

Last six months	Rate During Period	
	High \$	Low \$
2013		
October	1.38	1.35
November	1.36	1.34
December	1.38	1.35
2014		
January	1.37	1.35
February	1.38	1.35
March	1.39	1.37
April (through April 28)	1.39	1.37

On April 28, 2014, the exchange rate for euros and dollars (expressed in dollars per euro), as published by the ECB, was \$1.39.

For a discussion of the accounting principles used in translation of foreign currency-denominated assets and liabilities to euros, see Note 2 (a) to our consolidated financial statements.

B. Capitalization and indebtedness.

Not Applicable.

C. Reasons for the offer and use of proceeds.

Not Applicable.

D. Risk factors.

Macro-Economic Risks

Because our loan portfolio is concentrated in Continental Europe, the United Kingdom and Latin America, adverse changes affecting the economies of Continental Europe, the United Kingdom or certain Latin American countries could adversely affect our financial condition.

Our loan portfolio is concentrated in Continental Europe (in particular, Spain), the United Kingdom and Latin America. At December 31, 2013, Continental Europe accounted for 40% of our total loan portfolio (Spain accounted for 24% of our total loan portfolio), while the United Kingdom (where the loan portfolio consists primarily of residential mortgages) and Latin America accounted for 35% and 20%, respectively. Accordingly, the recoverability of these loan portfolios in particular, and our ability to increase the amount of loans outstanding and our results of operations and financial condition in general, are dependent to a significant extent on the level of economic activity in Continental Europe (in particular, Spain), the United Kingdom and Latin America. A return to recessionary conditions in the economies of Continental Europe (in particular, Spain), in the United Kingdom or the Latin American countries in which we operate, would likely have a significant adverse impact on our loan portfolio and, as a result, on our financial condition, cash flows and results of operations. See "Item 4. Information on the Company—B. Business Overview".

We are vulnerable to disruptions and volatility in the global financial markets.

In the past six years, financial systems worldwide have experienced difficult credit and liquidity conditions and disruptions leading to less liquidity, greater volatility, general widening of spreads and, in some cases, lack of price transparency on interbank lending rates. Global economic conditions deteriorated significantly between 2007 and 2009, and many of the countries in which we operate fell into recession and some countries have only recently begun to recover and this recovery may not be sustainable. Many major financial institutions, including some of the world's largest global commercial banks, investment banks, mortgage lenders, mortgage guarantors and insurance companies experienced, and some continue to experience, significant difficulties. Around the world, there have also been runs on deposits at several financial institutions, numerous institutions have sought additional capital or have been assisted by governments, and many lenders and institutional investors have reduced or ceased providing funding to borrowers (including to other financial institutions).

In particular, we face, among others, the following risks related to the economic downturn:

- Increased regulation of our industry. Compliance with such regulation will increase our costs and may affect the pricing for our products and services and limit our ability to pursue business opportunities.
- Reduced demand for our products and services.
- Inability of our borrowers to timely or fully comply with their existing obligations.
- The process we use to estimate losses inherent in our credit exposure requires complex judgments, including forecasts of economic conditions and how these economic conditions might impair the ability of our borrowers to repay their loans. The degree of uncertainty concerning economic conditions may adversely affect the accuracy of our estimates, which may, in turn, impact the reliability of the process and the sufficiency of our loan loss allowances.
- The value and liquidity of the portfolio of investment securities that we hold may be adversely affected.
- Any worsening of global economic conditions may delay the recovery of the international financial industry and impact our financial condition and results of operations.
- Macroeconomic shocks may negatively impact the household income of our retail customers and may adversely affect the recoverability of our retail loans, resulting in increased loan losses.

Despite recent improvements in certain segments of the global economy, uncertainty remains concerning the future economic environment. There can be no assurance that economic conditions in these segments will continue to improve or that the global economic condition as a whole will improve significantly. Such economic uncertainty could have a negative impact on our business and results of operations. Investors remain cautious and the downgrade of the sovereign debt of France, for example, has induced greater volatility in the capital markets. A slowing or failing of the economic recovery would likely aggravate the adverse effects of these difficult economic and market conditions on us and on others in the financial services industry.

Increased disruption and volatility in the global financial markets could have a material adverse effect on us, including our ability to access capital and liquidity on financial terms acceptable to us, if at all. If capital markets financing ceases to become available, or becomes excessively expensive, we may be forced to raise the rates we pay on deposits to attract more customers and become unable to maintain certain liability maturities. Any such increase in capital markets funding availability or costs or in deposit rates could have a material adverse effect on our interest margins and liquidity.

If all or some of the foregoing risks were to materialize, this could have a material adverse effect on us.

We may suffer adverse effects as a result of the ongoing economic and sovereign debt tensions in the eurozone.

Our results of operations are materially affected by conditions in the capital markets and the economy generally in the eurozone, which, although improving recently, continue to show signs of fragility and volatility and in some cases only sporadic access to capital markets. Interest rate differentials among eurozone countries are affecting government finance and borrowing rates in those economies.

The European Central Bank (the “ECB”) and European Council took actions in 2012 and 2013 to aim to reduce the risk of contagion throughout and beyond the eurozone. These included the creation of the Open Market Transaction facility of the ECB and the decision by eurozone governments to create a banking union. A significant number of financial institutions throughout Europe have substantial exposures to sovereign debt issued by nations that are under financial pressure. Should any of those nations default on their debt, or experience a significant widening of credit spreads, major financial institutions and banking systems throughout Europe could be destabilized, resulting in the further spread of the ongoing economic crisis.

The continued high cost of capital for some European governments has impacted the wholesale markets and there has been a consequent increase in the cost of retail funding, with greater competition in a savings market that is growing slowly by historical standards. In the absence of a permanent resolution of the eurozone crisis, conditions could deteriorate.

We have direct and indirect exposure to financial and economic conditions throughout the eurozone economies. A deterioration of the economic and financial environment could have a material adverse impact on the whole financial sector, creating new challenges in sovereign and corporate lending and resulting in significant disruptions in financial activities at both the market and retail levels. This could materially and adversely affect our operating results, financial position and prospects.

Exposure to sovereign debt could have a material adverse effect on us.

Like many other banks, we invest in debt securities of governments in the geographies in which we operate, including debt securities of the countries that have been most affected by the deterioration in economic conditions, such as Spain, Portugal, Italy and Ireland. Although doubts remain about the solvency of certain countries, the implementation of new regulations by the European Banking Authority may have reduced the risk associated with the sovereign debt of such countries. A failure by any such government to make timely payments under the terms of these securities, or a significant decrease in their market value, could have a material adverse effect on us.

Our growth, asset quality and profitability in Latin America may be adversely affected by volatile macroeconomic and political conditions.

The economies of some of the Latin American countries where we operate experienced significant volatility in recent decades, characterized, in some cases, by slow or regressive growth, declining investment and hyperinflation. This volatility resulted in fluctuations in the levels of deposits and in the relative economic strength of various segments of the economies to which we lend.

Negative and fluctuating economic conditions, such as a changing interest rate environment, impact our profitability by causing lending margins to decrease and leading to decreased demand for higher margin products and services. Negative and fluctuating economic conditions in these Latin American regions could also result in government defaults on public debt. This could affect us in two ways: directly, through portfolio losses, and indirectly, through instabilities that a default in public debt could cause to the banking system as a whole, particularly since commercial banks' exposure to government debt is high in these Latin American regions.

In addition, our revenues are subject to risk of loss from unfavorable political and diplomatic developments, social instability, and changes in governmental policies, including expropriation, nationalization, international ownership legislation, interest-rate caps and tax policies.

No assurance can be given that our growth, asset quality and profitability will not be affected by volatile macroeconomic and political conditions.

Risks Relating to Our Business

Legal, Regulatory and Compliance Risks

We are exposed to risk of loss from legal and regulatory proceedings.

We face risk of loss from legal and regulatory proceedings, including tax proceedings, that could subject us to monetary judgments, regulatory enforcement actions, fines and penalties. The current regulatory environment in the jurisdictions in which we operate reflects an increased supervisory focus on enforcement, combined with uncertainty about the evolution of the regulatory regime, and may lead to material operational and compliance costs.

We are from time to time subject to certain claims and parties to certain legal proceedings incidental to the normal course of our business, including in connection with conflicts of interest, lending activities, relationships with our employees and other commercial or tax matters. In view of the inherent difficulty of predicting the outcome of legal matters, particularly where the claimants seek very large or indeterminate damages, or where the cases present novel legal theories, involve a large number of parties or are in the early stages of discovery, we cannot state with confidence what the eventual outcome of these pending matters will be or what the eventual loss, fines or penalties related to each pending matter may be. We believe that we have made adequate reserves related to the costs anticipated to be incurred in connection with these various claims and legal proceedings. However, the amount of these provisions is substantially less than the total amount of the claims asserted against us and in light of the uncertainties involved in such claims and proceedings, there is no assurance that the ultimate resolution of these matters will not significantly exceed the reserves currently accrued by us. As a result, the outcome of a particular matter may be material to our operating results for a particular period, depending upon, among other factors, the size of the loss or liability imposed and our level of income for that period.

We are subject to substantial regulation which could adversely affect our business and operations.

