D. Risk Factors

MACROECONOMIC AND GEOPOLITICAL RISKS

A deterioration in economic conditions or the institutional environment in the countries where the Group operates could have a material adverse effect on the Group's business, financial condition and results of operations

The Group is sensitive to the deterioration of economic conditions or the alteration of the institutional environment of the countries in which it operates, and especially Spain, Mexico and Turkey, which respectively represented 59.9%, 20.1% and 9.3% of the Group's assets as of December 31, 2022 (62.4%, 17.8% and 8.5% as of December 31, 2021, respectively, and 55.6%, 15.0% and 8.1%, as of December 31, 2020, respectively). Additionally, the Group is exposed to sovereign debt, especially sovereign debt related to these countries. Furthermore, in May 2022, the Group increased its shareholding stake in Türkiye Garanti Bankası A.Ş. (Garanti BBVA) from 49.85% to 85.97%. For summarized information on the macroeconomic conditions that these countries are currently facing, and which could significantly affect the Group, see "*Item 5. Operating and Financial Review and Prospects—Operating Results—Operating Environment*".

In addition to the significant macroeconomic problems triggered by the COVID-19 pandemic, the global economy is currently facing a number of extraordinary challenges. Russia's invasion of Ukraine, the largest military attack on a European state since World War II, has led to significant disruption, instability and volatility in global markets, as well as higher inflation (including by contributing to further increases in the prices of oil, gas and other commodities and further disrupting supply chains) and lower economic growth. The European Union, the United States and other governments have imposed significant sanctions and export controls against Russia and Russian interests and additional sanctions and controls may be imposed in the future.

The Russia-Ukraine war has represented a significant supply shock for the global economy, which has hampered economic growth and added to inflationary pressures, mainly in European countries, due to their relatively significant economic ties with Ukraine and Russia. The economic effects are being felt mainly through higher commodity prices, mainly energy commodities, despite their moderation over the last few months in 2022. While the Group's direct exposure to Ukraine and Russia is limited, the war could adversely affect the Group's business, financial condition and results of operations. Geopolitical and economic risks have also increased lately as a result of trade tensions between the United States and China, Brexit and the rise of populism, among others. Growing tensions may lead, among others, to a deglobalization of the world economy, an increase in protectionism or barriers to immigration, a general reduction of international trade in goods and services and a reduction in the integration of financial markets, any of which could materially and adversely affect the Group's business, financial condition and results of operations.

Moreover, the world economy could be vulnerable to other factors such as the aggressive interest rate hikes adopted by central banks due to growing and widespread inflationary pressures, which could cause a significant growth slowdown, or a sharp economic recession, as well as financial crises. The central banks of many developed and emerging economies have significantly increased policy rates over the last year and the process of tightening monetary conditions is likely to continue going forward in many economies. The United States Federal Reserve and the European Central Bank have raised policy interest rates respectively by 425 and 250 basis points throughout 2022 and further increases are expected in the coming months, taking them up to around 5.0% in the first case and 3.75% in the case of the interest rates for refinancing operations in the Eurozone. The Group's results of operations have been affected by the increases in interest rates adopted by central banks in an attempt to tame inflation, contributing both to a rise in net interest income and a rise in funding costs. Further increases in interest rates could adversely affect the Group by reducing the demand for credit, limiting its ability to generate credit for its clients and/or increasing the default rate of its borrowers and counterparties.

There is also a risk of a sharp slowdown in the global GDP growth caused by a deceleration in the Chinese economy, due to the disruptions generated by COVID-19 infections following the flexibilization of the containment policies or other factors, such as the imbalances in real estate market.

The Group bears, among others, the following general risks with respect to the economic and institutional environment of the countries in which it operates: a deterioration in economic activity, including recession scenarios; more persistent inflationary pressures, which could trigger a more severe tightening of monetary conditions; the depreciation of local currencies, particularly the Turkish lira and the Mexican peso; the deterioration of the real estate market, to which the Group remains significantly exposed in Spain and, to a lesser extent, in Mexico and Turkey; depressed disposable income levels, including as a result of the impact of high oil and gas prices on areas that are net energy importers, such as Spain or Turkey; changes in regulatory or government policies, including in terms of exchange controls and restrictions on the distribution of dividends or the imposition of new taxes or charges; excessive public debt or external deficit, which could lead to a downward revision of the credit ratings of the sovereign debt or a default or restructuring of said debt; and episodes of market volatility, any of which could expose the Group to significant losses.

Any of these factors may have a material adverse effect on the Group's business, financial condition and results of operations.

Pandemics like the COVID-19 pandemic could have a material adverse effect on the Group’s business, financial condition and results of operations

The COVID-19 (coronavirus) pandemic has adversely affected the world economy, and economic activity and conditions in the countries in which the Group operates. Among other challenges, these countries have had to deal with supply disruptions and increasing inflationary pressures, while public debt has increased significantly due to the support and spending measures implemented by government authorities. Furthermore, there has been an increase in loan losses from both companies and individuals, which has been slowed down by the impact of government support measures, including bank payment deferrals, credit with public guarantee and direct aid measures (see *“Item 5. Operating and Financial Review and Prospects—Operating Results—Factors Affecting the Comparability of our Results of Operations and Financial Condition—The COVID-19 Pandemic*”).

With the outbreak of COVID-19, the Group experienced a decline in its activity. For example, the granting of new loans to individuals decreased during lockdowns. In addition, in several countries, including Spain, the Group closed a significant number of its branches and reduced the opening hours of working with the public, with central services teams having to work remotely. Furthermore, the Group has been affected by the measures and recommendations adopted by regulatory authorities in the banking sector, such as variations in reference interest rates, the modification of prudential requirements, the temporary suspension of dividend payments, changes to the terms of bank payment deferrals and the granting of credit with public guarantee and changes to the terms of the financial assets purchase programs implemented by the ECB. The finalization of COVID-19 related public relief measures may result in the deterioration of the credit quality of certain borrowers, especially SMEs, which may result in higher loan-loss provisions by the Group, particularly in the context of rising interest rates.

