Last six months	Rate During Period High $	Low $
2015		
October	1.14	1.09
November	1.10	1.06
December	1.10	1.06
2016		
January	1.09	1.07
February	1.13	1.09
March	1.14	1.09
April (through April 8)	1.14	1.13

On April 8, 2016, the exchange rate for euros and dollars (expressed in dollars per euro), as published by the ECB, was $1.14.

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.

1. Macro-Economic and Political Risks

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

Our loan portfolio is concentrated in Continental Europe (in particular, Spain), the United Kingdom, Latin America and the United States. At December 31, 2015, Continental Europe accounted for 36% of our total loan portfolio (Spain accounted for 20% of our total loan portfolio), the United Kingdom (where the loan portfolio consists primarily of residential mortgages) accounted for 36%, Latin America accounted for 17% (of which Brazil represents 8% of our total loan portfolio) and the United States accounted for 11%. 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, Latin America and the United States. A return to recessionary conditions in the economies of Continental Europe (in particular, Spain), the United Kingdom, some of the Latin American countries in which we operate or the United States, or continued recessionary conditions in Brazil, 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”.

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

In the past eight years, financial systems worldwide have experienced difficult credit and liquidity conditions and disruptions leading to less liquidity and greater volatility (such as volatility in spreads). Global economic conditions deteriorated significantly between 2007 and 2009, and many of the countries in which we operate fell into recession. Although most countries have begun to recover, 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:

- Reduced demand for our products and services.
- Increased regulation of our industry. Compliance with such regulation will continue to increase our costs and may affect the pricing for our products and services and limit our ability to pursue business opportunities.
- Inability of our borrowers to timely or fully comply with their existing obligations. 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.
- 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.

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. 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.

1.3 We may suffer adverse effects as a result of 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. 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 have taken actions with the aim of reducing the risk of contagion in the eurozone and beyond. These included the creation of the Open Market Transaction facility of the ECB and the decision by eurozone governments to progress towards the creation of a banking union. In January 2015, the ECB announced an extensive quantitative easing scheme. The scheme comprises a €60 billion-a-month bond-buying program across the eurozone, which was raised to €80 billion in March 2016, such program to last until at least September 2016, with a potential for extension if inflation in the eurozone does not meet the ECB target of 2%. Notwithstanding these measures, a significant number of financial institutions throughout Europe have substantial exposures to sovereign debt issued by eurozone nations, which are under financial stress. 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 recent economic crisis.

We have direct and indirect exposure to financial and economic conditions throughout the eurozone economies. While concerns relating to sovereign defaults or a partial or complete break-up of the European Monetary Union, including potential accompanying redenomination risks and uncertainties, seemed to have abated, such concerns could resurface (as it was demonstrated in the earlier part of 2015 with the doubts regarding Greece's membership of the eurozone). 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.

1.4 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. 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.

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

The economies of some of the countries where we operate, particularly in Latin America, have experienced significant volatility in recent decades. 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. In addition, some of the countries where we operate are particularly affected by commodities price fluctuations, which in turn may affect financial market conditions through exchange rate fluctuations, interest rate volatility and deposits volatility. Negative and fluctuating economic conditions, such as slowing or negative growth and a changing interest rate environment, impact our profitability by causing lending margins to decrease and credit quality to decline and leading to decreased demand for higher margin products and services. For instance, Brazil’s present high rate of inflation, compounded by high and increasing interest rates, declining consumer spending and increasing unemployment, have had and may continue to have a material adverse impact on the Brazilian economy as a whole as well as on our financial condition and earnings in Brazil, which represented 20% of profit attributable to the Parent bank’s total operating areas in 2015 and 8% of our total loans as of December 31, 2015. In addition, our business in Brazil will continue to be adversely affected by recessionary conditions and political instability in that country.

There is uncertainty over the long-term effects of the monetary and fiscal policies that have been adopted by the central banks and financial authorities of some of the world’s leading economies, including China. China’s economy is entering a period of slower growth. Any continuing or worsening slowdown in China could further reduce domestic demand in China which in turn could have ripple effects on the global economy. Furthermore, financial turmoil in emerging markets tends to adversely affect stock prices and debt securities prices of other emerging markets as investors move their money to more stable and developed markets. Continued or increased perceived risks associated with investing in emerging economies in general, or the emerging market economies where the Group operates in particular, could further dampen capital flows to such economies and adversely affect such economies, and as a result, could have an adverse impact on the Group’s business and results of operations.

Negative and fluctuating economic conditions in the countries in which we operate, such as those that certain Latin American and European countries have experienced recently, 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 regions or countries.

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. In particular, the UK government has committed to hold a referendum on the UK’s membership of the European Union in June 2016. Future UK political developments, including but not limited to any changes in government structure and policies, could affect the fiscal, monetary and regulatory landscape to which we are subject and also therefore our financing availability and terms.

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

2. Risks Relating to Our Business

2.1 Legal, Regulatory and Compliance Risks

2.1.1 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 party 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 (see note 25 to our consolidated financial statements). 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.

2.1.2 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. The statutes, regulations and policies to which we are subject may be changed at any time. In addition, the interpretation and the application by regulators of the laws and regulations to which we are subject may also change from time to time. 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 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. 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 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 compliance and other 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.

The regulations which most significantly affect the Bank, or which could most significantly affect the Bank in the future, relate to capital requirements, liquidity and funding, development of a fiscal and banking union in the European Union and regulatory reforms in the United States, and are discussed in further detail below. Other regulatory reforms adopted or proposed in the wake of the financial crisis have increased and may continue to materially increase our operating costs and negatively impact our business model. In addition, the volume, granularity, frequency and scale of regulatory and other reporting requirements necessitate a clear data strategy to enable consistent data aggregation, reporting and management. Inadequate management information systems or processes, including those relating to risk data aggregation and risk reporting, could lead to a failure to meet regulatory reporting requirements or other internal or external information demands and we may face supervisory measures as a result.