As a financial institution, we are subject to extensive regulation, which materially affects our businesses. For example, we are subject to capital adequacy requirements which, among other things, require us to maintain minimum ratios of regulatory capital to risk-weighted assets. Any failure by us to comply with capital adequacy requirements may result in administrative actions or sanctions which may affect our ability to fulfill our obligations.

Statutes, regulations and policies to which we are subject, in particular those relating to the banking sector and financial institutions, may be changed at any time. For example, in response to the recent financial crisis, regulators world-wide have imposed, and may continue to impose, more stringent capital adequacy requirements, including increasing the minimum regulatory capital requirements imposed on us. Regulators world-wide have also produced a range of proposals for future legislative and regulatory changes which could force us to comply with certain operational restrictions or take steps to raise further capital, or could increase our expenses, or otherwise adversely affect our operating results, financial condition and prospects. The interpretation and the application by regulators of the laws and regulations to which we are subject may also change from time to time. Any legislative or regulatory actions and any required changes to our business operations resulting from such legislation and regulations could result in significant loss of revenue, limit our ability to pursue business opportunities in which we might otherwise consider engaging, affect the value of assets that we hold, require us to increase our prices and therefore reduce demand for our products, impose additional costs on us or otherwise adversely affect our businesses. Accordingly, there can be no assurance that future changes in regulations or in their interpretation or application will not adversely affect us.

Changes in regulations may also cause us to face increased compliance costs and limitations on our ability to pursue certain business opportunities and provide certain products and services. As some of the banking laws and regulations have been recently adopted, the manner in which those laws and related regulations are applied to the operations of financial institutions is still evolving. Moreover, to the extent these recently adopted regulations are implemented inconsistently in the various jurisdictions in which we operate, it may face higher compliance costs. No assurance can be given generally that laws or regulations will be adopted, enforced or interpreted in a manner that will not have a material adverse effect on our business and results of operations.

Extensive legislation affecting the financial services industry has recently been adopted in regions that directly or indirectly affect our business, including Spain, the United States, the European Union, Latin America and other jurisdictions, and regulations are in the process of being implemented.

The European Union has created a European Systemic Risk Board to monitor financial stability and has implemented rules with the recommendations to increase capital requirements for certain trading instruments or exposures and to impose compensation limits on certain employees located in affected countries. In addition, the European Union Commission is considering a wide array of other initiatives, including new legislation that will affect derivatives trading, impose surcharges on “globally” systemically important firms and possibly impose new levies on bank balance sheets.

In December 2010, the Basel Committee on Banking Supervision (the “Basel Committee”) reached agreement on comprehensive changes to the capital adequacy framework, known as Basel III. A revised version of Basel III was published in June 2011. Basel III is intended to raise the resilience of the banking sector by increasing both the quality and quantity of the regulatory capital base and enhancing the risk coverage of the capital framework. Among other things, Basel III introduces new eligibility criteria for Common Equity Tier 1, Additional Tier 1 and Tier 2 capital instruments that are intended to raise the quality of regulatory capital, and increases the amount of regulatory capital that institutions are required to hold. Basel III also requires institutions to maintain a capital conservation buffer above the minimum capital ratios in order to avoid certain capital distribution constraints. The capital conservation buffer, to be comprised of Common Equity Tier 1 capital, would result in an effective Common Equity Tier 1 capital requirement of 7 percent of risk-weighted assets. In addition, Basel III directs national regulators to require certain institutions to maintain a counter-cyclical capital buffer during periods of excessive credit growth. Basel III introduces a leverage ratio for institutions as a backstop measure, to be applied from 2018 alongside current risk-based regulatory capital requirements. The changes in Basel III are intended to be phased in gradually between January 2013 and January 2022. The implementation of Basel III in the European Union is being performed through the Capital Requirements Directive IV (“CRD IV”) & Capital Requirements Regulation (“CRR”) legislative package. CRD IV was published in the Official Journal on June 27, 2013 entered into force in July 2013 (being CRR applicable from January 2014), with particular requirements being phased in over a period of time, to be effective by 2019, although requirements relating to certain deductions from Common Equity Tier 1 could be delayed until 2024. CRD IV substantially reflects the Basel III capital and liquidity standards and facilitates the applicable implementation timeframes. However, certain issues continue to remain under discussion and certain details remain to be clarified in further binding technical standards to be issued by the European Banking Authority.

In addition to the changes to the capital adequacy framework published in December 2010 and June 2011 described above, the Basel Committee also published its global quantitative liquidity framework, comprising the Liquidity Coverage Ratio (“LCR”) and Net Stable Funding Ratio (“NSFR”) metrics, with objectives to (1) promote the short-term resilience of banks’ liquidity risk profiles by ensuring they have sufficient high-quality liquid assets to survive a significant stress scenario; and (2) promote resilience over a longer time horizon by creating incentives for banks to fund their activities with more stable sources of funding on an ongoing basis. The LCR has been subsequently revised by the Basel Committee in January 2013 which amended the definition of high-quality liquid assets and agreed a revised timetable for phase-in of the standard from 2015 to 2019, as well as making some technical changes to some of the stress scenario assumptions. As with the Basel Committee’s proposed changes to the capital adequacy framework, the Basel III liquidity standards are being implemented within the European Union through the CRD IV legislative package. In January 2014 the Basel Committee published amendments to the Leverage Ratio and technical revisions to the NSFR ratio, confirming that it remains the intention that the latter ratio, including any future revisions, will become a minimum standard by January 1, 2018. Also, in January 2014, the Basel Committee proposed uniform disclosure standards related to the LCR and issued a new modification to the ratio, which should be adopted by banks from January 1, 2015.

As a Spanish financial institution, the Bank is subject to CRD IV, through which the European Union has implemented the Basel III capital standards and which are in the process of being phased in until January 1, 2019. The CRR is applicable from January 1, 2014 and the CRD IV Directive has already been partially implemented in Spain as of January 1, 2014 by RD-L 14/2013. This Royal Decree-Law has repealed, with effect from January 1, 2014, any Spanish regulatory provisions that may be incompatible with CRR.

In addition to RD-L 14/2013, the Bank of Spain approved on January 31, 2014 its new Circular 2/2014, which derogates its previous Circular 7/2012, and makes certain regulatory determinations contained in CRR pursuant to the delegation contained in RD-L 14/2013, including, relevant rules concerning the applicable transitional regime on capital requirements and the treatment of deductions.

Despite the CRD IV/Basel III framework setting minimum transnational levels of regulatory capital and a measured phase-in, many national authorities have started a race to the top for capital by adopting requirements and interpretation calendars that are more stringent than Basel III's.

For example, in the last three years the Bank of Spain and the European Banking Authority (the EBA) have imposed new capital requirements in advance of the entering into force of CRD IV. These measures have included Bank of Spain Circular 3/2008 (Circular 3/2008) of May 22, on the calculation and control of minimum capital requirements, which was amended by Bank of Spain Circular 4/2011 (Circular 4/2011) and implements Capital Requirements Directive III in Spain. In addition, some of the requirements of Basel III were already implemented by the Spanish Government in 2011 with Royal Decree-Law 2/2011 (RD-L 2/2011) of February 18 (as amended by Law 9/2012) which established a new minimum requirement in terms of capital on risk-weighted assets (Capital Principal) and required such capital to be greater than 9 per cent from January 1, 2013. RD-L 14/2013 specifically repealed, with effect from January 1, 2014, Title I of Royal Decree-Law 2/2011, which imposed the minimum Capital Principal requirement for credit institutions. Notwithstanding such repeal, as part of the assessment of additional capital requirements that could be required of credit institutions, the Bank of Spain has been given powers to stop or restrict, until December 31, 2014, any distributions of Tier 1 Capital which would have been caught by the minimum Capital Principal requirements stipulated in RD-L 2/2011, provided such distributions, accumulated over the year ended December 31, 2014, exceed in absolute terms the minimum Capital Principal legally required as at December 31, 2013 and further risk non-compliance with additional capital requirements that could be required by the Bank of Spain.

Furthermore, following an evaluation of the capital levels of 71 financial institutions throughout Europe (including the Bank) based on data available as of September 30, 2011, the EBA issued a recommendation on December 8, 2011 pursuant to which, on an exceptional and temporary basis, financial institutions based in the EU should reach a new minimum Core Tier 1 ratio (9 per cent.) by June 30, 2012. This recommendation has been replaced by the EBA recommendation of July 22, 2013 on the preservation of Core Tier 1 capital during the transition to CRD IV. This new recommendation provides for the maintenance of a nominal floor of capital denominated in the relevant reporting currency of Core Tier 1 capital corresponding to the amount of capital needed as at June 30, 2012 to meet the requirements of the above recommendation of December 8, 2011. Competent authorities may waive this requirement for institutions which maintain a minimum of 7 per cent of common equity Tier 1 capital under CRD IV rules applied after the transitional period.

In addition, in order to complete the implementation of CRD IV initiated by RD-L 14/2013, the Spanish Ministry of Economy and Competitiveness has prepared and recently published a draft of a new comprehensive law on the supervision and solvency of financial institutions (the Supervision and Solvency Law), that has been already approved by the Spanish Council of Ministers and is being reviewed in order to be approved by the Spanish Parliament.