Future pandemics (or a worsening of the COVID-19 pandemic) could be further detrimental to the Group. Furthermore, pandemics like the COVID-19 pandemic could adversely affect the business and operations of third parties that provide critical services to the Group and, in particular, the higher demand for and/or the lower availability of certain resources, compounded by any supply bottlenecks could make it more difficult for the Group to maintain the required service levels.

Further, pandemics such as the COVID-19 pandemic may exacerbate other risks disclosed in this section, including but not limited to risks associated with the credit quality of the Group’s borrowers and counterparties or collateral, the availability of ECB funding, the Group’s exposure to sovereign debt and rating downgrades, the Group’s ability to comply with its regulatory requirements, including MREL and other capital requirements, and the deterioration of economic conditions or changes in the institutional environment.

As a result of the above, a pandemic could have a material adverse effect on the Group’s business, financial condition and results of operations.

Political, economic and social conditions in Spain may have an adverse effect on our business, financial condition and results of operations

The Group has historically carried out its lending activity mainly in Spain, which continues to be its primary business area. As of December 31, 2022, total risk in financial assets in Spain (calculated as set forth in Appendix IX (Additional information on risk concentration) of the Consolidated Financial Statements) amounted to €225,825 million, equivalent to 37% of the Group’s total risk in financial assets. The Group’s gross exposure of loans and advances to customers in Spain totaled €214,126 million as of December 31, 2022, representing 58% of the Group’s total amount of loans and advances to customers. Following the sharp decline in economic activity in 2020, economic recovery has further deteriorated following the outbreak of the war in Ukraine. Measures adopted to support the economy as a result of the COVID-19 pandemic and, more recently, rising inflation, have given rise to concerns about the sustainability of very high public debt in the medium and long term. Moreover, the inflation rate was 5.7% in December 2022 (core inflation was 7.0%), with wages growing at a slower pace and structural unemployment remaining high. General elections will take place in December 2023 at the latest, and their outcome is uncertain.

Given the significance of the Group’s exposure to Spain, any adverse change affecting political, economic and social conditions in Spain could have a material adverse effect on the Group’s business, financial condition and results of operations.

Political, economic and social conditions in Turkey may have an adverse effect on our business, financial condition and results of operations

In May 2022, the Group increased its shareholding stake in Garanti BBVA (Turkey) from 49.85% to 85.97% following the completion of a voluntary takeover bid. See Note 3 to the Consolidated Financial Statements.

Turkey has, from time to time, experienced volatile political, economic and social conditions. Turkey is currently facing an economic crisis characterized by strong depreciation of the Turkish lira, high inflation (64.3% for the year ended December 31, 2022), a soaring trade deficit, depletion of the central bank's foreign reserves and rising external financing costs. The recent earthquakes of February 2023 are expected to deepen Turkey's economic struggles. In addition to the vast human losses, the earthquakes and government's response thereto are expected to add to mounting inflation and budget risks. Additionally, certain ongoing geopolitical tensions referred to in this section, as well as continuing regional conflicts (such as in Syria and in Armenia/Azerbaijan), may pose further strain on the country's economy. Continuing unfavorable economic conditions in Turkey, such as the elevated inflation and devaluation of the Turkish lira, may result in a potential deterioration in the purchasing power and creditworthiness of our clients (both individual and corporate). In addition, the Turkish central bank's repeated interest rate cuts in the midst of rising inflation and continued currency depreciation has affected and may continue to affect the Group's results.

Further, the Group may continue to be affected by regulation and measures specifically affecting the financial sector, such as the central bank's "liraization" strategy (which seeks to increase the weight of Turkish lira-denominated assets and liabilities of the banking system) and restrictions on the fees and commissions that may be charged to customers.

Challenges faced by the Turkish economy and any impositions on the Turkish banking sector may have a material adverse effect on the Group's business, financial condition and results of operations.

BUSINESS RISKS

The Group's businesses are subject to inherent risks concerning borrowers and counterparties' credit quality and the value of collateral

The total maximum credit risk exposure of the Group (calculated as set forth in Note 7.2.2 to the Consolidated Financial Statements) as of December 31, 2022 was €816,778 million (€753,730 million and €747,145 million as of December 31, 2021 and 2020, respectively). The Group has exposures to many different products and counterparties (including borrowers), and the credit quality of its exposures can have a significant effect on the Group's earnings. Adverse changes in the credit quality of the Group's counterparties, including as a result of changes in their businesses, or any adverse changes in the value of the collateral they may have provided, may reduce the value of the Group's assets, and materially increase the Group's write-downs and loss allowances. Credit risk can be affected by a range of factors, including an adverse economic environment, a decrease in consumption or corporate or government spending, changes in the rating of individual contractual counterparties, their debt levels and the environment in which they operate, increased unemployment, higher commodity prices (especially of energy commodities), reduced asset values, increased retail or corporate insolvency levels, reduced corporate profits, changes in interest rates (as well as the timing, magnitude and pace of these changes), litigation and legal and regulatory developments.

In recent years, the Group's NPL ratio (3.4%, 4.1% and 4.2% as of December 31, 2022, 2021 and 2020, respectively) has benefited from the low interest rate environment, which has led to increased recoveries and repayments. Recent and any further interest rate increases will likely lead to a deterioration of the Group's NPL ratio and an increase in the Group's RWAs. See "*—The Group's business is particularly vulnerable to interest rates and is exposed to risks associated with the continuity of certain reference rates and the transition to alternative reference rates*".

Furthermore, economic deterioration typically results in a decrease in the price of real estate assets. The Group remains significantly exposed to the real estate market, mainly in Spain and, to a lesser extent, Mexico and Turkey, due to the fact that many of its loans are secured by real estate assets and due to the significant volume of real estate assets that it maintains on its balance sheet. A fall in the price of real estate assets in a particular region would reduce the value of any real estate securing loans granted by the Group in such region and, therefore, in the event of default, the amount of the expected losses related to such loans would increase. Further, a fall in real estate prices could have a material adverse effect on the default rates of the Group's residential mortgage and real estate developer credit portfolios. The balance of the Group's residential mortgage portfolio was €92,064 million at a global level as of December 31, 2022 (€91,324 million and €91,428 million as of December 31, 2021 and 2020, respectively), 73.2% of which related to Spain as of December 31, 2022. Further, the Group's corporate credit portfolios include real estate developers and constructors. As of December 31, 2022, the Group's exposure to the construction and real estate sectors (excluding the mortgage portfolio) in Spain was equivalent to €9,549 million, of which €1,861 million corresponded to loans for construction and development activities in Spain (representing 1.1% of the Group's loans and advances to customers in Spain (excluding the public sector) and 0.3% of the Group's consolidated assets as of December 31, 2022). The total real estate exposure (excluding the mortgage portfolio), including developer credit and foreclosed assets had a coverage ratio of 34% in Spain as of December 31, 2022.

