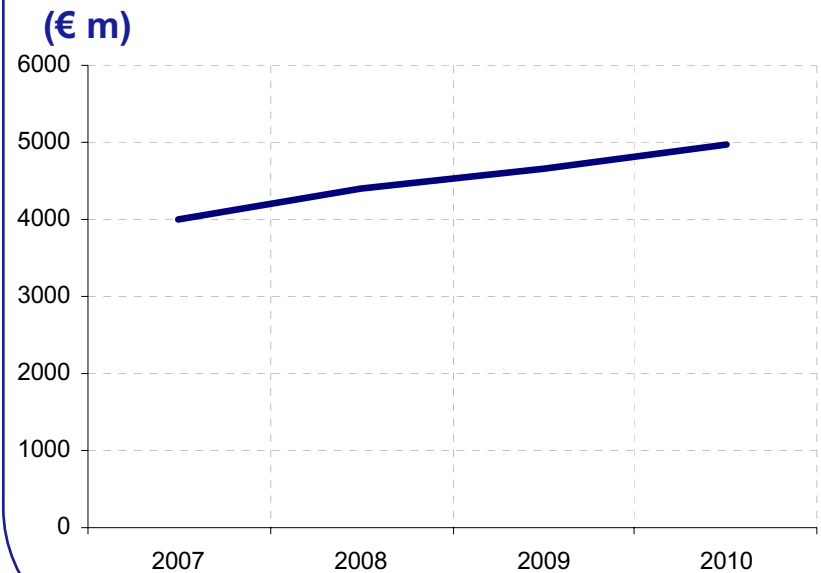
# Forward looking: stable risk premiums, larger weighting of specific provisions

## Spain and Global Businesses

### Risk premium (\*)



### Generic provision=Maximum provision



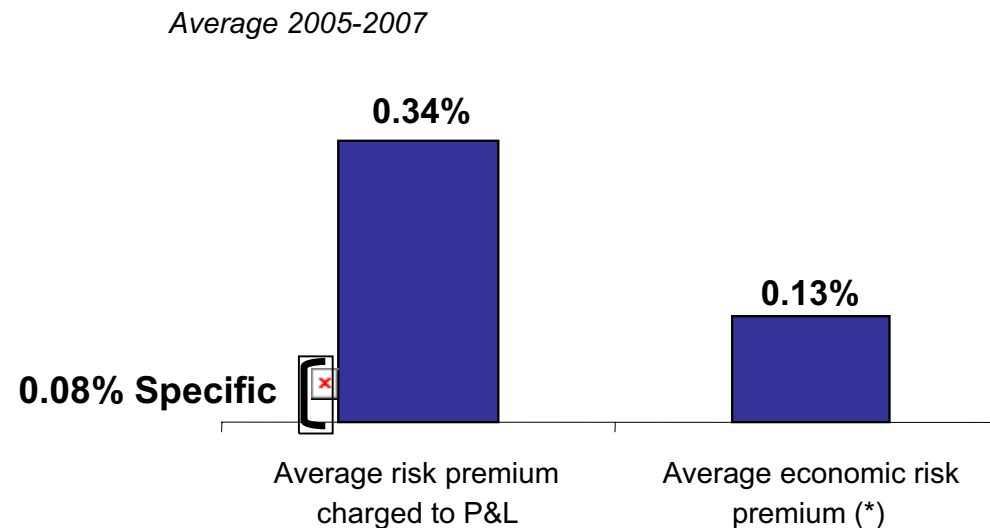
(\*) Provisions on average lending



# Generic provisions account for most of risk premium

## Spain and Global Businesses

### Risk premium charged to P&L vs estimated economic risk premium



**€3.8 billion generic provisions vs  
€0.8 billion expected loss, cycle adjusted (Basel II criteria)**

(\*) According to internal models based on own experience, in validation process by Bank of Spain.