Capital requirements, liquidity, funding and structural reform

Increasingly onerous capital requirements constitute one of the Bank’s main regulatory challenges. Increasing capital requirements may adversely affect the Bank’s profitability and create regulatory risk associated with the possibility of failure to maintain required capital levels. As a Spanish financial institution, the Bank is subject to the Capital Requirements Regulation (CRR) and the Capital Requirements Directive (“CRD IV”), through which the European Union began implementing the Basel III capital reforms from January 1, 2014, with certain requirements in the process of being phased in until January 1, 2019. While the CRD IV requires national transposition, the CRR is directly applicable in all the EU member states. This regulation is complemented by several binding technical standards and guidelines issued by the EBA , directly applicable in all EU member states, without the need for national implementation measures. The implementation of the CRD IV Directive into Spanish law has largely taken place through Royal Decree Law 14/2013 and Law 10/2014, Bank of Spain Circular 2/2014 and Bank of Spain Circular 2/2016. Credit institutions, such as the Bank, are required, on a standalone and consolidated basis, to hold a minimum amount of regulatory capital of 8% of risk weighted assets (of which at least 4.5% must be Common Equity Tier 1 (“CET1”) capital and at least 6% must be Tier 1 capital). In addition to the minimum regulatory capital requirements, CRD IV also introduces capital buffer requirements that must be met with CET1 capital. CRD IV introduces five new capital buffers: (1) the capital conservation buffer for unexpected losses, requiring additional CET1 of up to 2.5% of total weighted exposures; (2) the institution-specific counter-cyclical capital buffer, requiring additional CET1 of up to 2.5% of total weighted exposures; (3) the global systemically important institutions buffer of between 1% and 3.5% of CET1; (4) the other systemically important institutions buffer, which may be as much as 2% of CET1; and (5) the Common Equity Tier 1 systemic risk buffer. Beginning in 2016, and subject to the applicable phase-in period, entities will be required to comply with the “combined buffer requirement” (broadly, the combination of the capital conservation buffer, the institution-specific counter-cyclical buffer and the higher of (depending on the institution) the systemic risk buffer, the global systemically important institutions buffer and the other systemically important financial institutions buffer, in each case as applicable to the institution).The Bank will be required to maintain a conservation buffer of 2.5% and a systemically important institutions buffer of 1%, in each case considered on a fully loaded basis. However, as of the date of this Report, due to the application of the phase-in period, the Bank is required to maintain a conservation buffer of 2.5% and a systemically important institutions buffer of 0.25%.

Article 104 of the CRD IV Directive, as implemented by Article 68 of Law 10/2014, and similarly Article 16 of Council Regulation (EU) No 1024/2013 of October 15, 2013 conferring specific tasks on the European Central Bank (the “ECB”) concerning policies relating to the prudential supervision of credit institutions (the “SSM Regulation”), also contemplate that in addition to the minimum “Pillar 1” capital requirements (including, if applicable, any buffer capital as discussed above), supervisory authorities may impose further “Pillar 2” capital requirements to cover other risks, including those not considered to be fully captured by the minimum capital requirements under CRD IV or to address macro-prudential considerations. This may result in the imposition of additional capital requirements on the Bank and/or the Group pursuant to this “Pillar 2” framework. Any failure by the Bank and/or the Group to maintain its “Pillar 1” minimum regulatory capital ratios, any “Pillar 2” additional capital requirements could result in administrative actions or sanctions, which, in turn, may have a material adverse impact on the Group’s results of operations.

The ECB is required to carry out, at least on an annual basis, assessments under CRD IV of the additional “Pillar 2” capital requirements that may be imposed for each of the European banking institutions subject to the Single Supervisory Mechanism (the “SSM”). Any additional capital requirement that may be imposed on the Bank and/or the Group by the ECB pursuant to these assessments may require the Bank and/or the Group to hold capital levels similar to, or higher than, those required under the full application of CRD IV. There can be no assurance that the Group will be able to continue to maintain such capital ratios.

In addition to the above, the EBA published on December 19, 2014 its final guidelines for common procedures and methodologies in respect of its supervisory review and evaluation process (SREP). Included in this were the EBA’s proposed guidelines for a common approach to determining the amount and composition of additional capital requirements to be implemented by January 1, 2016. Under these guidelines, national supervisors must set a composition requirement for the additional capital requirements to cover certain specified risks of at least 56% CET1 capital and at least 75% Tier 1 capital. The guidelines also contemplate that national supervisors should not set additional capital requirements in respect of risks which are already covered by capital buffer requirements and/or additional macro-prudential requirements; and, accordingly, the above “combined buffer requirement” is in addition to the minimum capital requirement and to the additional capital requirement. In this regard, under article 141 of the CRD IV Directive, Member States of the European Union must require that institutions that fail to meet the “combined buffer requirement” or the “Pillar 2” capital requirements described above, will be prohibited from paying any “discretionary payments” (which are defined broadly by the CRD IV Directive as payments relating to Common Equity Tier 1, variable remuneration and payments on Additional Tier 1 capital instruments), until it calculates its applicable restrictions and communicates them to the Regulator and, once completed, such institution will be subject to restricted “discretionary payments”. The restrictions will be scaled according to the extent of the breach of the “combined buffer requirement” and calculated as a percentage of the profits of the institution since the last distribution of profits or “discretionary payment”. Such calculation will result in a “Maximum Distributable Amount” in each relevant period. As an example, the scaling is such that in the bottom quartile of the “combined buffer requirement”, no “discretionary distributions” will be permitted to be paid. Articles 43 to 49 of Law 10/2014 and Chapter II of Title II of Royal Decree 84/2015 implement the above provisions in Spain. In particular article 48 of Law 10/2014 and articles 73 and 74 of Royal Decree 84/2014 deal with restrictions on distributions. In connection with this, Banco Santander announced on December 23, 2015 that it had received from the ECB its decision regarding prudential minimum capital phase-in requirements for 2016, following the results of SREP. The ECB decision requires that the Group maintains a Common Equity Tier 1 capital ratio of 9.75% on a consolidated basis. This 9.75% capital requirement includes: the minimum Pillar 1 requirement (4.5%); the Pillar 2 requirement including the capital conservation buffer (5.0%); and the requirement from its consideration as a global systemic financial institution (0.25%). The ECB decision also requires that Banco Santander, S.A. maintains a Common Equity Tier 1 capital ratio of 9.50% on an individual basis. This 9.50% capital requirement includes: the minimum Pillar 1 requirement (4.5%), and the Pillar 2 requirement including the capital conservation buffer (5.0%). These capital requirements do not imply any limitations referred to in CRR to distributions in the form of dividends, variable remuneration and coupon payments to holders of AT1 instruments.