The impact of an increase in default rates on the Group will depend on its magnitude, timing and pace, and could be significant. Furthermore, it is possible that the Group has incorrectly assessed the creditworthiness or willingness to pay of its counterparties, that it has underestimated the credit risks and potential losses inherent in its credit exposure and that it has made insufficient provisions for such risks in a timely manner. The processes involved in making such assessments, which have a crucial impact on the Group's results and financial condition, require difficult, subjective and complex calculations, including forecasts of the impact that macroeconomic conditions could have on these counterparties. In particular, the Group's estimates of losses derived from its exposure to credit risk may prove to be inadequate or insufficient in the current environment of economic uncertainty, which could affect the adequacy of the provisions for insolvencies provided by the Group. An increase in non-performing or low-quality loans could significantly and adversely affect the Group's business, financial condition and results of operations.

The Group's business is particularly vulnerable to interest rates and is exposed to risks associated with the continuity of certain reference rates and the transition to alternative reference rates

The Group's results of operations are substantially dependent upon the level of its net interest income, which is the difference between interest income from interest-earning assets and interest expense on interest-bearing liabilities. It is possible that changes in market interest rates affect the Group's interest-earning assets differently from the Group's interest-bearing liabilities. This, in turn, may lead to a reduction in the Group's net interest margin, which could have a material adverse effect on its results. Moreover, changes in interest rates may affect the Group's credit risk exposure (*see "—The Group's businesses are subject to inherent risks concerning borrowers and counterparties' credit quality and the value of collateral"*).

Interest rates are highly sensitive to many factors beyond the Group's control, including fiscal and monetary policies of governments and central banks, regulation of the financial sector, domestic and international economic and political conditions and other factors. The COVID-19 pandemic triggered a process of cuts in reference interest rates, which were then progressively reversed by central banks in order to combat inflation, with four interest rate increases implemented by the ECB since July 2022 through December 2022 and additional increases expected this year. However, interest rate increases are being implemented at a different pace across regions and it is possible that such increases could be reversed due to economic growth concerns or otherwise. The Group's results of operations have been affected by the increases in interest rates adopted by central banks in an attempt to tame inflation, contributing both to a rise in net interest income and a rise in funding costs. Further increases in interest rates could adversely affect the Group by reducing the demand for credit, limiting its ability to generate credit for its clients and/or increasing the default rate of its borrowers and counterparties. In particular, the repayment capacity of loans tied to variable interest rates is more sensitive to changes in interest rates. As of December 31, 2022, 2021 and 2020, 49.2%, 50.2% and 53.2%, respectively, of the Group's gross exposure of loans and advances to customers with maturity greater than one year had floating-interest rates.

Moreover, the transition away from and discontinuation of interbank offer rates ("**IBORs**") could have an adverse effect on the Group. In recent years, international regulators have been driving a transition from the use of IBORs, including the London interbank offered rate ("**LIBOR**"), the euro interbank offered rate ("**EURIBOR**") and the euro overnight index average ("**EONIA**"), to alternative risk free rates ("**RFRs**"). This has resulted in regulatory reform and changes to existing IBORs, with further changes anticipated. These reforms and changes may cause an IBOR to perform differently than it has done in the past or to be discontinued. The Group is particularly exposed to EURIBOR-based financial instruments. However, as of December 31, 2022, the Group considers that there are limited transition risks relating to EURIBOR as it has been replaced by the hybrid EURIBOR which uses a methodology that meets the requirements of the European Regulation of Reference Indices.

Although the transition from EUR, CHF, JPY and GBP LIBOR has been carried out without any material impact on the Group, the Group continues to maintain financial assets and liabilities whose contracts are referenced to LIBOR USD including, among others, loans, deposits and debt issuances as well as underlying derivative financial instruments, and the Group continues to work to adapt or modify the related documentation. The uncertainty about the nature and extent of USD LIBOR reforms and changes, and how they might affect financial instruments, could negatively impact the valuation and/or trading of a wide range of financial instruments for which USD LIBOR is used, including securities, loans, deposits and derivative instruments based on USD LIBOR issued by the Group or otherwise included in the financial assets and liabilities of the Group. Such uncertainty may also affect the availability and cost of hedging instruments and debt.

The implementation of any alternative RFRs may be impossible or impracticable under the existing terms of certain financial instruments. Such transition could also result in pricing risks arising from how changes to reference rates could impact pricing mechanisms in some instruments, and could have an adverse effect on the value of, return on and trading market for such financial instruments and on the Group's profitability. In addition, the transition to RFRs will require important operational changes to the Group's systems and infrastructure, as all systems will need to account for the changes in the reference rates.

As a result of the foregoing, the evolution of interest rates and the transition to RFRs could have a material adverse effect on the Group's business, financial condition and results of operations.

The Group faces increasing competition and is exposed to a changing business model

The markets in which the Group operates are highly competitive and it is expected that this trend will continue in the coming years with the increasing entry of non-bank competitors (some of which have large client portfolios and strong brand recognition) and the emergence of new business models. In recent years, the financial services sector has undergone a significant transformation driven by the development of mobile technologies, the entry of new players into activities previously controlled by financial institutions and consolidation in the banking industry. Although the Group is making efforts to adapt to these changes through its digital transformation, its competitive position is affected by the fact that non-bank operators are less heavily regulated than banks such as BBVA. For example, banking groups are subject to prudential regulations that have implications for most of their businesses, including those in which they compete with non-bank operators (such as FinTechs or BigTechs) that are subject only to regulations specific to the activity they develop or that benefit from loopholes in the regulatory environment. Furthermore, when banking groups such as the Group carry out financial activities through the use of new technologies, they are generally subject to additional internal governance rules that place such groups at a competitive disadvantage.