There can be no assurance that the implementation of these new standards will not adversely affect the Bank's ability to pay dividends or require it to issue additional securities that qualify as regulatory capital, to liquidate assets, to curtail business or to take any other actions, any of which may have adverse effects on the Bank's business, financial condition and results of operations. Furthermore, increased capital requirements may negatively affect the Bank's return on equity and other financial performance indicators.

Finally, in February 2014 the IMF recommended that the Bank of Spain limit the amount of dividends payable in cash in 2014 by Spanish banking institutions to 25% of such bank's attributable profits. The Bank of Spain has given this recommendation to the Spanish banking institutions.

Effective management of our capital position is important to our ability to operate our business, to continue to grow organically and to pursue our business strategy. However, in response to the global financial crisis, a number of changes to the regulatory capital framework have been adopted or continue to be considered. As these and other changes are implemented or future changes are considered or adopted that limit our ability to manage our balance sheet and capital resources effectively or to access funding on commercially acceptable terms, we may experience a material adverse effect on our financial condition and regulatory capital position.

In September 2011, the European Commission (the "Commission") tabled a proposal for a common system of financial transactions taxes ("FTT"). Despite intense discussions on this proposal there was no unanimity amongst the 27 Member States. Eleven Member States ("participating Member States") requested enhanced cooperation on a FTT based upon the Commission's original proposal. The Commission presented a decision to this effect which was adopted by the EU's Council of Finance Ministers at its committee meeting on January 22, 2013. The proposal of Directive was published on February 14, 2013, under which participating Member States may charge a FTT on all financial transactions where (i) at least one party to the transaction is established in the territory of a participating Member State and a financial institution established in the territory of a participating Member State is a party to the transaction acting either for its own account or for the account of another person, or is acting in the name of a party to the transaction or (ii) a financial institution is a party to a transaction with a financial instrument issued within the territory of a participating Member State. We are still assessing the proposals currently under discussion to determine the likely impact on Banco Santander and its affiliates.

The Spanish Government approved on February 3, 2012 the Royal Decree-Law 2/2012 and Law 8/2012, of October 20, 2012, on the clean-up of the financial sector (replacing Royal Decree-Law 18/2012, of May 11, 2012), through which the following actions were performed:

- Review of the minimum provisioning percentages to be taken into consideration in the estimate of the impairment losses relating to financing granted to the property sector in Spain and to the foreclosed assets and assets received in payment of debt arising from financing granted to that sector, as a result of the impairment of these assets.
- Increase in the level of minimum capital requirements of Spanish credit institutions on the basis of the assets relating to the property sector in Spain presented on the balance sheet of each entity at December 31, 2012.

The Spanish Government also approved Law 9/2012, of November 14, 2012 which established a new regime on restructuring and resolution of credit institutions and a statutory loss absorbency regime applicable within the framework of restructuring and resolution processes, both based on the legislative proposal for a directive providing for the establishment of an European Union wide framework for the recovery and resolution of credit institutions and investment firms, the first draft of which (and the draft upon which Law 9/2012 was based) was published by the European Commission on June 6, 2012.

In June 2012, a number of agreements were reached to reinforce the monetary union, including the definition of a broad roadmap towards a single banking and fiscal union. While support for a banking union in Europe is strong and significant advances have been made in terms of the development of a single-rule book through CRD IV, there is ongoing debate on the extent and pace of integration. On September 13, 2012, the European Parliament approved a proposal for the creation of the Single Supervisory Mechanism, so that 128 of the largest EU banks (including the Bank) will come under the ECB direct oversight from November 2014. The ECB comprehensive assessment includes a supervisory risk assessment, an asset quality review and a stress test to be conducted by national supervisors and the ECB in coordination with the EBA before the ECB becomes the single European bank supervisor in November 2014. The assessment is an important step in preparing the single supervisory mechanism and, more generally, towards bringing about greater transparency of the banks' balance sheets and consistency of supervisory practices in Europe. The assessment started in November 2013 and will take 12 months to complete, ending in October 2014. The comprehensive assessment consists of three closely interlinked components:

- a supervisory risk assessment - to review, quantitatively and qualitatively, key risks, including liquidity, leverage and funding;
- an asset quality review (AQR) - to enhance the transparency of bank exposures by reviewing the quality of banks' assets, including the adequacy of asset and collateral valuation and related provisions;
- a stress test - to examine the resilience of banks' balance sheets to stress scenarios.

The assessment will be based on a capital benchmark of 8% Common Equity Tier 1, drawing on the definition of the Capital Requirements Directive IV/Capital Requirements Regulation, including transitional arrangements, for both the AQR and the baseline stress test scenario.

Other open issues include the representation and voting power of non-eurozone countries, the accountability of the ECB to European institutions as part of the Single Supervision Mechanism, the final status of the EBA, the development of a new bank resolution regime and the creation of a common deposit-guarantee scheme. In particular, the Bank Recovery and Resolution Directive (BRRD) and the Deposit Guarantee Schemes Directive were submitted to the European Parliament in June 2013. They have been approved by the European Parliament on April 15, 2014 and approval by the European Council is expected in May 2014 for its official publication. The BRRD is expected to enter into force in 2015, but the bail-in tool will only be operational from 2016. The final regulation on direct recapitalization by the European Stability Mechanism is still pending. European leaders have also supported the reinforcement of the fiscal union but continue negotiating on how to achieve it.

Regulations adopted towards achieving a banking and/or fiscal union in the EU and decisions adopted by the ECB in its future capacity as the Bank's main supervisory authority may have a material impact on the Bank's business, financial condition and results of operations.

On January 29, 2014, the European Commission, taking into account the October 2002 report by the High Level Expert Group chaired by Erkki Liikanen on the reform of the structure of the EU Banking Sector, proposed new rules to prevent the largest and most complex EU banks with significant trading activities (including us) from engaging in the activity of proprietary trading in financial instruments and commodities. The new proposed regulation would also grant supervisors the power and, in certain instances, the obligation to require the transfer of other high-risk trading activities (such as market-making, complex derivatives and securitization operations) to separate legal trading entities within their group ("subsidiarisation"). Notwithstanding this, banks would have the possibility of not separating activities if they can show to the satisfaction of their supervisor that the risks generated are mitigated by other means. The proposal would also provide rules on the economic, legal, governance, and operational links between the separated trading entity and the rest of the banking group. Furthermore, the proposal is also aimed at increasing transparency of certain transactions in the shadow banking sector.

The European Parliament approved the following dossiers in April 2014 to develop a European Banking Union:

- The proposal for the BRRD is expected to be approved by ECOFIN in May 2014 for its official publication. The BRRD is the single rulebook for the resolution of banks and large investment firms in all EU Member States. It harmonizes and upgrades the tools for dealing with bank crises across the EU. Banks will be required to prepare recovery plans to overcome financial distress, while authorities will lay out plans to resolve failed banks in a way which preserves their most critical functions and avoids taxpayer-funded bailouts. Authorities are granted a set of powers to intervene in the operations of banks to help prevent failure. If they do face failure, authorities are equipped with comprehensive powers and tools to restructure them, allocating losses to shareholders and creditors following a clearly defined hierarchy.
- The agreement with the EU Council on the Single Resolution Mechanism (SRM) is expected to be approved by the Parliament in July or September 2014. The agreement includes the creation of a Single Resolution Fund (SRF) which will be fully endowed in a maximum of eight years. It is expected that the agreement between governments will be signed in May 2014 and approved by national parliaments by year end. The SRM will complement the Single Supervisory Mechanism (SSM) and will ensure that, if a bank subject to the SSM faces serious difficulties, its resolution can be managed efficiently with minimal costs to taxpayers and the real economy. The SRM will apply to all banks in the Euro Area and other Member States that choose to participate. The division of powers between the Single Resolution Board and national resolution authorities broadly follows the division of supervisory powers between the ECB and national supervisors in the context of the Single Supervisory Mechanism.

The Single Resolution Fund will be financed with contributions from all banks in the participating Member States. It will be administrated by the Board. The Fund has a target level, to be reached over eight years, of €55 billion and can borrow from the markets by order of the Board. During the transition, the Fund will be divided among national compartments whose resources will be progressively mutualized, starting with 40% of funds in the first year. The Fund and decision-making on its use is regulated by the SRM Regulation, while the transfer of contributions raised nationally towards the Single Fund and the mutualization of the national compartments is set out in an inter-governmental agreement established among the participating Member States.
- The proposal for recast Directive on Deposit Guarantee Schemes (DGS) ensures that depositors will continue to benefit from a guaranteed coverage of €100,000 in case of bankruptcy backed by funds to be collected in advance from the banking sector. In principle, the target level for ex ante funds of DGS is 0.8% of covered deposits (i.e. about € 55billion) to be collected from banks over a 10-year period. Repayment deadlines will be gradually reduced from the current 20 working days to 7 working days in 2024. The new Directive will require that better information be provided to depositors to ensure that they are aware of how their deposits are protected by the guarantee schemes.

Regulations adopted on structural measures to improve the resilience of EU credit institutions may have a material impact on the Bank's business, financial condition and results of operations. These regulations, if adopted, may also cause the Group to invest significant management attention and resources to make any necessary changes.