In addition to the above, the CRR also includes a requirement for institutions to calculate a leverage ratio, report it to their supervisors and to disclose it publicly from January 1, 2015 onwards. More precisely, Article 429 of the CRR requires institutions to calculate their leverage ratio (LR) in accordance with the methodology laid down in that article. In January 2014, the Basel Committee finalized a definition of how the LR should be prepared and set an indicative benchmark (namely 3% of Tier 1 capital). Such 3% Tier 1 LR will be tested during the monitoring period until 2017 when the Basel Committee will decide on the final calibration. Thus, the CRR does not contain a requirement for institutions to have a capital requirement based on the LR and the decision on whether such a requirement will be introduced has been left for a later date. In accordance with Article 511 of the CRR, the European Commission is required to submit, by the end of 2016, a report on the LR to the Council and the Parliament. The report will be based on an EBA report and will be accompanied, where appropriate, by a legislative proposal to introduce a binding LR or different LRs for different business models, applicable from January 1, 2018 onwards. At December 31, 2015 the Group's fully loaded LR was 4.73% and the phase-in LR was 5.38%.

On November 9, 2015, the Financial Stability Board (the "FSB") published its final principles and term sheet containing an international standard to enhance the loss absorbing capacity of global systemically important banks ("G-SIBs"), such as the Bank. The final standard consists of an elaboration of the principles on loss absorbing and recapitalization capacity of G-SIBs in resolution and a term sheet setting out a proposal for the implementation of these proposals in the form of an internationally agreed standard on total loss absorbing capacity ("TLAC") for G-SIBs. Once implemented in the relevant jurisdictions, these principles and terms will form a new minimum TLAC standard for G-SIBs, and in the case of G-SIBs with more than one resolution group, each resolution group within the G-SIB. If implemented as contemplated, the TLAC requirement is expected to create material additional quantitative requirements for the Bank and each of its resolution sub-groups, including new minimum risk-based and leverage TLAC ratios of (i) the Bank's and each of its resolution sub-groups' regulatory capital plus certain types of long-term unsecured debt instruments and other eligible liabilities that can be written down or converted into equity during resolution to (ii) the Bank's or the resolution sub-group's risk-weighted assets and the Basel III leverage ratio denominator.

The FSB term sheet reflects a minimum Pillar 1 risk-based TLAC requirement of 16% of the Bank's and each of its resolution sub-groups' risk weighted assets as from January 1, 2019 and 18% as from January 1, 2022. Minimum TLAC under the term sheet must be also at least 6% of the Basel III leverage ratio denominator as from January 1, 2019, and at least 6.75% as from January 1, 2022.

While definitive TLAC requirements remain subject to significant uncertainty, based on our interpretation of the FSB's final principles and term sheet from November 2015 and assuming TLAC requirements at 18% (the fully phased-in requirement at 2022), a Basel III capital conservation buffer of 2.5% and a G-SIB surcharge of 1.0%, the estimated shortfall between our current capital levels and the requirements expected to be in force by 2019 would be such that, given historical annual debt issuance volumes by the Group, we believe the Group has flexibility to comply with expected TLAC requirements through recurring issuances of qualifying debt.

Furthermore, the European Bank Recovery and Resolution Directive ("BRRD") requires all European banks to maintain a minimum requirement for own funds and eligible liabilities ("MREL"). The purpose of MREL, which is calculated as a percentage of the total liabilities and own funds of an institution, is to ensure that institutions maintain enough capital capable of being written down and/or bailed-in, so as to facilitate resolution. Therefore, the objective of the MREL is broadly the same as TLAC.

The obligation to set an MREL for the Group and individual Group entities applied under the BRRD from January 1, 2016. The European Union Single Resolution Board (SRB) intends to determine MREL for all major banking groups established in the Banking Union over the course of 2016 although during this year the SRB will focus on determining MREL at the consolidated level of each group only. The MREL determinations allow for a case-by-case analysis. In the case of G-SIBs and the other major banking groups for which it is the resolution authority, the SRB will make its decisions taking into account the main features of TLAC so that these entities would be subject to a single requirement for loss absorbing capacity.

TLAC requirements contain a common minimum requirement but allow resolution authorities to specify additional TLAC requirements on an individual institution basis. TLAC requirements may further be imposed in addition to the minimum "own funds" requirements under CRD IV. Any failure by an institution to meet the applicable minimum TLAC requirements are supposed to be treated in the same manner as a failure to meet minimum regulatory capital requirements, where resolution authorities must ensure that they intervene and place an institution into resolution sufficiently early if it is deemed to be failing or likely to fail and there is no reasonable prospect of recovery.

The conditions required of TLAC eligible instruments (other than own funds) and those required of eligible liabilities for MREL purposes under the BRRD are different. Furthermore, the implementation of TLAC at the European level is currently being discussed. Only some jurisdictions have designed a framework for such eligible instruments (other than own funds instruments) but there is not yet a European solution that gives certainty in relation to the eligibility of instruments and enforcement action for breach of the requirement to hold MREL. There can be no assurance that the Bank and each of its European resolution sub-groups, will be able to issue sufficient TLAC and MREL eligible liabilities to meet their requirements. That may limit the quantity of the Bank's CET1 capital which is available to meet its "combined buffer requirement", and may, therefore, limit the Bank's ability to make "discretionary payments" in the form of dividends, variable remuneration and coupon payments to holders of AT1 instruments.

EU fiscal and banking union

The project of achieving a European banking union was launched in the summer of 2012. Its main goal is to resume progress towards the European single market for financial services by restoring confidence in the European banking sector and ensuring the proper functioning of monetary policy in the eurozone.

The Banking union is expected to be achieved through new harmonized banking rules (the single rulebook) and a new institutional framework with stronger systems for both banking supervision and resolution that will be managed at the European level. Its two main pillars are the Single Supervisory Mechanism ("SSM") and the Single Resolution Mechanism ("SRM").

The SSM (comprised by both the ECB and the national competent authorities) is designed to assist in making the banking sector more transparent, unified and safer. In accordance with the SSM Regulation, the ECB fully assumed its new supervisory responsibilities within the SSM, in particular direct supervision of the 123 largest European banks (including the Bank), on November 4, 2014. In preparation for this step, between November 2013 and October 2014, the ECB conducted, together with national supervisors, a comprehensive assessment of 130 banks, which together hold more than 80% of eurozone banking assets. The exercise consisted of three elements: (i) a supervisory risk assessment, which assessed the main balance sheet risks including liquidity, funding and leverage; (ii) an asset quality review, which focused on credit and market risks; and (iii) a stress test to examine the need to strengthen capital or take other corrective measures.