Moreover, the widespread adoption of new technologies, including crypto currencies and alternative payment systems that do not use the banking system, could erode the Group’s business or require the Group to make substantial investment to modify or adapt existing products and services, including its mobile and internet banking capabilities. Likewise, the increasing use of these new technologies and mobile banking platforms could have an adverse impact on the Group’s investments in facilities, equipment and employees of the branch network. A faster pace of transformation towards mobile and online banking models could require changes in the Group’s commercial banking strategy, including the closure, restructuring or sale of branches, and significant reductions in employees. These changes could result in significant expenses as the Group reconfigures or reduces its commercial network. In addition, the trend towards the consolidation in the banking industry has created larger banks with which the Group must compete. According to the Bank of Spain, as a result of consolidation in the banking industry, the ten largest banking entities managed 87% of customer deposits in Spain as of March 2022. Any failure by the Group to adapt to its competitive environment or to implement any necessary changes to its business model efficiently or on a timely basis could have a material adverse impact on the Group’s competitive position or otherwise have a material adverse effect on the Group’s business, financial condition and results of operations.

The future success of the Group depends, in part, on its ability to use technology to provide suitable products and services for customers. While the Group has focused on developing its technological capabilities in recent years and is committed to digitization, its ability to compete successfully is likely to be adversely affected by, on the one hand, the existing uneven playing field between banks and non-bank players and, on the other, the increasing relevance of access to digital data and interactions for customer relationship management, which places digital platforms at an advantage. Digital platforms (such as those maintained by large technology or social media companies, and FinTechs) increasingly dominate access to data and control over digital interactions, and are already eroding the Group’s results in highly relevant markets such as payments. These platforms can leverage their advantage in access to data to compete with the Group in other markets and could reduce the Group’s operations and margins in its core businesses such as lending or wealth management. Some of the Group’s competitors have created alliances with BigTechs that may affect the Group’s ability to compete successfully and could adversely affect the Group. In the event that the Group is not successful in addressing increasing competition, its business, financial condition and results of operations could be materially and adversely affected.

The Group faces risks derived from its international geographic diversification and its significant presence in emerging countries

The Group is made up of commercial banks, insurance companies and other financial services companies in various countries and its performance as a global business depends on its ability to manage its different businesses under various economic, social and political conditions, as well as different legal and regulatory requirements (including, among others, different supervisory regimes and different tax and legal regimes related to the repatriation of funds or the nationalization or expropriation of assets). In addition, the Group’s international operations may expose it to risks and challenges to which its local competitors may not be exposed, such as currency risk, the difficulty of managing or supervising a local entity from abroad, political risks (which could affect only foreign investors) or limitations on the distribution or repatriation of dividends, thus worsening its position compared to that of local competitors.

There can be no guarantee that the Group will be successful in developing and implementing policies and strategies in all of the countries in which it operates, some of which have experienced significant economic, political and social volatility in recent decades. In particular, the Group has significant operations in several emerging countries, such as Mexico and Turkey, and is therefore vulnerable to any deterioration in economic, social or political conditions in these countries. Emerging markets are generally affected by the conditions of other commercially or financially related markets and by the evolution of global financial markets in general (they may be affected, for example, by the evolution of GDP and interest rates in the United States and the exchange rate of the U.S. dollar), as well as, by fluctuations in the prices of commodities. The perception that the risks associated with investing in emerging economies have increased, in general, or in emerging markets where the Group operates, in particular, could reduce capital flows to those economies and adversely affect such economies and therefore the Group. Moreover, emerging countries are more prone to experience significant changes in inflation and foreign exchange rates, which may have a material impact on the Group’s results of operations, assets (including RWAs) and liabilities. In Turkey, for example, inflation was 64.3% for the year ended December 2022 (according to the Turkish Statistical Institute, TUIK) and the Turkish lira depreciated 23.7% against the euro as of December 31, 2022 compared to December 31, 2021.

The Group’s operations in emerging countries are also exposed to heightened political risks, such as changes in governmental policies, expropriation, nationalization, interest rate limits, exchange controls, capital controls, government restrictions on dividends or bank fees and adverse tax policies. For example, the repatriation of dividends from BBVA’s Venezuelan, Argentinian and Turkish subsidiaries is subject to certain restrictions and there is no assurance that further restrictions will not be imposed. As BBVA’s ability to pay dividends depends, in part, on the receipt of dividends from its subsidiaries, such restrictions may in turn affect BBVA’s ability to pay dividends.

If the Group failed to adopt effective and timely policies and strategies in response to the risks and challenges it faces in each of the regions where it operates, particularly in emerging countries, the Group’s business, financial condition and results of operations could be materially and adversely affected.

The Group is exposed to various risks in connection with climate change

Climate change, which is resulting in an increase in the intensity and frequency of extreme weather events and environmental degradation, presents both short, medium and long-term risks to the Group and its customers and counterparties, with the risks expected to increase over time. Risks posed by climate change may be classified into transition and physical risks.

Transition risks refer to changes in, among others, regulations, technologies and market preferences linked to the transition toward a less carbon-dependent economy, including the following:

- *Legal and regulatory risks*. Legislative or regulatory changes regarding how banks manage climate risk or otherwise affecting banking practices or disclosure of climate-related information may result in higher compliance, operational and credit risks and costs. The Group’s customers and counterparties may also face similar challenges. Moreover, there are significant risks and uncertainties inherent in the development of adequate climate change-related risk assessment and modelling capabilities and the collection of customer, third party or other data, which may result in the Group’s systems or frameworks (or those of its customers and counterparties, where applicable) being inadequate, inaccurate or susceptible to incorrect customer, third party or other data.
- *Technological risks*. Certain of the Group’s customers and counterparties may be adversely affected by the progressive transition to a low-carbon economy and/or risks associated with new low-carbon technologies. If our customers and counterparties fail to adapt to the transition to a low-carbon economy, or if the costs of doing so adversely affect their creditworthiness, this could adversely affect the Group’s relevant loan portfolios.
- *Market risks*. The funding costs of businesses that are perceived to be more exposed to climate change could increase, which may result in the deterioration of their creditworthiness and credit ratings, adversely affecting the Group’s relevant loan portfolios. The Group could also be adversely affected by changes in demand brought by climate change, as well as changes in energy supply and prices, among others.
- *Reputational risks*. The perception of climate change as a risk by society, shareholders, customers, governments and other stakeholders continues to increase, including in relation to the financial sector’s operations and strategy. This may result in increased scrutiny of the Group’s activities, as well as its climate change-related policies, goals and disclosure. The Group’s reputation may be harmed if its efforts to reduce environmental and social risks are deemed to be insufficient. Divergent views on ESG policies may also have a negative impact on the Group’s reputation. Increased scrutiny of climate change-related policies, goals and disclosure may result in litigation and regulatory investigations and actions. The Group has disclosed certain aspirational climate-related goals and such goals, which are being pursued over the long-term, may prove to be considerably more costly or difficult than currently expected, or even impossible, to achieve, including as a result of changes in environmental and energy regulation and policy, the pace of technological change and innovation and the actions of governments, Group’s customers and competitors.

The physical risk arising from climate change could result from increased frequency and/or severity of adverse weather events or the impact of climate change over the long term. The activities of the Group or those of its customers or counterparties could be adversely affected by the physical risks arising from climate change. For example, extreme weather events may damage or destroy the properties and other assets of the Group or those of its customers or counterparties, result in increased costs, or otherwise disrupt their respective operations (for example, if supply chains are disrupted as a result), diminishing –in the case of the Group’s customers or counterparties - their repayment capacity and, if applicable, the value of assets pledged as collateral to the Group. The Group is also exposed to potential long-term risks arising from climate change, such as increases in credit-related costs due to deteriorating macroeconomic conditions, which may be caused in part by an increase in infectious diseases or other ailments resulting from climate change. The Group could also be adversely affected by widespread declines in asset values as a result of climate change or climate change-related risks, reduced availability of insurance and significant interruptions to business operations, and may be required to change its business models in response to those consequences.

Any of these factors may have a material adverse effect on the Group’s business, financial condition and results of operations.

The Group faces risks related to its acquisitions and divestitures

The Group has acquired and sold several companies and businesses over the past few years. For additional information on recent transactions, see “*Item 4. Information on the Company—History and Development of the Company—Capital Divestitures*” and “*—Capital Expenditures*”.

The Group may not complete any ongoing or future transactions in a timely manner, on a cost-effective basis or at all and, if completed, they may not have the expected results. In addition, if completed, the Group’s results of operations could be adversely affected by divestiture or acquisition-related charges and contingencies. The Group may be subject to litigation in connection with, or as a result of, divestitures or acquisitions, including claims from terminated employees, customers or third parties. In the case of an acquisition, the Group may be liable for potential or existing litigation and claims related to an acquired business, including because either the Group is not indemnified for such claims or the indemnification is insufficient. Further, in the case of a divestiture, the Group may be required to indemnify the buyer in respect of similar or other matters, including claims against the divested entity or business.

In the case of an acquisition, even though the Group reviews the companies it plans to acquire, it is often not possible for these reviews to be complete in all respects and there may be risks associated with unforeseen events or liabilities relating to the acquired assets or businesses that may not have been revealed or properly assessed during the due diligence processes, resulting in the Group assuming unforeseen liabilities or an acquisition not performing as expected. In addition, acquisitions are inherently risky because of the difficulties that may arise in integrating people, operations and technologies. There can be no assurance that any of the businesses the Group acquires can be successfully integrated or that they will perform well once integrated.

Acquisitions may also lead to potential write-downs that adversely affect the Group’s results of operations. Any of the foregoing may cause the Group to incur significant unexpected expenses, may divert significant resources and management attention from the Group’s other business concerns, or may otherwise have a material adverse effect on the Group’s business, financial condition and results of operations.

FINANCIAL RISKS

The Group has a continuous demand for liquidity to finance its activities and the withdrawal of deposits or other sources of liquidity could significantly affect it

Traditionally, one of the Group’s main sources of financing has been savings accounts and demand deposits. As of December 31, 2022, the balance of customer deposits represented 75% of the Group’s total financial liabilities at amortized cost. However, the volume of wholesale and retail deposits can fluctuate significantly, including as a result of factors beyond the Group’s control, such as general economic conditions, changes in economic policy or administrative decisions that diminish their attractiveness as savings instruments (for example, as a consequence of changes in taxation, coverage by guarantee funds for deposits or expropriations) or competition from other savings or investment instruments (including deposits from other banks).

Likewise, changes in interest rates and credit spreads may significantly affect the cost of the Group’s short and long-term wholesale financing. Changes in credit spreads are driven by market factors and are also influenced by the market’s perception of the Group’s solvency. As of December 31, 2022, debt securities issued by the Group represented 10.5% of the total financial liabilities at amortized cost of the Group.

In addition, the Group has made and continues to make significant use of public sources of liquidity, such as the ECB's extraordinary measures taken in response to the financial crisis since 2008 or those taken in connection with the crisis caused by the COVID-19 pandemic. As of December 31, 2022, BBVA had drawn down €26,711 million under the ECB's Targeted Long Term Refinancing Operations (TLTRO) III program (€38,692 million as of December 31, 2021 and €35,032 million as of December 31, 2020). However, the conditions of this or other ECB programs could be revised or they could be cancelled at any time.

In the event of a withdrawal of deposits or other sources of liquidity, especially if it is sudden or unexpected, the Group may not be able to finance its financial obligations or meet the minimum liquidity requirements that apply to it, and may be forced to incur higher financial costs, liquidate assets and take additional measures to reduce leverage. Furthermore, the Group could be subject to the adoption of early intervention measures or, ultimately, to the adoption of a resolution measure by the Relevant Spanish Resolution Authority (see "*Item 4. Information on the Company—Business Overview—Supervision and Regulation—Capital Requirements, MREL and Resolution*"). Any of the above could have a material adverse effect on the Group's business, financial condition and results of operations.