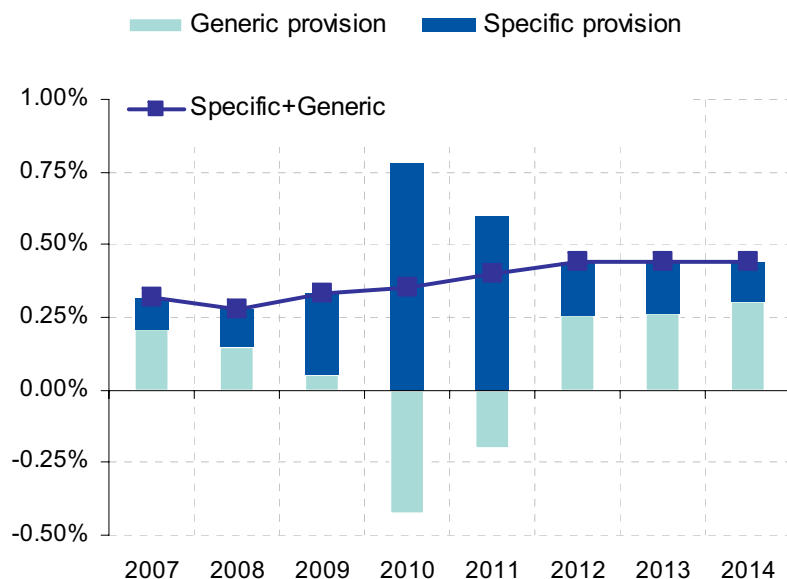




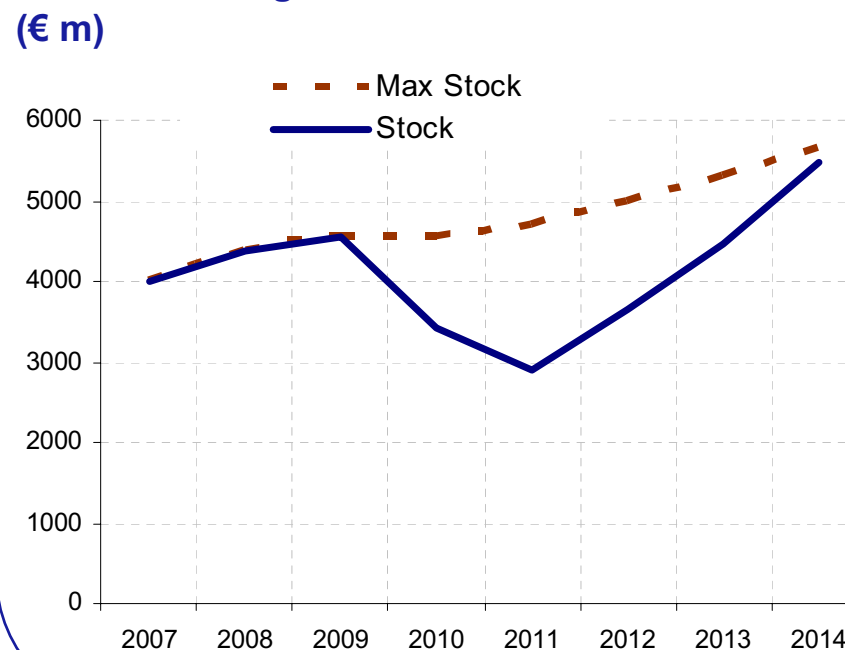
Thus, according to our models, stability in risk premium is ensured even in worst case scenarios