The SSM represents a significant change in the approach to bank supervision at a European and global level. The SSM results in the direct supervision of 123 financial institutions (as of September 30, 2015), including the Bank, and indirect supervision of around 3,500 financial institutions and is now one of the largest in the world in terms of assets under supervision. In the coming years, the SSM is expected to work to establish a new supervisory culture importing best practices from the 19 national competent authorities that are part of the SSM. Several steps have already been taken in this regard such as the recent publication of the Supervisory Guidelines and the approval of the Regulation (EU) No 468/2014 of the European Central Bank of April 16, 2014, establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities (SSM Framework Regulation). In addition, this new body represents an extra cost for the financial institutions that funds it through payment of supervisory fees.

The other main pillar of the EU banking union is the SRM, the main purpose of which is to ensure a prompt and coherent resolution of failing banks in Europe at minimum cost for the taxpayers and the real economy. Regulation (EU) No. 806/2014 of the European Parliament and the Council of the European Union (the "SRM Regulation"), which was passed on July 15, 2014, and became effective from January 1, 2015, establishes uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of the SRM and a Single Resolution Fund ("SRF"). Under the intergovernmental agreement ("IGA") signed by 26 EU member states on May 21, 2014, contributions by banks raised at national level were transferred to the SRF. The new Single Resolution Board ("SRB"), which is the central decision-making body of the SRM, started operating on January 1, 2015 and has fully assumed its resolution powers on January 1, 2016. The SRB is responsible for managing the SRF and its mission is to ensure that credit institutions and other entities under its remit, which face serious difficulties, are resolved effectively with minimal costs to taxpayers and the real economy. From that date onwards the Single Resolution Fund is also in place, funded by contributions from European banks in accordance with the methodology approved by the Council of the European Union. The Single Resolution Fund is intended to reach a total amount of €55 billion by 2024 and to be used as a separate backstop only after an 8% bail-in of a bank's liabilities has been applied to cover capital shortfalls (in line with the BRRD).

By allowing for the consistent application of EU banking rules through the SSM and the SRM, the banking union is expected to help resume momentum towards economic and monetary union. In order to complete such union, a single deposit guarantee scheme is still needed which may require a change to the existing European treaties. This is the subject of continued negotiation by European leaders to ensure further progress is made in European fiscal, economic and political integration.

Regulations adopted towards achieving a banking and/or fiscal union in the EU and decisions adopted by the ECB in its capacity as the Bank's main supervisory authority may have a material impact on the Bank's business, financial condition and results of operations. In particular, the BRRD and Directive 2014/49/EU on deposit guarantee schemes were published in the Official Journal of the EU on June 12, 2014. The BRRD was required to be implemented on or before January 1, 2015, although the bail-in tool only applies since January 1, 2016. The BRRD was partially implemented in Spain in June 2015 through Law 11/2015 and Royal Decree 1012/2015.

In addition, on January 29, 2014, the European Commission released its proposal on the structural reforms of the European banking sector that will impose new constraints on the structure of European banks. The proposal aims at ensuring the harmonization between the divergent national initiatives in Europe. It includes a prohibition on proprietary trading similar to that contained in Section 619 of the Dodd-Frank Act (also known as the Volcker Rule) and a mechanism to potentially require the separation of trading activities (including market making), such as in the Financial Services (Banking Reform) Act 2013, complex securitizations and risky derivatives.

Moreover, 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.

Other regulatory reforms adopted or proposed in the wake of the financial crisis

On August 16, 2012, the EU Regulation on over-the-counter ("OTC") derivatives, central counterparties and trade repositories, referred to as EMIR, entered into force. While a number of the compliance requirements introduced by EMIR already apply, the European Securities and Markets Authority is still in the process of finalizing some of the implementing rules mandated by EMIR. EMIR introduced a number of requirements, including clearing obligations for certain classes of OTC derivatives, exchange of initial and variation margin and various reporting and disclosure obligations. Although some of the particular effects brought about by EMIR are not yet fully foreseeable, many of its elements have led and may lead to changes which may negatively impact our profit margins, require us to adjust our business practices or increase our costs (including compliance costs). The Markets in Financial Instruments legislation (which comprises a regulation ("MiFIR") and a directive ("MiFID")), introduces a trading obligation for those OTC derivatives which are subject to mandatory clearing and which are sufficiently standardized. Additionally, it includes other requirements such as enhancing the investor protection's regime and governance and reporting obligations. It also extends transparency requirements to OTC operations in non-equity instruments. MiFID was initially intended to enter into effect on January 3, 2017. Notwithstanding this, in order to ensure legal certainty and avoid potential market disruption, the European Commission has proposed delaying the effective date of MiFID 12 months, until January 3, 2018.

Separately, on September 28, 2011, the European Commission tabled a proposal for an European Council Directive on a common system of financial transaction tax (FTT) and amending Directive 2008/7/EC. The objective of the proposal was to ensure a fair contribution of the financial sector to the costs of the financial crisis, avoid fragmentation of the single market and create appropriate disincentives for transactions that do not enhance the efficiency of financial markets. At the European Council meetings of June 22 and July 10, 2012 and at the European Council meeting on June 28/29, 2012, it was ascertained that essential differences in opinion remained as regards the need to establish a common system of FTT at EU level and that the proposal would have not received unanimous support within the Council in the foreseeable future. On the basis of the request of eleven Member States (Austria, Belgium, Estonia, France, Germany, Greece, Italy, Portugal, Slovakia, Slovenia and Spain (the "Participating Member States")), and in accordance with the authorization of the European Council of January 22, 2013, which was adopted following the European Parliament's consent given on December 12, 2012, the European Commission on March 14, 2013 submitted a proposal for a Council Directive implementing enhanced cooperation in the area of financial transaction tax (the "Commission Proposal"). The Commission Proposal, essentially, mirrored the scope and objectives of the original FTT proposal put forward by the European Commission in 2011. Though further progress during 2015 was expected, work will have to continue in 2016 on a number of other open questions that constitute the "building blocks" of the design of the future FTT. This work will have to cover all remaining aspects of the Commission Proposal on FTT, and in particular whether the final compromise should include specific provisions or exemptions to address concerns relating to the potential impact of the future FTT on the real economy and retirement schemes (pension plans, funds, and other products serving similar objective). The ECOFIN meeting held on December 8, 2015 was intended to be a make or break meeting for the prospects of an enhanced co-operation FTT. A statement following the meeting released by the 10 remaining Participating Member states (Estonia has now dropped out) represents progress of sorts but significant differences still remain. A further deadline of June 2016 has been set to reach consensus, though there is still real uncertainty over the prospects of the EU FTT. Depending on the final details, the proposed financial transaction tax could have a materially negative effect on the Bank's profits and business. Different forms of national financial transaction taxes have already been implemented in a number of European jurisdictions, including France and Italy, and these taxes may result in compliance costs as well as market consequences which may affect the Bank's revenues.