The Group depends on its credit ratings and sovereign credit ratings, especially Spain's credit ratings

Rating agencies periodically review the Group's debt credit ratings. Any reduction, effective or anticipated, in any such ratings of the Group, whether below investment grade or otherwise, could limit or impair the Group's access to capital markets and other possible sources of liquidity and increase the Group's financing cost, and entail the breach or early termination of certain contracts or give rise to additional obligations under those contracts, such as the need to grant additional guarantees. Furthermore, if the Group were required to cancel its derivative contracts with some of its counterparties and were unable to replace them, its market risk would worsen. Likewise, a reduction in the credit rating could affect the Group's ability to sell or market some of its products or to participate in certain transactions, and could lead to the loss of customer deposits and make third parties less willing to carry out commercial transactions with the Group (especially those that require a minimum credit rating), having a material adverse effect on the Group's business, financial condition and results of operations.

Furthermore, the Group's credit ratings could be affected by variations in sovereign credit ratings, particularly the rating of Spanish sovereign debt. The Group holds a significant portfolio of debt issued by Spain, by the Spanish autonomous communities and by other government or government-related Spanish issuers. As of December 31, 2022 the Group's exposure (European Banking Authority ("**EBA**") criteria) to such debt was €39,485 million, representing 5.5% of the consolidated total assets of the Group. Any decrease in the credit rating of Spain could adversely affect the valuation of the respective debt portfolios held by the Group and lead to a reduction in the Group's credit ratings. Additionally, counterparties to many of the credit agreements signed with the Group could also be affected by a decrease in the credit rating of Spain, which could limit their ability to attract additional resources or otherwise affect their ability to pay their outstanding obligations to the Group. It is possible that current or future economic and geopolitical conditions or other factors could lead to ratings actions and changes to BBVA's credit ratings, any of which could have a material adverse effect on the Group's business, financial condition and results of operations.

The Group's earnings and financial condition have been, and its future earnings and financial condition may continue to be, materially affected by asset impairment

Regulatory, business, economic or political changes and other factors could lead to asset impairment. In recent years, severe market events such as the past sovereign debt crisis, rising risk premiums and falls in share market prices, have resulted in the Group recording large write-downs on its credit market exposures. Doubts regarding the asset quality of European banks has also affected their evolution in the market in recent years.

Several ongoing factors could depress the valuation of the Group's assets or otherwise lead to the impairment of such assets (including goodwill and deferred tax assets). This includes a deteriorating macroeconomic environment, Russia's invasion of Ukraine and the possible escalation of conflict, new COVID-19 outbreaks, the consequences of Brexit, the surge of populist trends in several countries, increased trade tensions and potential changes in U.S. economic policies implemented by the current U.S. administration, any of which could increase global financial volatility and lead to the reallocation of assets. In addition, uncertainty about China's growth expectations and its policymaking capability to address certain severe challenges has contributed to the deterioration of the valuation of global assets and further increased volatility in the global financial markets. Any asset impairments resulting from these or other factors could have a material adverse effect on the Group's business, financial condition and results of operations.

The Group has a substantial amount of commitments with personnel considered wholly unfunded due to the absence of qualifying plan assets

The Group faces liquidity risk in connection with its ability to make payments on its unfunded commitments with personnel (which are recognized under the heading "Provisions—Provisions for pensions and similar obligations" in the Group's consolidated balance sheet), which it seeks to mitigate, with respect to post-employment benefits, by maintaining insurance contracts which were contracted with insurance companies owned by the Group. The insurance companies have recorded in their balance sheets specific assets (fixed interest deposit and bonds) assigned to the funding of these commitments. The insurance companies also manage derivatives (primarily swaps) to mitigate the interest rate risk in connection with the payments of these commitments. The Group seeks to mitigate liquidity risk with respect to early retirements and post-employment welfare benefits through oversight by the Assets and Liabilities Committee ("**ALCO**") of the Group. The Group's ALCO manages a specific asset portfolio to mitigate the liquidity risk resulting from the payments of these commitments. These assets are government and covered bonds which are issued at fixed interest rates with maturities matching the aforementioned commitments. The Group's ALCO also manages derivatives (primarily swaps) to mitigate the interest rate risk in connection with the payments of these commitments. Should BBVA fail to adequately manage liquidity risk and interest rate risk either as described above or otherwise, it could have a material adverse effect on the Group's business, financial condition and results of operations.

LEGAL RISKS

The Group is party to a number of legal and regulatory actions and proceedings

The financial sector faces an environment of increasing regulatory and litigation pressure. The Group is party to government procedures and investigations, such as those carried out by the antitrust authorities which, among other things, have in the past and could in the future result in sanctions, as well as lead to claims by customers and others.

The various Group entities are also frequently party to individual or collective judicial proceedings (including class actions) resulting from their activity and operations, as well as arbitration proceedings. For example, in April 2017, the Mexican Federal Economic Competition Commission (*Comisión Federal de Competencia Económica*) launched an antitrust investigation relating to alleged monopolistic practices of certain financial institutions, including BBVA's subsidiary BBVA Mexico, in connection with transactions in Mexican government bonds. This investigation concluded with the Commission imposing fines to all financial institutions involved, with BBVA Mexico being imposed with a fine insignificant in amount, which BBVA Mexico has challenged. In March 2018, BBVA Mexico and certain other affiliates of the Group were named as defendants in a putative class action lawsuit filed in the United States District Court for the Southern District of New York, alleging that the defendant banks and their named subsidiaries engaged in collusion with respect to the purchase and sale of Mexican government bonds. In December 2019, following a decision from the judge assigned to hear the proceedings, plaintiffs withdrew their claims against BBVA Mexico's affiliates. In November 2020, the judge granted the remaining defendants' motion to dismiss for lack of personal jurisdiction. Plaintiffs filed a motion for reconsideration of that decision in May 2021, which the judge denied in March 2022. Final judgment dismissing plaintiffs' claims was entered in August 2022. In September 2022 plaintiffs appealed the district court's decisions to the United States Court of Appeals for the Second Circuit. Briefing on the appeal was completed in late February 2023.

More generally, in recent years, regulators have increased their supervisory focus on consumer protection and corporate behavior, which has resulted in an increased number of regulatory actions.