### Spain and Global Businesses

#### Risk Premium



#### Change in Generic Provision

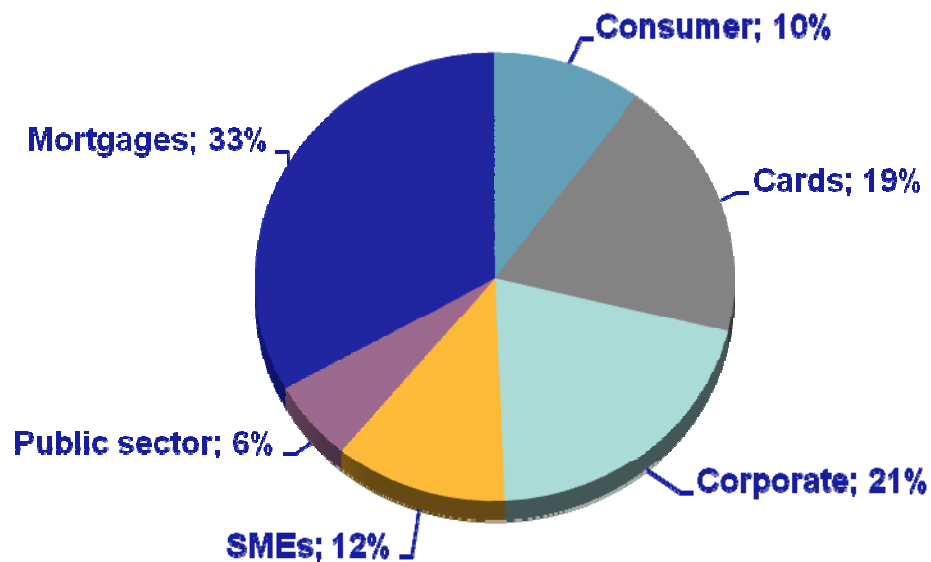


Simulation on Spanish GDP performance 1991-1993: growth in years 2008, 2009 and 2010: +2.5%, +0.9% and -1.0% respectively.

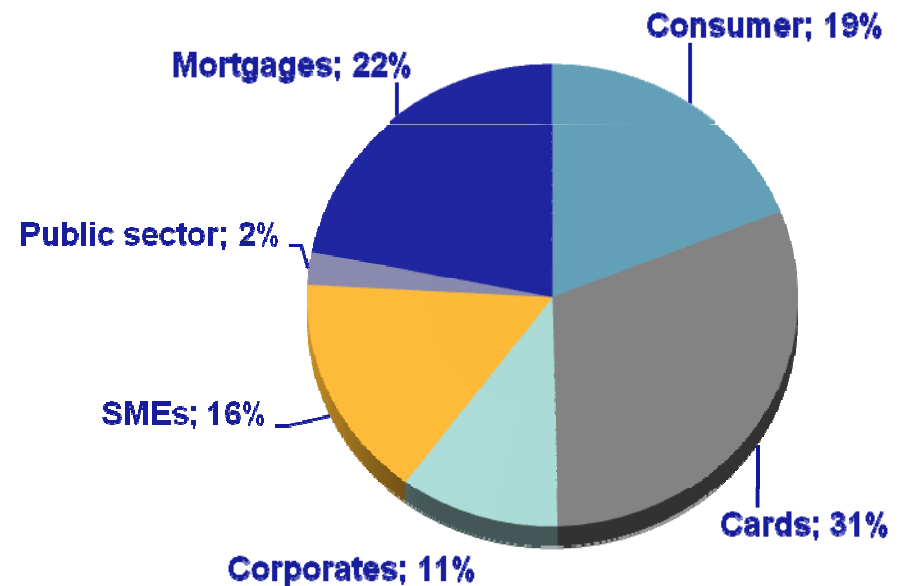


# Mexico credit risk: retail profile, diversified by product

## Distribution of balances



## Distribution of economic capital by credit risk



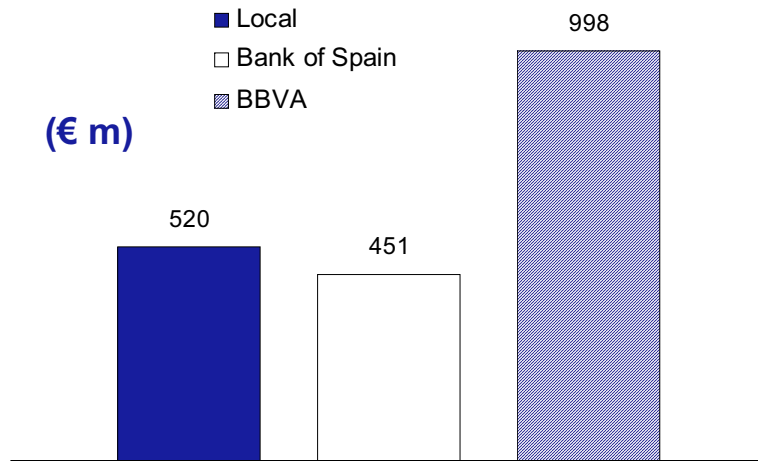
In a process of increasing banking penetration with permanent focus on RAROC