In the United States, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") which was adopted in 2010 will continue to result in significant structural reforms affecting the financial services industry. This legislation provides for, among other things, the establishment of a Consumer Financial Protection Bureau with broad authority to regulate the credit, savings, payment and other consumer financial products and services that we offer, the creation of a structure to regulate systemically important financial companies, more comprehensive regulation of the over-the-counter derivatives market, prohibitions on engagement in certain proprietary trading activities and restrictions on ownership of, investment in or sponsorship of hedge funds and private equity funds, restrictions on the interchange fees earned through debit card transactions, and a requirement that bank regulators phase out the treatment of trust preferred capital instruments as Tier 1 capital for regulatory capital purposes.

With respect to OTC derivatives, the Dodd-Frank Act provides for an extensive framework for the regulation of OTC derivatives, including mandatory clearing, exchange trading and transaction reporting of certain OTC derivatives. Entities that are swap dealers, security-based swap dealers, major swap participants or major security-based swap participants are required to register with the CFTC or the SEC, or both, and are or will be subject to new capital, margin, business conduct, recordkeeping, clearing, execution, reporting and other requirements. Banco Santander, S.A. and Abbey National Treasury Services plc became provisionally registered as swap dealers with the CFTC on July 8, 2013 and November 4, 2013, respectively. In addition, we may register one more subsidiary as swap dealer with the CFTC.

In July 2013, the U.S. bank regulators issued the U.S. Basel III final rules implementing the Basel III capital framework for U.S. banks and bank holding companies and other U.S. capital reform. Certain aspects of the U.S. Basel III final rules, such as new minimum capital ratios and a revised methodology for calculating risk-weighted assets, will become effective on January 1, 2015. Other aspects of the U.S. Basel III final rules, such as the capital conservation buffer and the new regulatory deductions from and adjustments to capital, will be phased in over several years beginning on January 1, 2015.

In addition, the Board of Governors of the Federal Reserve System (the "Federal Reserve") and other U.S. regulators issued for public comment in October 2013 a proposed rule that would introduce a quantitative liquidity coverage ratio requirement on certain large banks and bank holding companies. The proposed liquidity coverage ratio is broadly consistent with the Basel Committee's revised Basel III liquidity rules, but is more stringent in several important respects. The Federal Reserve has also stated that it intends, through future rulemakings, to apply the Basel III liquidity coverage ratio and net stable funding ratio to the U.S. operations of some or all large foreign banking organizations ("FBOs").

In February 2014, the Federal Reserve approved a final rule to enhance its supervision and regulation of the U.S. operations of FBOs such as us. Under the Federal Reserve's rule, FBOs with \$50 billion or more in U.S. assets held outside of their U.S. branches and agencies ("Large FBOs"), will be required to create a separately capitalized top-tier U.S. intermediate holding company ("IHC") that will hold substantially all of the FBO's U.S. bank and nonbank subsidiaries, such as Santander Bank, N.A. An IHC will be subject to U.S. risk-based and leverage capital, liquidity, risk management, stress testing and other enhanced prudential standards on a consolidated basis. Under the final rule, a Large FBO that is subject to the IHC requirement may request permission from the Federal Reserve to establish multiple IHCs or use an alternative organizational structure. The final rule also permits the Federal Reserve to apply the IHC requirement in a manner that takes into account the separate operations of multiple foreign banks that are owned by a single Large FBO. Although U.S. branches and agencies of a Large FBO will not be required to be held beneath an IHC, such branches and agencies will be subject to liquidity, and, in certain circumstances, asset maintenance requirements. Large FBOs generally will be required to establish IHCs and comply with the enhanced prudential standards beginning July 1, 2016. An IHC's compliance with applicable U.S. leverage ratio requirements is generally delayed until January 1, 2018. FBOs that have \$50 billion or more in non-branch/agency U.S. assets as of June 30, 2014 will be required to submit an implementation plan by January 1, 2015 on how the FBO will comply with the IHC requirement. Enhanced prudential standards will apply to our top-tier U.S.-based bank holding companies beginning on January 1, 2015 until we form or designate an IHC and the IHC becomes subject to corresponding enhanced prudential standards. The Federal Reserve has stated that it will issue, at a later date, final rules to implement certain other enhanced prudential standards under the Dodd-Frank Act for large bank holding companies and large FBOs, including single counterparty credit limits and an early remediation framework.

Within the Dodd-Frank Act, the Volcker Rule prohibits "banking entities" from engaging in certain forms of proprietary trading or from sponsoring or investing in certain covered funds, in each case subject to certain limited exceptions. The Volcker Rule became effective on July 21, 2012 and on December 10, 2013, U.S. regulators issued final rules implementing the Volcker Rule. The final rules also limit the ability of banking entities and their affiliates to enter into certain transactions with such funds with which they or their affiliates have certain relationships. The final rules contain exclusions and certain exemptions for market-making, hedging, underwriting, trading in U.S. government and agency obligations as well as certain foreign government obligations, trading solely outside the United States, and also permits certain ownership interests in certain types of funds to be retained. The final rules implementing the Volcker Rule extended the period for all banking entities to conform to the Volcker Rule and implement a compliance program until July 21, 2015, and additional extensions are possible. Banking entities must bring their activities and investments into compliance with the requirements of the Volcker Rule by the end of the conformance period. We are assessing how the final rules implementing the Volcker Rule will affect our businesses and are developing and implementing plans to bring affected businesses into compliance.

Furthermore, Title I of the Dodd-Frank Act and the implementing regulations issued by the Federal Reserve and the Federal Deposit Insurance Corporation ("FDIC") require each bank holding company with assets of \$50 billion or more, including us, to prepare and submit annually a plan for the orderly resolution of our subsidiaries and operations that are domiciled in the United States in the event of future material financial distress or failure. The plan must include information on resolution strategy, major counterparties and interdependencies, among other things, and requires substantial effort, time and cost. We submitted our U.S. resolution plan in December 2013. The resolution plan is subject to review by the Federal Reserve Board and the FDIC.

Each of these aspects of the Dodd-Frank Act, as well as others, may directly and indirectly impact various aspects of our business. The full spectrum of risks that the Dodd-Frank Act, including the Volcker Rule, poses to us is not yet known, however, such risks could be material and we could be materially and adversely affected by them.

These and any additional legislative or regulatory actions in Spain, the European Union, the United States, the U.K., Latin America or other countries, and any required changes to our business operations resulting from such legislation and regulations, could result in reduced capital availability, significant loss of revenue, limit our ability to continue organic growth (including increased lending), pursue business opportunities in which we might otherwise consider engaging and provide certain products and services, affect the value of assets that we hold, require us to increase our prices and therefore reduce demand for our products, impose additional costs on us or otherwise adversely affect our businesses. Accordingly, we cannot provide assurance that any such new legislation or regulations would not have an adverse effect on our business, results of operations or financial condition in the future.

We may also face increased compliance costs. As some of the banking laws and regulations have been recently adopted, the manner in which those laws and related regulations are applied to the operations of financial institutions is still evolving. Moreover, to the extent these recently adopted regulations are implemented inconsistently in the various jurisdictions in which we operate, we may face higher compliance costs. No assurance can be given generally that laws or regulations will be adopted, enforced or interpreted in a manner that will not have material adverse effect on our business and results of operations.

We may not be able to detect money laundering and other illegal or improper activities fully or on a timely basis, which could expose us to additional liability and could have a material adverse effect on us.

We are required to comply with applicable anti-money laundering, anti-terrorism and other laws and regulations in the jurisdictions in which we operate. These laws and regulations require us, among other things, to adopt and enforce “know-your-customer” policies and procedures and to report suspicious and large transactions to the applicable regulatory authorities. These laws and regulations have become increasingly complex and detailed, require improved systems and sophisticated monitoring and compliance personnel and have become the subject of enhanced government supervision.

While we have adopted policies and procedures aimed at detecting and preventing the use of our banking network for money laundering and related activities, such policies and procedures may not completely eliminate instances where we may be used by other parties to engage in money laundering and other illegal or improper activities. To the extent we fail to fully comply with applicable laws and regulations, the relevant government agencies to which we report have the power and authority to impose fines and other penalties on us, including the revocation of licenses. In addition, our business and reputation could suffer if customers use our banking network for money laundering or illegal or improper purposes.

In addition, while we review our relevant counterparties’ internal policies and procedures with respect to such matters, we, to a large degree, rely upon our relevant counterparties to maintain and properly apply their own appropriate anti-money laundering procedures. Such measures, procedures and compliance may not be completely effective in preventing third parties from using our (and our relevant counterparties’) services as a conduit for money laundering (including illegal cash operations) without our (and our relevant counterparties’) knowledge. If we are associated with, or even accused of being associated with, or become a party to, money laundering, then our reputation could suffer and/or we could become subject to fines, sanctions and/or legal enforcement (including being added to any “black lists” that would prohibit certain parties from engaging in transactions with us), any one of which could have a material adverse effect on our operating results, financial condition and prospects.

Changes in taxes and other assessments may adversely affect us.

The legislatures and tax authorities in the tax jurisdictions in which we operate regularly enact reforms to the tax and other assessment regimes to which we and our customers are subject. Such reforms include changes in the rate of assessments and, occasionally, enactment of temporary taxes, the proceeds of which are earmarked for designated governmental purposes. The effects of these changes and any other changes that result from enactment of additional tax reforms cannot be quantified and there can be no assurance that any such reforms would not have an adverse effect upon our business.

Financial Reporting and Control Risks

Changes in accounting standards could impact reported earnings.