United States significant regulation

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 provided 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 or sponsorship of, or entering into certain credit-related transactions with related, covered 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, trading through electronic platforms 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 a swap dealer 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. Although many significant regulations applicable to swap dealers are already in effect, some of the most important rules, such as margin requirements for uncleared swaps and capital rules for swap dealers, are not yet effective and we continue to assess how compliance with these new rules will affect our business.

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. 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, became effective for part of the Bank's U.S. operations 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, in September 2014 the Board of Governors of the Federal Reserve System (the "Federal Reserve Board") and other U.S. regulators issued a final rule introducing a quantitative liquidity coverage ratio requirement on certain large banks and bank holding companies. The liquidity coverage ratio is part of the Basel Committee's international standards on quantitative liquidity metrics, which are in turn part of the international Basel III framework. The U.S. implementation of the liquidity coverage ratio is broadly consistent with the Basel Committee's liquidity standards, but is more stringent in several important respects. Although this final rule does not apply to foreign banking organizations ("FBOs"), the Federal Reserve Board has stated that it intends, through future rulemakings, to apply the liquidity coverage ratio and another Basel III liquidity metric to the U.S. operations of some or all large FBOs.

On February 18, 2014, the Federal Reserve Board issued a final rule to enhance its supervision and regulation of certain FBOs. Among other things, this rule requires FBOs with over $50 billion of U.S. non-branch assets to establish or designate a U.S. intermediate holding company (an "IHC") and to transfer its entire ownership interest in substantially all of its U.S. subsidiaries to such IHC by July 1, 2016. U.S. branches and agencies are not required to be transferred to the IHC. The IHC will be subject to an enhanced supervision framework, including enhanced risk-based and leverage capital requirements, liquidity requirements, risk management and governance requirements, and stress-testing requirements. A phased-in approach is being used for the standards and requirements. Certain enhanced standards are effective in 2015, with other standards and requirements becoming effective between July 1, 2016 and January 1, 2018. Pursuant to the final rule, as an FBO with over $50 billion of U.S. non-branch assets as of June 30, 2014, we submitted an IHC implementation plan to the Federal Reserve Board by January 1, 2015. As of the date of this annual report, we are continuing to refine this plan. Implementation and compliance with this plan have caused and will continue to cause the Group to invest significant management attention and resources.

The Volcker Rule, a statutory provision of the Dodd-Frank Act, prohibits "banking entities" from engaging in certain forms of proprietary trading or from sponsoring, investing in, or entering into certain credit-related transactions with related, covered funds, in each case subject to certain exceptions. The term "covered fund" is defined very broadly to include traditional hedge funds, private equity funds, certain securitization vehicles and other entities that rely on Sections 3(c)(1) or 3(c)(7) of the U.S. Investment Company Act of 1940 for an exemption under that Act, as well as certain similar foreign funds. The Volcker Rule became effective in July 2012 and in December 2013 U.S. regulators issued final rules implementing the Volcker Rule. The statute and final rules also 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, and trading solely outside the United States, and also permit certain ownership interests in certain types of funds to be retained. Banking entities such as the Bank must bring their activities and investments into compliance with the requirements of the Volcker Rule by the end of the conformance period applicable to each requirement. In general, all banking entities were required to conform to the requirements of the Volcker Rule, except for provisions related to certain funds, and to implement a compliance program by July 21, 2015. In December 2014, the Federal Reserve Board issued an order extending the Volcker Rule's general conformance period until July 21, 2016 for investments in and relationships with covered funds and certain foreign funds that were in place on or prior to December 31, 2013 ("legacy covered funds"), and stated its intention to grant a final one-year extension of the general conformance period, to July 21, 2017, for banking entities to conform ownership interests in and relationships with legacy covered funds. This extension of the conformance period does not apply to the Volcker Rule's prohibitions on proprietary trading and does not appear to apply to any investments in and relationships with covered funds put in place after December 31, 2013. We have assessed how the final rules implementing the Volcker Rule affect our businesses and have adopted the necessary measures to bring our activities into compliance with the rules.

Furthermore, Title I of the Dodd-Frank Act and the implementing regulations issued by the Federal Reserve Board 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 to the Federal Reserve Board and the FDIC 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. In addition, each insured depository institution ("IDI") with assets of $50 billion or more, such as Santander Bank, N.A., our U.S. national bank subsidiary, must submit a separate IDI resolution plan annually to the FDIC. The Title I and IDI plans each must include information on resolution strategy, major counterparties and interdependencies, among other things, and require substantial effort, time and cost to prepare. We submitted our most recent annual U.S. resolution plans in December 2015. The Title I plan resolution plan is subject to review by the Federal Reserve Board and the FDIC. The IDI plan is subject to review solely by the FDIC.

On October 30, 2015, the Federal Reserve Board proposed a rule that would establish certain TLAC and long-term debt requirements in the United States generally consistent with the FSB's international TLAC standard. The proposed U.S. TLAC rule would require, among other things, the U.S. IHCs of non-U.S. G-SIBs, including the Group's future U.S. IHC, to maintain a minimum amount of internal TLAC and would separately require them to maintain a minimum amount of internal long-term debt. The terms "internal TLAC" and "internal long-term debt" refer to instruments that would be required to be issued internally within the banking group, from the IHC to a foreign parent entity. The proposed minimum amounts of internal TLAC and internal long-term debt vary depending on the home country resolution authority's preferred resolution strategy. Under the proposed rule, the Group's U.S. IHC, if it is treated as a resolution entity IHC under the proposed rule, would be required to maintain, on a fully phased-in basis by 2022, internal TLAC of at least 18% of risk-weighted assets (plus an internal TLAC buffer of an additional 2.5%), at least 6.75% of the Basel III leverage ratio denominator and at least 9% of average total consolidated assets, as well as internal long-term debt of at least 7% of risk-weighted assets, at least 3% of the Basel III leverage ratio denominator and at least 4% of average total consolidated assets. Internal long-term debt instruments would be subject to certain eligibility criteria, including issuance to a foreign parent entity (a non-U.S. entity that controls the IHC) and the inclusion of a contractual trigger allowing for, in limited circumstances, the cancellation of, or immediate conversion or exchange of the instrument into, common equity tier 1 capital upon an order by the Federal Reserve Board. As proposed, the internal TLAC requirements may be satisfied with a combination of eligible long-term debt instruments and tier 1 capital, whereas the internal long-term debt requirements would be required to be satisfied only with eligible long-term debt instruments. The proposed rule would also require internal TLAC to be contractually subordinated to ineligible debt instruments and prohibit the U.S. IHC from issuing any external short-term debt, issuing parent guarantees with certain impermissible cross defaults, entering into any qualified financial contract with a third party, benefitting from upstream guarantees or issuing any instruments with certain setoff rights.