In Spain and in other jurisdictions where the Group operates, legal and regulatory actions and proceedings against financial institutions, prompted in part by certain recent national and supranational rulings in favor of consumers (with regards to matters such as credit cards and mortgage loans), have increased significantly in recent years and this trend could continue in the future. Legal and regulatory actions and proceedings faced by other financial institutions, especially if such actions or proceedings result in favorable resolutions for the consumer, could also adversely affect the Group. See "*Item 4. Information on the Company—Business Overview—Supervision and Regulation—Principal Markets*" for information on certain additional legal and regulatory actions and initiatives.

All of the above may result in a significant increase in operating and compliance costs and/or a reduction in revenues, and it is possible that an adverse outcome in any proceedings (depending on the amount thereof, the penalties imposed or the resulting procedural or management costs for the Group) could materially and adversely affect the Group, including by damaging its reputation.

It is difficult to predict the outcome of legal and regulatory actions and proceedings, both those to which the Group is currently exposed and those that may arise in the future, including actions and proceedings relating to former Group subsidiaries or in respect of which the Group may have indemnification obligations. Any of such outcomes could be adverse to the Group. In addition, a decision in any matter, whether against the Group or against another credit entity facing similar claims as those faced by the Group, could give rise to other claims against the Group. In addition, these actions and proceedings draw resources away from the Group and may require significant attention on the part of the Group's management and employees.

As of December 31, 2022, the Group had €685 million in provisions for the proceedings it is facing (which are included in the line item “Provisions for taxes and other legal contingencies” in the consolidated balance sheet) of which €524 million corresponded to legal contingencies and €161 million corresponded to tax-related contingencies. However, the uncertainty arising from these proceedings (including those for which no provisions have been made, either because it is not possible to estimate any such provisions or for other reasons) makes it impossible to guarantee that the possible losses arising from such proceedings will not exceed, where applicable, the amounts that the Group currently has provisioned and, therefore, could affect the Group’s consolidated results.

As a result of the above, legal and regulatory actions and proceedings currently faced by the Group or to which it may become subject in the future or which may otherwise affect the Group, whether individually or in the aggregate, if resolved in whole or in part adversely to the Group’s interests, could have a material adverse effect on the Group’s business, financial condition and results of operations.

The Spanish judicial authorities are carrying out a criminal investigation relating to possible bribery, revelation of secrets and corruption by BBVA

Spanish judicial authorities are investigating the activities of Centro Exclusivo de Negocios y Transacciones, S.L. (“**Cenyt**”). Such investigation includes the provision of services by Cenyt to BBVA. On July 29, 2019, BBVA was named as an investigated party (*investigado*) in a criminal judicial investigation (Preliminary Proceeding No. 96/2017 – Piece No. 9, Central Investigating Court No. 6 of the National High Court) for alleged facts which could constitute bribery, revelation of secrets and corruption. On February 3, 2020, BBVA was notified by the Central Investigating Court No. 6 of the National High Court of the order lifting the secrecy of the proceedings. Certain current and former officers and employees of the Group, as well as former directors, have also been named as investigated parties in connection with this investigation. BBVA has been and continues to be proactively collaborating with the Spanish judicial authorities, including sharing with the courts information obtained in the internal investigation hired by the entity in 2019 to contribute to the clarification of the facts. As at the date of this Annual Report, no formal accusation against BBVA has been made.

This criminal judicial proceeding is in the pre-trial phase. Therefore, it is not possible at this time to predict the scope or duration of such proceeding or any related proceeding or its or their possible outcomes or implications for the Group, including any fines, damages or harm to the Group’s reputation caused thereby.

REGULATORY, TAX, COMPLIANCE AND REPORTING RISKS

The financial services sector is one of the most regulated sectors in the world. The Group is subject to a broad regulatory and supervisory framework, which has increased significantly in the last decade. Regulatory activity in recent years has affected multiple areas, including changes in accounting standards; strict regulation of capital, liquidity and remuneration; bank charges and taxes on financial transactions; regulations affecting mortgages, banking products and consumers and users; recovery and resolution measures; stress tests; prevention of money laundering and terrorist financing; market abuse; conduct in the financial markets; anti-corruption; and requirements as to the periodic publication of information. Governments, regulatory authorities and other institutions continually make proposals to strengthen the resistance of financial institutions to future crises. Further, there is an increasing focus on the climate-related financial risk management capabilities of banks.

Furthermore, the international nature of the Group’s operations means that the Group is subject to a wide and complex range of local and international regulations in these matters, sometimes with overlapping scopes and areas regulated. This complexity, which can be exacerbated by differences and changes in the interpretation or application of these standards by local authorities, makes compliance risk management difficult and costly, requiring highly sophisticated monitoring, qualified personnel and general training of employees.

Any change in the Group’s business that is necessary to comply with any particular regulations at any given time, especially in Spain, Mexico or Turkey, could lead to a considerable loss of income, limit the Group’s ability to identify business opportunities, affect the valuation of its assets, force the Group to increase its prices and, therefore, reduce the demand for its products, impose additional costs on the Group or otherwise adversely affect its business, financial condition and results of operations.

The Group is subject to a comprehensive regulatory and supervisory framework, including resolution regulations, which could have a material adverse effect on its business, financial condition and results of operations

The Group is subject to a comprehensive regulatory and supervisory framework, the complexity and scope of which has increased significantly following the 2008 global financial crisis and the crisis caused by the COVID-19 pandemic. In particular, the banking sector is subject to continuous scrutiny at the political level and by the supervisory bodies, and it is foreseeable that in the future there will continue to be political intervention in regulatory and supervisory processes, as well as in the governance of the main financial entities. For these reasons, the laws, regulations and policies to which the Group is subject, as well as their interpretation and application, may change at any time. In addition, supervisors and regulators have significant discretion in carrying out their duties, which gives rise to uncertainty regarding the interpretation and implementation of the regulatory framework. Moreover, regulatory fragmentation and the implementation by some countries of more flexible or stricter rules or regulations could also negatively affect the Group’s ability to compete with financial institutions that may or may not have to comply with any such rules or regulations, as applicable.