The accounting standard setters and other regulatory bodies periodically change the financial accounting and reporting standards that govern the preparation of our consolidated financial statements. These changes can materially impact how we record and report our financial condition and results of operations. In some cases, we could be required to apply a new or revised standard retroactively, resulting in the restatement of prior period financial statements.

Our financial statements are based in part on assumptions and estimates which, if inaccurate, could cause material misstatement of the results of our operations and financial position.

The preparation of financial statements requires management to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities, income and expenses. Due to the inherent uncertainty in making estimates, actual results reported in future periods may be based upon amounts which differ from those estimates. Estimates, judgments and assumptions are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Revisions to accounting estimates are recognized in the period in which the estimate is revised and in any future periods affected. The accounting policies deemed critical to our results and financial position, based upon materiality and significant judgments and estimates, include impairment of loans and advances, goodwill impairment, valuation of financial instruments, impairment of available-for-sale financial assets, deferred tax assets and provision for liabilities.

The valuation of financial instruments measured at fair value can be subjective, in particular where models are used which include unobservable inputs. Given the uncertainty and subjectivity associated with valuing such instruments it is possible that the results of our operations and financial position could be materially misstated if the estimates and assumptions used prove to be inaccurate.

If the judgment, estimates and assumptions we use in preparing our consolidated financial statements are subsequently found to be incorrect, there could be a material effect on our results of operations and a corresponding effect on our funding requirements and capital ratios.

The preparation of our tax returns requires the use of estimates and interpretations of complex tax laws and regulations and is subject to review by taxing authorities. We are subject to the income tax laws of Spain and certain foreign countries. These tax laws are complex and subject to different interpretations by the taxpayer and relevant governmental taxing authorities, which are sometimes subject to prolonged evaluation periods until a final resolution is reached. In establishing a provision for income tax expense and filing returns, we must make judgments and interpretations about the application of these inherently complex tax laws. If the judgment, estimates and assumptions we use in preparing our tax returns are subsequently found to be incorrect, there could be a material effect on our results of operations.

Disclosure controls and procedures over financial reporting may not prevent or detect all errors or acts of fraud.

Disclosure controls and procedures over financial reporting are designed to reasonably assure that information required to be disclosed by the company in reports filed or submitted under the Securities Exchange Act is accumulated and communicated to management, and recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

These disclosure controls and procedures have inherent limitations which include the possibility that judgments in decision-making can be faulty and that breakdowns occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by any unauthorized override of the controls. Consequently, our businesses are exposed to risk from potential non-compliance with policies, employee misconduct or negligence and fraud, which could result in regulatory sanctions and serious reputational or financial harm. In recent years, a number of multinational financial institutions have suffered material losses due to the actions of 'rogue traders' or other employees. It is not always possible to deter employee misconduct and the precautions we take to prevent and detect this activity may not always be effective. Accordingly, because of the inherent limitations in the control system, misstatements due to error or fraud may occur and not be detected.

Liquidity and Financing Risks

Liquidity and funding risks are inherent in our business and could have a material adverse effect on us.

Liquidity risk is the risk that we either do not have available sufficient financial resources to meet our obligations as they fall due or can secure them only at excessive cost. This risk is inherent in any retail and commercial banking business and can be heightened by a number of enterprise-specific factors, including over-reliance on a particular source of funding, changes in credit ratings or market-wide phenomena such as market dislocation. While we implement liquidity management processes to seek to mitigate and control these risks, unforeseen systemic market factors in particular make it difficult to eliminate completely these risks. Adverse and continued constraints in the supply of liquidity, including inter-bank lending, has affected and may materially and adversely affect the cost of funding our business, and extreme liquidity constraints may affect our current operations as well as limit growth possibilities.

Continued or worsening disruption and volatility in the global financial markets could have a material adverse effect on our ability to access capital and liquidity on financial terms acceptable to us.

Our cost of obtaining funding is directly related to prevailing market interest rates and to our credit spreads. Increases in interest rates and our credit spreads can significantly increase the cost of our funding. Changes in our credit spreads are market-driven, and may be influenced by market perceptions of our creditworthiness. Changes to interest rates and our credit spreads occur continuously and may be unpredictable and highly volatile.

If wholesale markets financing ceases to become available, or becomes excessively expensive, we may be forced to raise the rates we pay on deposits, with a view to attracting more customers, and/or to sell assets, potentially at depressed prices. The persistence or worsening of these adverse market conditions or an increase in base interest rates could have a material adverse effect on our ability to access liquidity and cost of funding (whether directly or indirectly).

We rely, and will continue to rely, primarily on commercial deposits to fund lending activities. The ongoing availability of this type of funding is sensitive to a variety of factors outside our control, such as general economic conditions and the confidence of commercial depositors in the economy, in general, and the financial services industry in particular, and the availability and extent of deposit guarantees, as well as competition between banks for deposits. Any of these factors could significantly increase the amount of commercial deposit withdrawals in a short period of time, thereby reducing our ability to access commercial deposit funding on appropriate terms, or at all, in the future. If these circumstances were to arise, this could have a material adverse effect on our operating results, financial condition and prospects.

We anticipate that our customers will continue, in the near future, to make short-term deposits (particularly demand deposits and short-term time deposits), and we intend to maintain our emphasis on the use of banking deposits as a source of funds. The short-term nature of this funding source could cause liquidity problems for us in the future if deposits are not made in the volumes we expect or are not renewed. If a substantial number of our depositors withdraw their demand deposits or do not roll over their time deposits upon maturity, we may be materially and adversely affected.

We cannot assure you that in the event of a sudden or unexpected shortage of funds in the banking system, we will be able to maintain levels of funding without incurring high funding costs, a reduction in the term of funding instruments or the liquidation of certain assets. If this were to happen, we could be materially adversely affected.

Credit, market and liquidity risk may have an adverse effect on our credit ratings and our cost of funds. Any downgrading in our credit rating would likely increase our cost of funding, require us to post additional collateral or take other actions under some of our derivative contracts and adversely affect our interest margins and results of operations.

Credit ratings affect the cost and other terms upon which we are able to obtain funding. Rating agencies regularly evaluate us, and their ratings of our debt are based on a number of factors, including our financial strength and conditions affecting the financial services industry generally. In addition, due to the methodology of the main rating agencies, our credit rating is affected by the rating of Spanish sovereign debt. If Spain's sovereign debt is downgraded, our credit rating would also likely be downgraded by an equivalent amount.

Any downgrade in our debt credit ratings would likely increase our borrowing costs and require us to post additional collateral or take other actions under some of our derivative contracts, and could limit our access to capital markets and adversely affect our commercial business. For example, a ratings downgrade could adversely affect our ability to sell or market certain of our products, engage in certain longer-term and derivatives transactions and retain our customers, particularly customers who need a minimum rating threshold in order to invest. In addition, under the terms of certain of our derivative contracts, we may be required to maintain a minimum credit rating or terminate such contracts. Any of these results of a ratings downgrade, in turn, could reduce our liquidity and have an adverse effect on us, including our operating results and financial condition.

Banco Santander, S.A.'s long-term debt is currently rated investment grade by the major rating agencies—Baa1 by Moody's Investors Service España, S.A., BBB by Standard & Poor's Ratings Services and BBB+ by Fitch Ratings Ltd.—all of which have stable outlook. During 2012, following downgrades of Spanish sovereign debt, all three agencies downgraded Banco Santander, S.A.'s rating together with that of the other main Spanish banks, due to the weaker-than-previously-anticipated macroeconomic and financial environment in Spain with dimming growth prospects in the near term, depressed real estate market activity and heightened turbulence in the capital markets. In the fourth quarter of 2013 and first quarter of 2014 the three agencies revised our outlook from negative to stable reflecting the gradual improvement of the Spanish economy and the view that any further weakening of our credit profile was unlikely to be significant. In March 2014, Moody's Investors Service upgraded our rating from Baa2 to Baa1 following the upgrade of Spain's sovereign debt rating announced on February 21 along with the change of the outlook on Spain's rating to positive from stable.

Santander UK's long-term debt is currently rated investment grade by the major rating agencies: A2 with negative outlook by Moody's Investors Service, A with negative outlook by Standard & Poor's Ratings Services and A with stable outlook by Fitch Ratings. All three agencies revised Santander UK's ratings during 2012 following the downgrades of the Spanish sovereign debt and remained unchanged in 2013. Negative outlooks by Moody's and Standard & Poor's reflect the negative trend that they see for the U.K. banking industry.

We conduct substantially all of our material derivative activities through Banco Santander, S.A. and Santander UK. We estimate that as of December 31, 2013, if all the rating agencies were to downgrade Banco Santander, S.A.'s long-term senior debt ratings by one notch we would be required to post up to €3 million in additional collateral pursuant to derivative and other financial contracts. A hypothetical two notch downgrade would result in a requirement to post up to €14 million in additional collateral. We estimate that as of December 31, 2013, if all the rating agencies were to downgrade Santander UK's long-term credit ratings by one notch, and thereby trigger a short-term credit rating downgrade, this could result in contractual outflows from Santander UK's total liquid assets of £7.6 billion of cash and additional collateral that Santander UK would be required to post under the terms of secured funding and derivatives contracts. A hypothetical two notch downgrade would result in an additional contractual outflow of £1.9 billion of cash and collateral under secured funding and derivatives contracts.