Each of these aspects of the Dodd-Frank Act, as well as other changes in U.S. banking regulations, may directly and indirectly impact various aspects of our business. The full spectrum of risks that the Dodd-Frank Act poses to us is not yet known; however, such risks could be material and we could be materially and adversely affected by them.

United States stress testing, capital planning, and related supervisory actions

Certain of our U.S. subsidiaries, including Santander Holdings USA, our U.S. bank holding company subsidiary, are subject to stress testing and capital planning requirements under regulations implementing the Dodd-Frank Act or other banking laws or policies. In March 2014 and March 2015, the Federal Reserve Board, as part of its Comprehensive Capital Analysis and Review ("CCAR") process, objected on qualitative grounds to the capital plans submitted by Santander Holdings USA. In its 2015 public report on CCAR, the Federal Reserve Board cited widespread and critical deficiencies in Santander Holdings USA's capital planning processes, including specific deficiencies in governance, internal controls, risk identification and risk management, management information systems, and supporting assumptions and analysis. As a result of the 2014 and 2015 CCAR objections, Santander Holdings USA is not permitted to make any capital distributions without the Federal Reserve Board's approval, other than the continued payment of dividends on Santander Holdings USA's outstanding class of preferred stock, until a new capital plan is approved by the Federal Reserve Board. The deadline for Santander Holdings USA's next capital plan submission is in April 2016, and there is the risk that the Federal Reserve Board will object to Santander Holdings USA's next capital plan.

In addition, Santander Holdings USA is subject to supervisory actions in the United States related to the CCAR stress testing and capital planning processes. Specifically, on September 15, 2014, Santander Holdings USA and the Federal Reserve Bank of Boston ("FRB Boston") executed a written agreement relating to a subsidiary's declaration and payment of dividends in the second quarter of 2014 without the Federal Reserve Board's approval. Under the written agreement, Santander Holdings USA agreed to submit to the FRB Boston written procedures to strengthen board oversight of management regarding planned capital distributions by Santander Holdings USA and its subsidiaries. In addition, Santander Holdings USA agreed to subject future distributions to the prior written approval of Federal Reserve System and to take necessary actions to ensure that no such distributions are made.

Other supervisory actions and restrictions on U.S. activities

In addition to the foregoing, U.S. bank regulatory agencies from time to time take supervisory actions under certain circumstances that restrict or limit a financial institution's activities. In some instances, we are subject to significant legal restrictions on our ability to publicly disclose these actions or the full details of these actions. Furthermore, as part of the regular examination process, our U.S. banking subsidiaries' regulators may advise our U.S. banking subsidiaries to operate under various restrictions as a prudential matter. The U.S. supervisory environment has become significantly more demanding and restrictive since the financial crisis of 2008. Under the U.S. Bank Holding Company Act, the Federal Reserve Board has the authority to disallow us and our U.S. banking subsidiaries from engaging in certain categories of new activities in the United States or acquiring shares or control of other companies in the United States. Such actions and restrictions currently applicable to us or our U.S. banking subsidiaries could adversely affect our costs and revenues. Moreover, efforts to comply with nonpublic supervisory actions or restrictions could require material investments in additional resources and systems, as well as a significant commitment of managerial time and attention. As a result, such supervisory actions or restrictions could have a material adverse effect on our business and results of operations; and we may be subject to significant legal restrictions on our ability to publicly disclose these matters or the full details of these actions. In addition to such confidential actions and restrictions, in July 2015, Santander Holdings USA became subject to a public enforcement action with the FRB Boston under which Santander Holdings USA entered into a written agreement to make enhancements with respect to, among other matters, board oversight of the consolidated organization, risk management, capital planning and liquidity risk management.

2.1.3 We are subject to potential intervention by any of our regulators or supervisors, particularly in response to customer complaints.

As noted above, our business and operations are subject to increasingly significant rules and regulations that are required to conduct banking and financial services business. These apply to business operations, affect financial returns, include reserve and reporting requirements, and prudential and conduct of business regulations. These requirements are set by the relevant central banks and regulatory authorities that authorize, regulate and supervise us in the jurisdictions in which we operate.

In their supervisory roles, the regulators seek to maintain the safety and soundness of financial institutions with the aim of strengthening the protection of customers and the financial system. The supervisors' continuing supervision of financial institutions is conducted through a variety of regulatory tools, including the collection of information by way of prudential returns, reports obtained from skilled persons, visits to firms and regular meetings with management to discuss issues such as performance, risk management and strategy. In general, these regulators have a more outcome-focused regulatory approach that involves more proactive enforcement and more punitive penalties for infringement. As a result, we face increased supervisory scrutiny (resulting in increasing internal compliance costs and supervision fees), and in the event of a breach of our regulatory obligations we are likely to face more stringent regulatory fines. Some of the regulators are focusing intently on consumer protection and on conduct risk and will continue to do so. This has included a focus on the design and operation of products, the behavior of customers and the operation of markets. Some of the laws in the relevant jurisdictions on which we operate, give the regulators the power to make temporary product intervention rules either to improve a firm's systems and controls in relation to product design, product management and implementation, or to address problems identified with financial products. These problems may potentially cause significant detriment to consumers because of certain product features or governance flaws or distribution strategies. Such rules may prevent institutions from entering into product agreements with customers until such problems have been solved. Some of the regulatory regimes on the relevant jurisdictions on which we operate, require us to be in compliance across all aspects of our business, including the training, authorization and supervision of personnel, systems, processes and documentation. If we fail to comply with the relevant regulations, there would be a risk of an adverse impact on our business from sanctions, fines or other actions imposed by the regulatory authorities. Customers of financial services institutions, including our customers, may seek redress if they consider that they have suffered loss as a result of the mis-selling of a particular product, or through incorrect application of the terms and conditions of a particular product. Given the inherent unpredictability of litigation and the evolution of judgments by the relevant authorities, it is possible that an adverse outcome in some matters could harm our reputation or have a material adverse effect on our operating results, financial condition and prospects arising from any penalties imposed or compensation awarded, together with the costs of defending such an action, thereby reducing our profitability.

