

**FINANCIAL RISKS**

The financial risks taken by the Banco de España stem from the financial transactions carried out in order to perform its functions and achieve the objectives set for it by law. They are essentially the following:

- **Credit risk:** the risk of incurring losses as a result of total or partial non-compliance with the contractual obligations of the issuers, counterparties or depositaries of its financial assets.
- **Market risk:** the risk of incurring losses as a result of fluctuations in the price of financial assets (including foreign exchange rates and interest rates) and gold prices.

Structural balance sheet risk (i.e. the risk of adverse variations in the Bank's profits in the long term owing to higher costs of liabilities or a lower return on assets) is also monitored.

The risks to which the Bank is exposed arise both from its monetary policy operations and from other financial

investments in various portfolios, which may be denominated in euro, foreign currency or gold. The number of portfolios, their desired net changes and the asset allocation targets are determined annually according to the currency of denomination. In addition, the currencies in which investments may be made, the eligible financial instruments and transactions, the eligible issuers, guarantors and counterparties and any limitations on each of these for prudential reasons are regularly reviewed.

The Credit Risk Committee proposes measures to be adopted for managing financial risks and their provisioning levels, and monitors them.

Credit and market risk are quantified by the 99% expected shortfall metric, estimating the average loss that may arise from changes in the risk factors in the worst 1% of the simulated scenarios and with a one-year time horizon. The resulting figure is used as a benchmark to assess the financial risk provisioning needs.