While certain potential impacts of these downgrades are contractual and quantifiable, the full consequences of a credit rating downgrade are inherently uncertain, as they depend upon numerous dynamic, complex and inter-related factors and assumptions, including market conditions at the time of any downgrade, whether any downgrade of a firm's long-term credit rating precipitates downgrades to its short-term credit rating, and assumptions about the potential behaviors of various customers, investors and counterparties. Actual outflows could be higher or lower than this hypothetical example, depending upon certain factors including which credit rating agency downgrades our credit rating, any management or restructuring actions that could be taken to reduce cash outflows and the potential liquidity impact from loss of unsecured funding (such as from money market funds) or loss of secured funding capacity. Although, unsecured and secured funding stresses are included in our stress testing scenarios and a portion of our total liquid assets is held against these risks, it is still the case that a credit rating downgrade could have a material adverse effect on Banco Santander, S.A., and/or its subsidiaries.

In addition, if we were required to cancel our derivatives contracts with certain counterparties and were unable to replace such contracts, our market risk profile could be altered.

In light of the difficulties in the financial services industry and the financial markets, there can be no assurance that the rating agencies will maintain the current ratings or outlooks. Failure to maintain favorable ratings and outlooks could increase our cost of funding and adversely affect interest margins, which could have a material adverse effect on us.

Risk Management

Failure to successfully implement and continue to improve our risk management policies, procedures and methods, including our credit risk management system, could materially and adversely affect us, and we may be exposed to unidentified or unanticipated risks.

The management of risk is an integral part of our activities. We seek to monitor and manage our risk exposure through a variety of separate but complementary financial, credit, market, operational, compliance and legal reporting systems. While we employ a broad and diversified set of risk monitoring and risk mitigation techniques, such techniques and strategies may not be fully effective in mitigating our risk exposure in all economic market environments or against all types of risk, including risks that we fail to identify or anticipate.

Some of our qualitative tools and metrics for managing risk are based upon our use of observed historical market behavior. We apply statistical and other tools to these observations to arrive at quantifications of our risk exposures. These qualitative tools and metrics may fail to predict future risk exposures. These risk exposures could, for example, arise from factors we did not anticipate or correctly evaluate in our statistical models. This would limit our ability to manage our risks. Our losses thus could be significantly greater than the historical measures indicate. In addition, our quantified modeling does not take all risks into account. Our more qualitative approach to managing those risks could prove insufficient, exposing us to material unanticipated losses. If existing or potential customers believe our risk management is inadequate, they could take their business elsewhere. This could have a material adverse effect on our operating results, financial condition and prospects.

As a commercial bank, one of the main types of risks inherent in our business is credit risk. For example, an important feature of our credit risk management system is to employ an internal credit rating system to assess the particular risk profile of a customer. As this process involves detailed analyses of the customer, taking into account both quantitative and qualitative factors, it is subject to human error. In exercising their judgment, our employees may not always be able to assign an accurate credit rating to a customer or credit risk, which may result in our exposure to higher credit risks than indicated by our risk rating system.

In addition, we have been trying to refine our credit policies and guidelines to address potential risks associated with particular industries or types of customers. However, we may not be able to timely detect these risks before they occur, or due to limited tools available to us, our employees may not be able to effectively implement them, which may increase our credit risk. Failure to effectively implement, consistently follow or continuously refine our credit risk management system may result in an increase in the level of non-performing loans and a higher risk exposure for us, which could have a material adverse effect on us.

Credit Risks

If we are unable to effectively control the level of non-performing or poor credit quality loans in the future, or if our loan loss reserves are insufficient to cover future loan losses, this could have a material adverse effect on us.

Risks arising from changes in credit quality and the recoverability of loans and amounts due from counterparties are inherent in a wide range of our businesses. Non-performing or low credit quality loans have in the past and can continue to negatively impact our results of operations. We cannot assure you that we will be able to effectively control the level of the impaired loans in our total loan portfolio. In particular, the amount of our reported non-performing loans may increase in the future as a result of growth in our total loan portfolio, including as a result of loan portfolios that we may acquire in the future, or factors beyond our control, such as adverse changes in the credit quality of our borrowers and counterparties or a general deterioration in economic conditions in Continental Europe, the United Kingdom, Latin America, the United States or global economic conditions, impact of political events, events affecting certain industries or events affecting financial markets and global economies.

Our current loan loss reserves may not be adequate to cover any increase in the amount of non-performing loans or any future deterioration in the overall credit quality of our total loan portfolio. Our loan loss reserves are based on our current assessment of and expectations concerning various factors affecting the quality of our loan portfolio. These factors include, among other things, our borrowers' financial condition, repayment abilities and repayment intentions, the realizable value of any collateral, the prospects for support from any guarantor, government macroeconomic policies, interest rates and the legal and regulatory environment. As the recent global financial crisis has demonstrated, many of these factors are beyond our control. As a result, there is no precise method for predicting loan and credit losses, and we cannot assure you that our loan loss reserves will be sufficient to cover actual losses. If our assessment of and expectations concerning the above mentioned factors differ from actual developments, if the quality of our total loan portfolio deteriorates, for any reason, including the increase in lending to individuals and small and medium enterprises, the volume increase in the credit card portfolio and the introduction of new products, or if the future actual losses exceed our estimates of incurred losses, we may be required to increase our loan loss reserves, which may adversely affect us. If we were unable to control or reduce the level of our non-performing or poor credit quality loans, this could have a material adverse effect on us.

Mortgage loans are one of our principal assets, comprising 53% of our loan portfolio as of December 31, 2013. As a result, we are exposed to developments in housing markets, especially in Spain and the United Kingdom. In addition, we have exposure to a number of large real estate developers in Spain. From 2002 to 2007, demand for housing and mortgage financing in Spain increased significantly driven by, among other things, economic growth, declining unemployment rates, demographic and social trends, the desirability of Spain as a vacation destination and historically low interest rates in the eurozone. The United Kingdom also experienced an increase in housing and mortgage demand driven by, among other things, economic growth, declining unemployment rates, demographic trends and the increasing prominence of London as an international financial center. During late 2007, the housing market began to adjust in Spain and the United Kingdom as a result of excess supply (particularly in Spain) and higher interest rates. Since 2008, as economic growth stalled in Spain and the United Kingdom, persistent housing oversupply, decreased housing demand, rising unemployment, subdued earnings growth, greater pressure on disposable income, a decline in the availability of mortgage finance and the continued effect of global market volatility have caused home prices to decline, while mortgage delinquencies increased. As a result of these and other factors, our NPL ratio increased from 0.94% at December 31, 2007, to 2.02% at December 31, 2008, to 3.24% at December 31, 2009, to 3.55% at December 31, 2010, to 3.89% at December 31, 2011 and to 4.54% at December 31, 2012. At December 31, 2013, our NPL ratio was 5.64%. These trends, especially higher unemployment rates coupled with declining real estate prices, could have a material adverse impact on our mortgage payment delinquency rates, which in turn could have a material adverse effect on our business, financial condition and results of operations.

Our loan and investment portfolios are subject to risk of prepayment, which could have a material adverse effect on us.

Our fixed rate loan and investment portfolios are subject to prepayment risk, which results from the ability of a borrower or issuer to pay a debt obligation prior to maturity. Generally, in a declining interest rate environment, prepayment activity increases, which reduces the weighted average lives of our earning assets and could have a material adverse effect on us. We would also be required to amortize net premiums into income over a shorter period of time, thereby reducing the corresponding asset yield and net interest income. Prepayment risk also has a significant adverse impact on credit card and collateralized mortgage loans, since prepayments could shorten the weighted average life of these assets, which may result in a mismatch in our funding obligations and reinvestment at lower yields. Prepayment risk is inherent to our commercial activity and an increase in prepayments could have a material adverse effect on us.

The value of the collateral securing our loans may not be sufficient, and we may be unable to realize the full value of the collateral securing our loan portfolio.

The value of the collateral securing our loan portfolio may fluctuate or decline due to factors beyond our control, including macroeconomic factors affecting Europe, the United States and Latin American countries. The value of the collateral securing our loan portfolio may be adversely affected by force majeure events, such as natural disasters, particularly in locations where a significant portion of our loan portfolio is composed of real estate loans. Natural disasters such as earthquakes and floods may cause widespread damage which could impair the asset quality of our loan portfolio and could have an adverse impact on the economy of the affected region. We may also not have sufficiently recent information on the value of collateral, which may result in an inaccurate assessment for impairment losses of our loans secured by such collateral. If any of the above were to occur, we may need to make additional provisions to cover actual impairment losses of our loans, which may materially and adversely affect our results of operations and financial condition.

We are subject to counterparty risk in our banking business.

We are exposed to counterparty risk in addition to credit risks associated with lending activities. Counterparty risk may arise from, for example, investing in securities of third parties, entering into derivative contracts under which counterparties have obligations to make payments to us or executing securities, futures, currency or commodity trades from proprietary trading activities that fail to settle at the required time due to non-delivery by the counterparty or systems failure by clearing agents, clearing houses or other financial intermediaries.