2.1.4 We are subject to review by taxing authorities, and an incorrect interpretation by us of tax laws and regulations may have a material adverse effect on us.

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 adverse effect on our results of operations.

2.1.5 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.

2.1.6 We may not be able to detect or prevent money laundering and other financial crime 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 (“AML”), anti-terrorism, sanctions and other laws and regulations in the jurisdictions in which we operate. These laws and regulations require us, among other things, to conduct full customer due diligence regarding sanctions and politically-exposed person screening, keep our customer, account and transaction information up to date and have implemented effective financial crime policies and procedures detailing what is required from those responsible. Our requirements also include AML training for our employees, reporting suspicious transactions and activity to appropriate law enforcement following full investigation by our local AML team.

Financial crime has become the subject of enhanced regulatory scrutiny and supervision by regulators globally. AML sanctions, laws and regulations are increasingly complex and detailed and have become the subject of enhanced regulatory supervision, requiring improved systems, sophisticated monitoring and skilled compliance personnel.

We have developed policies and procedures aimed at detecting and preventing the use of our banking network for money laundering and other financial crime related activities. These require implementation and embedding within our business effective controls and monitoring, which in turn requires on-going changes to systems and operational activities. Financial crime is continually evolving and subject to increasingly stringent regulatory oversight and focus. This requires proactive and adaptable responses from us so that we are able to deter threats and criminality effectively. Even known threats can never be fully eliminated, and there will be instances where we may be used by other parties to engage in money laundering and other illegal or improper activities. In addition, we rely heavily on our employees to assist us by spotting such activities and reporting them, and our employees have varying degrees of experience in recognizing criminal tactics and understanding the level of sophistication of criminal organizations. Where we outsource any of our customer due diligence, customer screening or anti financial crime operations, we remain responsible and accountable for full compliance and any breaches. If we are unable to apply the necessary scrutiny and oversight, there remains a risk of regulatory breach.

If we are unable to fully comply with applicable laws, regulations and expectations, our regulators and relevant law enforcement agencies have the ability and authority to impose significant fines and other penalties on us, including requiring a complete review of our business systems, day-to-day supervision by external consultants and ultimately the revocation of our banking license.

The reputational damage to our business and global brand would be severe if we were found to have breached AML or sanctions requirements. Our reputation could also suffer if we are unable to protect our customers or our business from being used by criminals for 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.

Any such risks could have a material adverse effect on our operating results, financial condition and prospects.

2.2 Liquidity and Financing Risks

2.2.1 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 and our ability to fulfill regulatory liquidity requirements, as well as limit growth possibilities.

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.

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 or competition with other products, such as mutual funds. 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 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 some deposits 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.

Central banks have taken extraordinary measures to increase liquidity in the financial markets as a response to the financial crisis. If current facilities were rapidly removed or significantly reduced, this could have an adverse effect on our ability to access liquidity and on our funding costs.

We cannot assure 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.

2.2.2 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—A3 stable outlook by Moody's Investors Service España, S.A., A- stable outlook by Standard & Poor's Ratings Services and A- stable outlook by Fitch Ratings Ltd. In June 2015, Moody's upgraded Banco Santander, S.A.'s rating from Baa1 to A3 in light of their new banking methodology and in October 2015 Standard & Poor's upgraded Banco Santander, S.A.'s rating from BBB+ to A- following the upgrade of the sovereign credit rating of Spain.

Santander UK's long-term debt is currently rated investment grade by the major rating agencies: A1 with stable outlook by Moody's Investors Service, A with stable outlook by Standard & Poor's Ratings Services and A with positive outlook by Fitch Ratings.

Banco Santander (Brasil)'s long-term debt in foreign currency is currently rated BB with a negative outlook by Standard & Poor's Ratings Services, BBB- with negative outlook by Fitch Ratings Ltd. and Ba3 with a negative outlook by Moody's Investors Service. During the course of 2015 and the first quarter of 2016 the three major agencies lowered the rating as a result of the lowering of Brazil's sovereign credit rating.

We conduct substantially all of our material derivative activities through Banco Santander, S.A. and Santander UK. We estimate that as of December 31, 2015, 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 €200 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 €6 million in additional collateral. We estimate that as of December 31, 2015, 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 £4.6 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 £0.3 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.

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.

2.3 Credit Risks

2.3.1 If the level of non-performing loans increases or the credit quality deteriorates in the future, or if our loan loss reserves are insufficient to cover 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 business. Non-performing or low credit quality loans have in the past and can continue to negatively impact our results of operations. 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, particularly Brazil, the United States or global economic conditions, impact of political events, events affecting certain industries or events affecting financial markets and global economies. We cannot assure that we will be able to effectively control the level of the non-performing loans in 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 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 that our current or future 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 49% of our loan portfolio as of December 31, 2015. We are exposed to developments in housing markets, especially in Spain and the United Kingdom, and 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 and forbearances have 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 3.54% at December 31, 2010, to 3.90% at December 31, 2011, to 4.54% at December 31, 2012 and to 5.64% at December 31, 2013. Although the trend changed during the last two years as our NPL ratio decreased to 5.19% at December 31, 2014 and to 4.36% at December 31, 2015, we can provide no assurance that our NPL ratio will not increase again as a result of the aforementioned and other factors. High 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.

2.3.2 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.

2.3.3 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.

2.4 Market Risks

2.4.1 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, inflation, 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;
- volatility of credit spreads;
- the market value of our securities holdings;
- gains from sales of loans and securities; and
- gains and losses from derivatives.

Interest rates are 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. Variations in interest rates could affect our net interest income, which comprises the majority of our revenue, reducing our growth rate and potentially resulting in losses. This results from the varying effect that a change in interest rates may have on the interest earned on our assets and the interest paid on our borrowings. In addition, we may incur costs (which, in turn, will impact our results) as we implement strategies to reduce future interest rate exposure.

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.

In addition, we may experience increased delinquencies in a low interest rate environment when such an environment is accompanied by high unemployment and recessionary conditions.

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. The continued depreciation of the Latin American currencies against the U.S. dollar could make our Latin American subsidiaries' foreign currency-linked obligations and funding more expensive and have similar consequences for our borrowers in Latin America.

We are also exposed to equity price risk in our investments in equity securities in the banking book and in the trading portfolio. 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 equity securities 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.

2.4.2 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 eight 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.

2.4.3 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 depend 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.