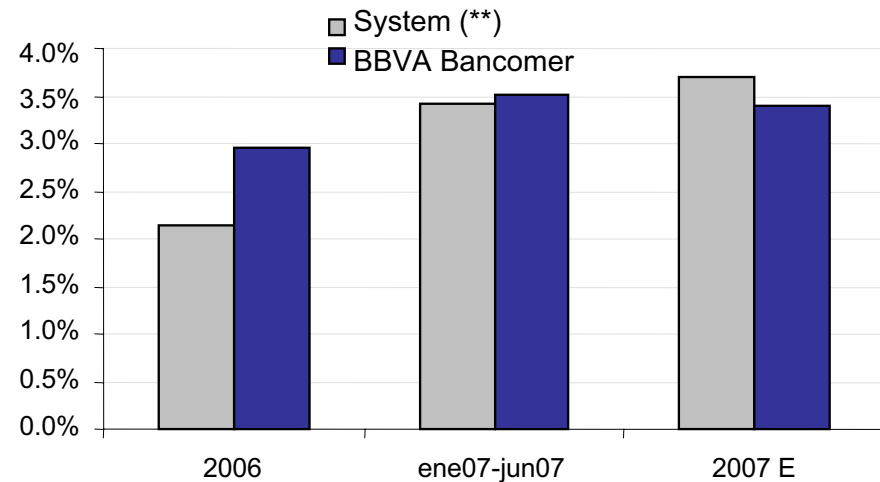
# Mexico: strict provisioning methodology based on expected loss

Provisions far in excess of both local requirements and Bank of Spain standard coefficients

Provisions for mortgages + consumer + cards



BBVA risk premium stability (\*)



(\*) Provisions on average lending

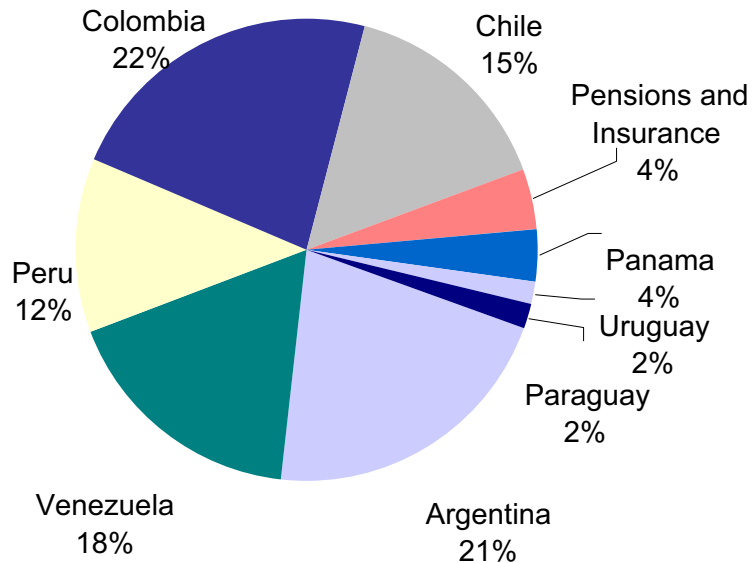
(\*\*) Source: Comisión Nacional Bancaria y de Valores

Allowing for more stable risk premiums throughout the cycle and growth based on solid foundations