We routinely transact with counterparties in the financial services industry, including brokers and dealers, commercial banks, investment banks, mutual funds, hedge funds and other institutional clients. Defaults by, and even rumors or questions about the solvency of, certain financial institutions and the financial services industry generally have led to market-wide liquidity problems and could lead to losses or defaults by other institutions. Many of the routine transactions we enter into expose us to significant credit risk in the event of default by one of our significant counterparties.

Market Risks

Our financial results are constantly exposed to market risk. We are subject to fluctuations in interest rates and other market risks, which may materially and adversely affect us.

Market risk refers to the probability of variations in our net interest income or in the market value of our assets and liabilities due to volatility of interest rate, exchange rate or equity price. Changes in interest rates affect the following areas, among others, of our business:

- net interest income;
- the volume of loans originated;
- the market value of our securities holdings;
- gains from sales of loans and securities; and
- gains and losses from derivatives.

Variations in short-term interest rates could affect our net interest income, which comprises the majority of our revenue, reducing our growth rate and potentially resulting in losses. When interest rates rise, we may be required to pay higher interest on our floating-rate borrowings while interest earned on our fixed-rate assets does not rise as quickly, which could cause profits to grow at a reduced rate or decline in some parts of our portfolio. Interest rates are highly sensitive to many factors beyond our control, including increased regulation of the financial sector, monetary policies, domestic and international economic and political conditions and other factors.

Increases in interest rates may reduce the volume of loans we originate. Sustained high interest rates have historically discouraged customers from borrowing and have resulted in increased delinquencies in outstanding loans and deterioration in the quality of assets. Increases in interest rates may also reduce the propensity of our customers to prepay or refinance fixed-rate loans. Increases in interest rates may reduce the value of our financial assets and may reduce gains or require us to record losses on sales of our loans or securities.

If interest rates decrease, although this is likely to reduce our funding costs, it is likely to compress our net interest margins, as well as adversely impact our income from investments in securities and loans with similar maturities, which could have a negative effect on us. In addition, we may also experience increased delinquencies in a low interest rate environment when such an environment is accompanied by high unemployment and recessionary conditions.

The market value of a security with a fixed interest rate generally decreases when prevailing interest rates rise, which may have an adverse effect on our earnings and financial condition. In addition, we may incur costs (which, in turn, will impact our results) as we implement strategies to reduce future interest rate exposure. The market value of an obligation with a floating interest rate can be adversely affected when interest rates increase, due to a lag in the implementation of repricing terms or an inability to refinance at lower rates.

We are also exposed to foreign exchange rate risk as a result of mismatches between assets and liabilities denominated in different currencies. Fluctuations in the exchange rate between currencies may negatively affect our earnings and value of our assets and securities.

We are also exposed to equity price risk in connection with our trading investments in equity securities. The performance of financial markets may cause changes in the value of our investment and trading portfolios. The volatility of world equity markets due to the continued economic uncertainty and sovereign debt crisis has had a particularly strong impact on the financial sector. Continued volatility may affect the value of our investments in entities in this sector and, depending on their fair value and future recovery expectations, could become a permanent impairment which would be subject to write-offs against our results. To the extent any of these risks materialize, our net interest income or the market value of our assets and liabilities could be materially adversely affected.

Market conditions have resulted and could result in material changes to the estimated fair values of our financial assets. Negative fair value adjustments could have a material adverse effect on our operating results, financial condition and prospects.

In the past six years, financial markets have been subject to significant stress resulting in steep falls in perceived or actual financial asset values, particularly due to volatility in global financial markets and the resulting widening of credit spreads. We have material exposures to securities, loans and other investments that are recorded at fair value and are therefore exposed to potential negative fair value adjustments. Asset valuations in future periods, reflecting then-prevailing market conditions, may result in negative changes in the fair values of our financial assets and these may also translate into increased impairments. In addition, the value ultimately realized by us on disposal may be lower than the current fair value. Any of these factors could require us to record negative fair value adjustments, which may have a material adverse effect on our operating results, financial condition or prospects.

In addition, to the extent that fair values are determined using financial valuation models, such values may be inaccurate or subject to change, as the data used by such models may not be available or may become unavailable due to changes in market conditions, particularly for illiquid assets, and particularly in times of economic instability. In such circumstances, our valuation methodologies require us to make assumptions, judgments and estimates in order to establish fair value, and reliable assumptions are difficult to make and are inherently uncertain and valuation models are complex, making them inherently imperfect predictors of actual results. Any consequential impairments or write-downs could have a material adverse effect on our operating results, financial condition and prospects.

We are subject to market, operational and other related risks associated with our derivative transactions that could have a material adverse effect on us.

We enter into derivative transactions for trading purposes as well as for hedging purposes. We are subject to market, credit and operational risks associated with these transactions, including basis risk (the risk of loss associated with variations in the spread between the asset yield and the funding and/or hedge cost) and credit or default risk (the risk of insolvency or other inability of the counterparty to a particular transaction to perform its obligations thereunder, including providing sufficient collateral).

Market practices and documentation for derivative transactions in the countries where we operate differ from each other. In addition, the execution and performance of these transactions depends on our ability to maintain adequate control and administration systems and to hire and retain qualified personnel. Moreover, our ability to adequately monitor, analyze and report derivative transactions continues to depend, to a great extent, on our information technology systems. This factor further increases the risks associated with these transactions and could have a material adverse effect on us.

General Business and Industry Risks***The financial problems faced by our customers could adversely affect us.***

Market turmoil and economic recession could materially and adversely affect the liquidity, businesses and/or financial conditions of our borrowers, which could in turn increase our non-performing loan ratios, impair our loan and other financial assets and result in decreased demand for borrowings in general. In addition, our customers may further significantly decrease their risk tolerance to non-deposit investments such as stocks, bonds and mutual funds, which would adversely affect our fee and commission income. Any of the conditions described above could have a material adverse effect on our business, financial condition and results of operations.

Changes in our pension liabilities and obligations could have a material adverse effect on us.

We provide retirement benefits for many of our former and current employees through a number of defined benefit pension plans. We calculate the amount of our defined benefit obligations using actuarial techniques and assumptions, including mortality rates, the rate of increase of salaries, discount rates, inflation, the expected rate of return on plan assets, or others. These calculations are based on IFRS and on those other requirements defined by the local supervisors. Given the nature of these obligations, changes in the assumptions that support valuations, including market conditions, can result in actuarial losses which would in turn impact the financial condition of our pension funds. Because pension obligations are generally long term obligations, fluctuations in interest rates have a material impact on the projected costs of our defined benefit obligations and therefore on the amount of pension expense that we accrue.

Any increase in the current size of the deficit in our defined benefit pension plans, due to reduction in the value of the pension fund assets (depending on the performance of financial markets) or an increase in the pension fund liabilities due to changes in mortality assumptions, the rate of increase of salaries, discount rate assumptions, inflation, the expected rate of return on plan assets, or other factors, could result in our having to make increased contributions to reduce or satisfy the deficits which would divert resources from use in other areas of our business and reduce our capital resources. While we can control a number of the above factors, there are some over which we have no or limited control. Increases in our pension liabilities and obligations could have a material adverse effect on our business, financial condition and results of operations.

We depend in part upon dividends and other funds from subsidiaries.

Some of our operations are conducted through our financial services subsidiaries. As a result, our ability to pay dividends, to the extent we decide to do so, depends in part on the ability of our subsidiaries to generate earnings and to pay dividends to us. Payment of dividends, distributions and advances by our subsidiaries will be contingent upon our subsidiaries' earnings and business considerations and is or may be limited by legal, regulatory and contractual restrictions. Additionally, our right to receive any assets of any of our subsidiaries as an equity holder of such subsidiaries, upon their liquidation or reorganization, will be effectively subordinated to the claims of our subsidiaries' creditors, including trade creditors.

Increased competition and industry consolidation may adversely affect our results of operations.

We face substantial competition in all parts of our business, including in originating loans and in attracting deposits. The competition in originating loans comes principally from other domestic and foreign banks, mortgage banking companies, consumer finance companies, insurance companies and other lenders and purchasers of loans.

In addition, there has been a trend towards consolidation in the banking industry, which has created larger and stronger banks with which we must now compete. There can be no assurance that this increased competition will not adversely affect our growth prospects, and therefore our operations. We also face competition from non-bank competitors, such as brokerage companies, department stores (for some credit products), leasing and factoring companies, mutual fund and pension fund management companies and insurance companies.

Increasing competition could require that we increase our rates offered on deposits or lower the rates we charge on loans, which could also have a material adverse effect on us, including our profitability. It may also negatively affect our business results and prospects by, among other things, limiting our ability to increase our customer base and expand our operations and increasing competition for investment opportunities.

In addition, if our customer service levels were perceived by the market to be materially below those of our competitor financial institutions, we could lose existing and potential business. If we are not successful in retaining and strengthening customer relationships, we may lose market share, incur losses on some or all of our activities or fail to attract new deposits or retain existing deposits, which could have a material adverse effect on our operating results, financial condition and prospects.

Our ability to maintain our competitive position depends, in part, on the success of new products and services we offer our clients and our ability to continue offering products and services from third parties, and we may not be able to manage various risks we face as we expand our range of products and services that could have a material adverse effect on us.