2.5 Risk Management

2.5.1 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. We could face adverse consequences as a result of decisions, which may lead to actions by management, based on models that are poorly developed, implemented or used, or as a result of the modelled outcome being misunderstood or the use of such information for purposes for which it was not designed. In addition, if existing or potential customers or counterparties believe our risk management is inadequate, they could take their business elsewhere or seek to limit their transactions with us. This could have a material adverse effect on our reputation, 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 or IT systems errors. In exercising their judgment on current or future credit risk behavior of our customers, our employees may not always be able to assign an accurate credit rating, which may result in our exposure to higher credit risks than indicated by our risk rating system.

In addition, we have refined 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 all possible 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.

2.6 General Business and Industry Risks

2.6.1 The financial problems faced by our customers could adversely affect us.

Market turmoil and economic recession could materially and adversely affect the liquidity, credit ratings, 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. We may also be adversely affected by the negative effects of the heightened regulatory environment on our customers due to the high costs associated with regulatory compliance and proceedings. Any of the conditions described above could have a material adverse effect on our business, financial condition and results of operations.

2.6.2 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. The accounting and disclosures 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.

2.6.3 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.

2.6.4 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.

Non-traditional providers of banking services, such as Internet based e-commerce providers, mobile telephone companies and internet search engines may offer and/or increase their offerings of financial products and services directly to customers. These non-traditional providers of banking services currently have an advantage over traditional providers because they are not subject to banking regulation. Several of these competitors may have long operating histories, large customer bases, strong brand recognition and significant financial, marketing and other resources. They may adopt more aggressive pricing and rates and devote more resources to technology, infrastructure and marketing. New competitors may enter the market or existing competitors may adjust their services with unique product or service offerings or approaches to providing banking services. If we are unable to successfully compete with current and new competitors, or if we are unable to anticipate and adapt our offerings to changing banking industry trends, including technological changes, our business may be adversely affected. In addition, our failure to effectively anticipate or adapt to emerging technologies or changes in customer behavior, including among younger customers, could delay or prevent our access to new digital-based markets which would in turn have an adverse effect on our competitive position and business.

Increasing competition could also 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.

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.

2.6.5 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. Our success is also dependent on our ability to anticipate and leverage new and existing technologies that may have an impact on products and services in the banking industry. Technological changes may further intensify and complicate the competitive landscape and influence client behavior. If our products and services employ technology that is not as attractive to our clients as that employed by our competitors, if we fail to employ technologies desired by our clients before our competitors do so, or if we fail to execute effectively on targeted strategic technology initiatives, our business and results could be adversely affected. In addition, 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 again 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."

2.6.6 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, including local regulation that can reduce or eliminate expected synergies;
- 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 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.

In addition, any acquisition or venture could result in the loss of key employees and inconsistencies in standards, controls, procedures and policies.

Moreover, the success of the acquisition or venture will at least in part be subject to a number of political, economic and other factors that are beyond our control. Any of these factors, individually or collectively, could have a material adverse effect on us.

2.6.7 Goodwill impairments may be required in relation to acquired businesses.

We have made business acquisitions in recent years and may make further acquisitions in the future. It is possible that the goodwill which has been attributed, or may be attributed, to these businesses may have to be written-down if our valuation assumptions are required to be reassessed as a result of any deterioration in their underlying profitability, asset quality and other relevant matters. Impairment testing in respect of goodwill is performed annually, more frequently if there are impairment indicators present, and comprises a comparison of the carrying amount of the cash-generating unit with its recoverable amount. Goodwill impairment does not, however, affect our regulatory capital. While no material impairment of goodwill was recognized at Group level in 2013, 2014 or 2015, there can be no assurances that we will not have to write down the value attributed to goodwill in the future, which would adversely affect our results and net assets.

2.6.8 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.

2.6.9 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 are also subject to risk with respect to security breaches affecting the vendors and other parties that interact with our third party vendors. As our interconnectivity with these third parties increases, we increasingly face the risk of operational failure with respect to their systems. 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.

2.6.10 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 identify and manage potential conflicts of interest properly. 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.

2.6.11 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.

2.7 Technology Risks

2.7.1 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 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.

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

Like other financial institutions with a large customer base, we manage and hold confidential personal information of customers in the conduct of our banking operations, as well as a large number of assets. Accordingly, our business depends 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 information security risk, 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 those relating to any security breaches.

We have seen in recent years computer systems of companies and organizations being targeted, not only by cyber criminals, but also by activists and rogue states. We have been and continue to be subject to a range of cyber-attacks, such as denial of service, malware and phishing. Cyber-attacks could give rise to the loss of significant amounts of customer data and other sensitive information, as well as significant levels of liquid assets (including cash). In addition, cyber-attacks could give rise to the disablement of our information technology systems used to service our customers. As attempted attacks continue to evolve in scope and sophistication, we may incur significant costs in our attempt to modify or enhance our protective measures against such attacks, or to investigate or remediate any vulnerability or resulting breach, or in communicating cyber-attacks to our customers. If we fail to effectively manage our cyber security risk, e.g. by failing to update our systems and processes in response to new threats, this could harm our reputation and adversely affect our operating results, financial condition and prospects through the payment of customer compensation, regulatory penalties and fines and/or through the loss of assets. In addition, we may also be subject to cyber-attacks against critical infrastructures of the countries where we operate. Our information technology systems are dependent on such national critical infrastructure and any cyber-attack against such critical infrastructure could negatively affect our ability to service our customers. As we do not operate such national critical infrastructure, we have limited ability to protect our information technology systems from the adverse effects of such a cyber-attack. For further information see Item 11. Quantitative and Qualitative Disclosures about Market Risk—Part 6. Operational risk—3 Mitigation measures—Cybersecurity and data security plans.

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. Further, our business is 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. It is not always possible to deter or prevent employee misconduct, and the precautions we take to detect and prevent this activity may not always be effective. In addition, we may be required to report events related to information security issues (including any cyber security issues), events where customer information may be compromised, unauthorized access and other security breaches, to the relevant regulatory authorities. Any material disruption or slowdown of our systems could cause information, including data related to customer requests, to be lost or to be delivered to our clients with delays or errors, which could reduce demand for our services and products and could materially and adversely affect us.

2.8 Financial Reporting and Control Risks

2.8.1 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.

2.8.2 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 provision and pension obligation for liabilities.

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.

2.8.3 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 provide reasonable assurance 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 errors or mistakes. 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.

2.9 Foreign Private Issuer and Other Risks

2.9.1 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 U.S. 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.