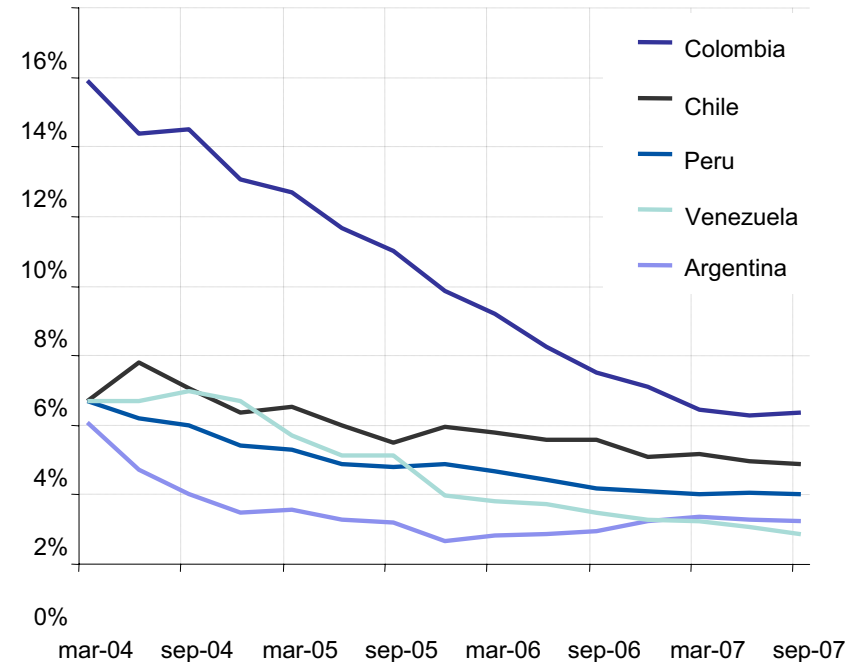


# South America credit risk: diversification and strong improvement in asset quality

## Distribution of economic capital Credit risk



## NPL ratio

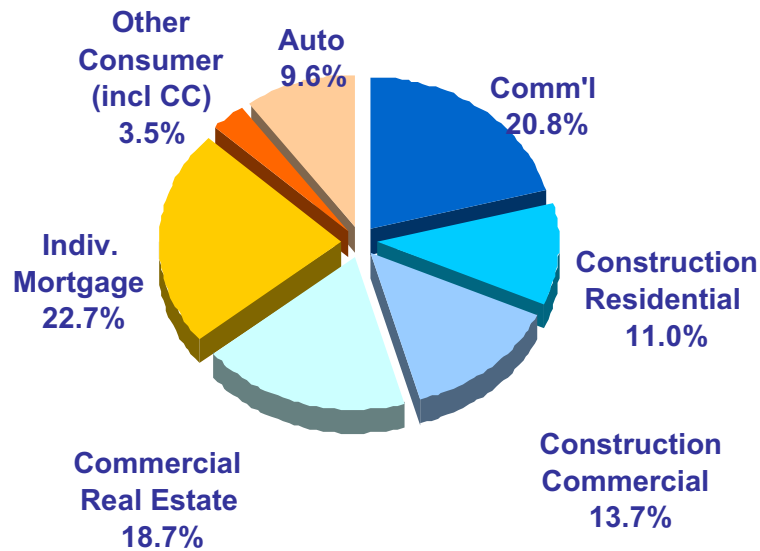


## Growth driven by consumer lending: focus on RAROC

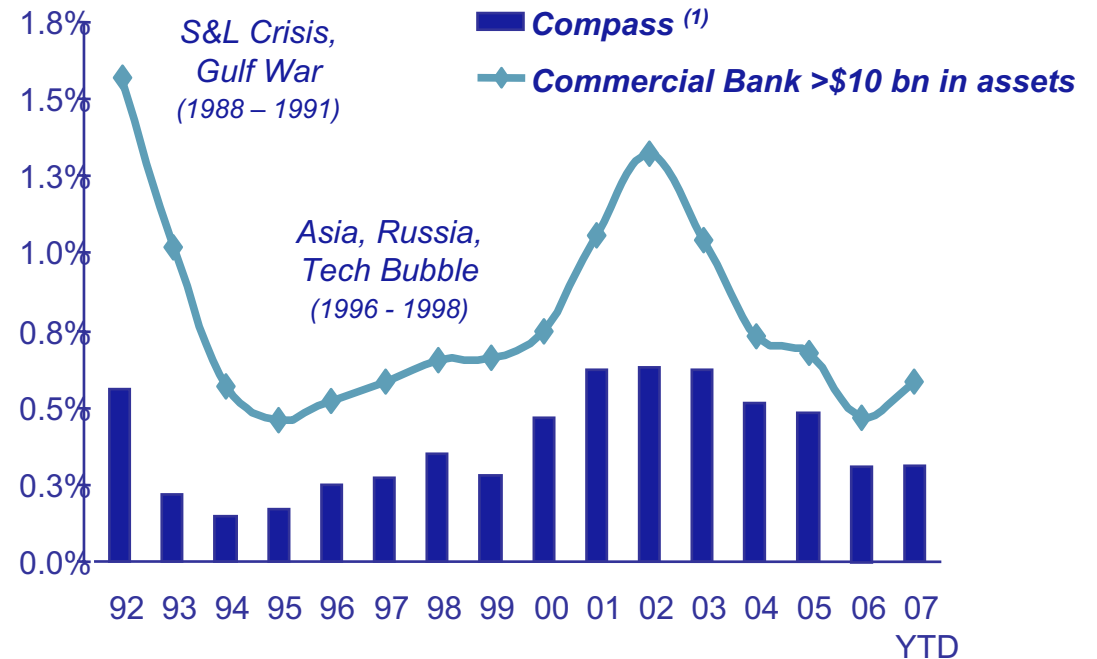


# BBVA USA: experienced management, prudent risk management and high diversification

Loan Portfolio (USA)