The success of our operations and our profitability depends, in part, on the success of new products and services we offer our clients and our ability to continue offering products and services from third parties. However, we cannot guarantee that our new products and services will be responsive to client demands or successful once they are offered to our clients, or that they will be successful in the future. In addition, our clients' needs or desires may change over time, and such changes may render our products and services obsolete, outdated or unattractive and we may not be able to develop new products that meet our clients' changing needs. If we cannot respond in a timely fashion to the changing needs of our clients, we may lose clients, which could in turn materially and adversely affect us.

As we expand the range of our products and services, some of which may be at an early stage of development in the markets of certain regions where we operate, we will be exposed to new and potentially increasingly complex risks and development expenses. Our employees and risk management systems, as well as our experience and that of our partners may not be sufficient or adequate to enable us to properly handle or manage such risks. In addition, the cost of developing products that are not launched is likely to affect our results of operations. Any or all of these factors, individually or collectively, could have a material adverse effect on us.

Further, our customers may issue complaints and seek redress if they consider that they have suffered loss from our products and services, for example, as a result of any alleged mis-selling or incorrect application of the terms and conditions of a particular product. This could in turn subject us to risks of potential legal action by our customers and intervention by our regulators. We have in the past experienced losses due to claims of mis-selling in the U.K., Spain and other jurisdictions and may do so in the future. For further detail on our legal and regulatory risk exposures, please see the Risk Factor entitled "We are exposed to risk of loss from legal and regulatory proceedings."

If we are unable to manage the growth of our operations this could have an adverse impact on our profitability.

We allocate management and planning resources to develop strategic plans for organic growth, and to identify possible acquisitions and disposals and areas for restructuring our businesses. From time to time, we evaluate acquisition and partnership opportunities that we believe offer additional value to our shareholders and are consistent with our business strategy. However, we may not be able to identify suitable acquisition or partnership candidates, and our ability to benefit from any such acquisitions and partnerships will depend in part on our successful integration of those businesses. Any such integration entails significant risks such as unforeseen difficulties in integrating operations and systems and unexpected liabilities or contingencies relating to the acquired businesses, including legal claims. We can give no assurances that our expectations with regards to integration and synergies will materialize. We also cannot provide assurance that we will, in all cases, be able to manage our growth effectively or deliver our strategic growth objectives. Challenges that may result from our strategic growth decisions include our ability to:

- manage efficiently the operations and employees of expanding businesses;
- maintain or grow our existing customer base;
- assess the value, strengths and weaknesses of investment or acquisition candidates;
- finance strategic investments or acquisitions;
- fully integrate strategic investments, or newly-established entities or acquisitions in line with its strategy;
- align our current information technology systems adequately with those of an enlarged group;
- apply our risk management policy effectively to an enlarged group; and
- manage a growing number of entities without over-committing management or losing key personnel.

Any failure to manage growth effectively, including relating to any or all of the above challenges associated with our growth plans, could have a material adverse effect on our operating results, financial condition and prospects.

We rely on recruiting, retaining and developing appropriate senior management and skilled personnel.

Our continued success depends in part on the continued service of key members of our management team. The ability to continue to attract, train, motivate and retain highly qualified professionals is a key element of our strategy. The successful implementation of our growth strategy depends on the availability of skilled management, both at our head office and at each of our business units. If we or one of our business units or other functions fails to staff its operations appropriately or loses one or more of its key senior executives and fails to replace them in a satisfactory and timely manner, our business, financial condition and results of operations, including control and operational risks, may be adversely affected.

In addition, the financial industry has and may continue to experience more stringent regulation of employee compensation, which could have an adverse effect on our ability to hire or retain the most qualified employees. If we fail or are unable to attract and appropriately train, motivate and retain qualified professionals, our business may also be adversely affected.

We rely on third parties for important products and services.

Third party vendors provide key components of our business infrastructure such as loan and deposit servicing systems, internet connections and network access. Third parties can be sources of operational risk to us, including with respect to security breaches affecting such parties. We may be required to take steps to protect the integrity of our operational systems, thereby increasing our operational costs and potentially decreasing customer satisfaction. In addition, any problems caused by these third parties, including as a result of their not providing us their services for any reason, their performing their services poorly, or employee misconduct, could adversely affect our ability to deliver products and services to customers and otherwise to conduct business. Replacing these third party vendors could also entail significant delays and expense.

Damage to our reputation could cause harm to our business prospects.

Maintaining a positive reputation is critical to our attracting and maintaining customers, investors and employees. Damage to our reputation can therefore cause significant harm to its business and prospects. Harm to our reputation can arise from numerous sources, including, among others, employee misconduct, litigation or regulatory outcomes, failure to deliver minimum standards of service and quality, compliance failures, unethical behavior, and the activities of customers and counterparties. Further, negative publicity regarding us, whether or not true, may result in harm to our prospects.

Actions by the financial services industry generally or by certain members of, or individuals in, the industry can also affect our reputation. For example, the role played by financial services firms in the financial crisis and the seeming shift toward increasing regulatory supervision and enforcement has caused public perception of us and others in the financial services industry to decline.

We could suffer significant reputational harm if we fail to properly identify and manage potential conflicts of interest. Management of potential conflicts of interest has become increasingly complex as we expand our business activities through more numerous transactions, obligations and interests with and among our clients. The failure to adequately address, or the perceived failure to adequately address, conflicts of interest could affect the willingness of clients to deal with us, or give rise to litigation or enforcement actions against us. Therefore, there can be no assurance that conflicts of interest will not arise in the future that could cause material harm to us.

We engage in transactions with our subsidiaries or affiliates that others may not consider to be on an arm's-length basis.

We and our affiliates have entered into a number of services agreements pursuant to which we render services, such as administrative, accounting, finance, treasury, legal services and others.

Spanish law provides for several procedures designed to ensure that the transactions entered into with or among our financial subsidiaries and/or affiliates do not deviate from prevailing market conditions for those types of transactions.

We are likely to continue to engage in transactions with our affiliates. Future conflicts of interests between us and any of affiliates, or among our affiliates, may arise, which conflicts are not required to be and may not be resolved in our favor.

Technology Risks

Any failure to effectively improve or upgrade our information technology infrastructure and management information systems in a timely manner could have a material adverse effect on us.

Our ability to remain competitive depends in part on our ability to upgrade our information technology on a timely and cost-effective basis. We must continually make significant investments and improvements in our information technology infrastructure in order to remain competitive. We cannot assure you that in the future we will be able to maintain the level of capital expenditures necessary to support the improvement or upgrading of our information technology infrastructure. Any failure to effectively improve or upgrade our information technology infrastructure and management information systems in a timely manner could have a material adverse effect on us.

Risks relating to data collection, processing and storage systems are inherent in our business.

Our businesses depend on the ability to process a large number of transactions efficiently and accurately, and on our ability to rely on our digital technologies, computer and email services, software and networks, as well as on the secure processing, storage and transmission of confidential and other information in our computer systems and networks. The proper functioning of financial control, accounting or other data collection and processing systems is critical to our businesses and to our ability to compete effectively. Losses can result from inadequate personnel, inadequate or failed internal control processes and systems, or from external events that interrupt normal business operations. We also face the risk that the design of our controls and procedures prove to be inadequate or are circumvented. Although we work with our clients, vendors, service providers, counterparties and other third parties to develop secure transmission capabilities and prevent against cyber-attacks, we routinely exchange personal, confidential and proprietary information by electronic means, and we may be the target of attempted cyber-attacks. If we cannot maintain an effective data collection, management and processing system, we may be materially and adversely affected.

We take protective measures and continuously monitor and develop our systems to protect our technology infrastructure and data from misappropriation or corruption, but our systems, software and networks nevertheless may be vulnerable to unauthorized access, misuse, computer viruses or other malicious code and other events that could have a security impact. An interception, misuse or mishandling of personal, confidential or proprietary information sent to or received from a client, vendor, service provider, counterparty or third party could result in legal liability, regulatory action and reputational harm. There can be no assurance that we will not suffer material losses from operational risk in the future, including relating to cyber-attacks or other such security breaches. Further, as cyber-attacks continue to evolve, we may incur significant costs in its attempt to modify or enhance our protective measures or investigate or remediate any vulnerabilities.

Failure to protect personal information could adversely affect us.

We manage and hold confidential personal information of customers in the conduct of our banking operations. Although we have procedures and controls to safeguard personal information in our possession, unauthorized disclosures could subject us to legal actions and administrative sanctions as well as damages that could materially and adversely affect our operating results, financial condition and prospects.

Foreign Private Issuer and Other Risks

Our corporate disclosure may differ from disclosure regularly published by issuers of securities in other countries, including the United States.

Issuers of securities in Spain are required to make public disclosures that are different from, and that may be reported under presentations that are not consistent with, disclosures required in other countries, including the United States. In particular, for regulatory purposes, we currently prepare and will continue to prepare and make available to our shareholders statutory financial statements in accordance with IFRS, which differs from US GAAP in a number of respects. In addition, as a foreign private issuer, we are not subject to the same disclosure requirements in the United States as a domestic U.S. registrant under the Exchange Act, including the requirements to prepare and issue quarterly reports, or the proxy rules applicable to domestic U.S. registrants under Section 14 of the Exchange Act or the insider reporting and short-swing profit rules under Section 16 of the Exchange Act. Accordingly, the information about us available to you will not be the same as the information available to shareholders of a U.S. company and may be reported in a manner that you are not familiar with.