Net Charge-Off Ratio



**Compass has historically outperformed the industry and its peers during different business cycles**

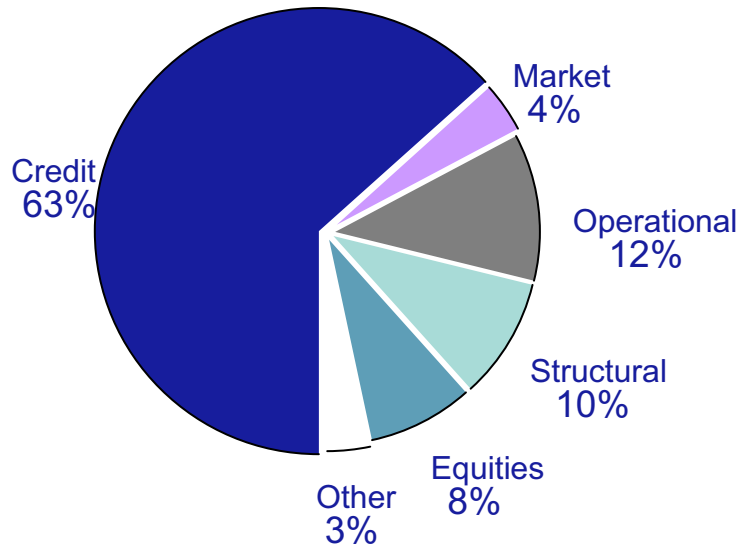


- The risk function
- Credit risk
- **Other risks**
- Basel II
- Conclusions





## Other risks: measured and managed with a global view (I)



- Global platform
- Corporate action framework
- Measurements and valuations independent of management unit
- Structural balance sheet risks managed globally by Finance division
  - Liquidity
  - Interest rate
  - Exchange rate

The recent market turbulence, a valuable stress test for this type of risks



## Other risks: measured and managed with a global view (II)

- Market risk: managed by the Markets Unit. Diversified and very limited (average VAR 3Q07 €21m). Internally approved capital calculation models
- Market risk culture based on “mark to market”. No use of SIV/conduit vehicles. Insignificant direct and indirect exposure to ABSs and CDOs
- Operating risk: managed in all business units. In process of validation for advanced Basel II models.
- Other risks:
  - Analysis and minimisation of biometric risks
  - Insurance company technical risks
  - Asset management fiduciary risks



- The risk function
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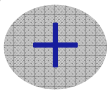


## Basel II process situation

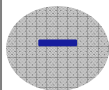
- **Internal models being validated in Spain and Mexico for operating and credit risk in 2008** (market risk model already in use prior to Basel II)
- **New Bank of Spain Capital Regulation in final preparation stage**
- **Pillar II: practical application standards in progress by Bank of Spain**



# BBVA well positioned for new regulatory environment



- Retail focus
- Good credit profile
- Little weight of trading book
- Internal operational risk model
- Significant excess of provisions
- Diversification benefits of economic capital models (Pillar II)



- Segments in banking penetration processes
- Equity portfolios

- **Better results than peers in impact studies (QIS)**
- **Parallel calculation exercises show 12% reduction of risk-weighted assets**
- **Future implementation of internal models in Compass will be positive**



- The risk function
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- Risk management model:
  - With global focus while concentrating on local implementation
  - Experienced teams, with cyclical view and prudent focus on business growth: mortgages, consumer, developers, SMEs, etc.
  - Integrated in the Group management model based on value
  - Vision of expected loss adjusted for cycle in the different businesses.
- With a risk profile that is:
  - Retail, very diversified
  - Well protected against market turbulence
  - With provisions in excess of expected loss
  - Diversified against stress scenarios

**Stable credit risk premiums expected in the years ahead**

150  
years

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