Regulatory changes over the last decade, as well as those currently being proposed (including changes in the interpretation or application of existing regulations), have increased and may continue to substantially increase the Group’s operating expenses and adversely affect its business model. For example, the imposition of prudential capital standards has limited and is expected to continue to limit the ability of subsidiaries to distribute capital to the Group, while liquidity standards may lead the Group to hold a higher proportion of financial instruments with higher liquidity and lower performance, which can adversely affect its net interest margin. In addition, the Group’s regulatory and supervisory authorities may require the Group to increase its loan loss allowances and record asset impairments, which could have an adverse effect on its financial condition. Any legislative or regulatory measure, any necessary change in the Group’s business operations as a consequence of such measures, as well as any failure to comply with them, could result in a significant loss of income, represent a limitation on the ability of the Group to take advantage of business opportunities and offer certain products and services, affect the value of the Group’s assets, force the Group to increase prices (which could reduce the demand for its products), impose additional compliance costs or result in other possible adverse effects for the Group.

One of the most significant regulatory changes resulting from the 2008 global financial crisis, was the introduction of resolution regulations (see “*Item 4. Information on the Company—Business Overview—Supervision and Regulation—Capital Requirements, MREL and Resolution*”). In the event that the Relevant Spanish Resolution Authority (as defined herein) considers that the Group is in a situation where conditions for early intervention or resolution are met, it may adopt the measures provided for in the applicable resolution regulations, including without prior notice. Such measures could include, among others, the write down and/or conversion into equity (or other securities or obligations) of unsecured debt claims of the Group. In addition, the Relevant Spanish Resolution Authority may apply Non-Viability Loss Absorption (as defined herein) in the event that it determines that the entity meets the conditions for its resolution or will no longer be viable unless capital instruments are written down or converted into equity or extraordinary public support is provided. Any such determination or the mere possibility that such determination could be made, could materially and adversely affect the Group’s business, financial condition and results of operations, as well as the market price and behavior of securities issued by the Group (or their terms, if amended following an exercise of the Spanish Bail-in-Power (as defined herein)).

Increasingly onerous capital and liquidity requirements may have a material adverse effect on the Group’s business, financial condition and results of operations

The Group is subject to various minimum capital, liquidity and funding requirements, among others. For example, in its capacity as a Spanish credit institution, the Group is subject to compliance with a “Pillar 1” solvency requirement, a “Pillar 2” solvency requirement and a “combined buffer requirement”, at both the individual and consolidated levels. For additional information on such requirements, see “*Item 4. Information on the Company—Business Overview—Supervision and Regulation—Capital Requirements, MREL and Resolution*” and, with respect to the Group’s requirements in particular, “*Item 5. Operating and Financial Review and Prospects—Liquidity and Capital Resources—Capital*” and Note 32.1 to the Consolidated Financial Statements.

While the Group believes it meets its current requirements (as applicable to the Bank and the Group as a whole, respectively), the capital requirements, the MREL requirements and the calculation of the own funds and the eligible liabilities available for MREL purposes are subject to interpretation and change and, therefore, no assurance can be given that the Group's interpretation is the appropriate one or that the Bank and/or the Group will not be subject to more stringent requirements at any future time. Likewise, no assurance can be given that the Bank and/or the Group will be able to fulfil whatever future requirements may be imposed, even if such requirements were to be equal or lower than those currently in force. No assurances can be made that the Bank and/or the Group will meet any capital target that may be announced to the market at any given time. If an announced target is not met, this could adversely affect the market value or behavior of securities issued by the Bank and/or the Group and/or lead to the implementation of new recommendations or requirements regarding "Pillar 2" or (should the Relevant Spanish Resolution Authority interpret that obstacles may exist for the viability of the resolution of the Bank and/or the Group), MREL. Further, the Bank and/or the Group may fail to meet consensus estimates, as occurred with respect to the CET 1 ratios as of December 31, 2021, which may also affect market perceptions of the Bank and the Group.

If the Bank or the Group failed to comply with its "combined buffer requirement", the Bank would have to calculate the Maximum Distributable Amount ("**MDA**") and, until such calculation has been undertaken and reported to the Bank of Spain, the Bank would not be able to make any discretionary payments. Once the MDA has been calculated and reported, such discretionary payments would be limited to the calculated MDA. Likewise, should the Bank or the Group not meet the applicable combined buffer requirement, it could result in the imposition of additional requirements of "Pillar 2". Regarding MREL, failure by BBVA to meet its relevant "combined buffer requirement" could result in the imposition of restrictions or prohibitions on discretionary payments. Additionally, failure to comply with the capital requirements may result in the implementation of early intervention measures or, ultimately, resolution measures by the resolution authorities. For additional information on such requirements, see "*Item 4. Information on the Company—Business Overview—Supervision and Regulation—Capital Requirements, MREL and Resolution*".

Regulation (EU) 2019/876 of the European Parliament and of the Council, of May 20, 2019 (as amended, replaced or supplemented at any time, "**CRR II**") establishes a binding requirement for the leverage ratio effective from June 28, 2021 of 3% of Tier 1 capital (as of December 31, 2022 the phased-in leverage ratio of the Group was 6.49% and the fully loaded ratio was 6.46%). Any failure to comply with this leverage ratio buffer may also result in the need to calculate and report the MDA, and restrictions on discretionary payments. Moreover, CRR II proposes new requirements that capital instruments must meet in order to be considered AT1 or Tier 2 instruments. Once the grandfathering period in CRR II has elapsed, AT1 and/or Tier 2 instruments which do not comply with the new requirements at such date will no longer be considered as capital instruments. This could give rise to shortfalls in the Bank's or the Group's regulatory capital and, ultimately, could result in failure to comply with the applicable minimum regulatory capital requirements, with the aforementioned consequences.

Additionally, the full implementation of the ECB expectations regarding prudential provisions for NPLs (published on May 15, 2018) and the ECB's review of internal models being used by banks subject to its supervision for the calculation of their RWAs ("**TRIMs**"), as well as complementary regulatory initiatives like the EBA's roadmap to repair internal models used to calculate own funds requirements for credit risk under the Internal Ratings Based (IRB) approach, could result in the need to increase provisions for future NPLs and increases in the Group's capital needs.

Furthermore, the implementation of the Basel III reforms (informally referred to as Basel IV) described in "*Item 4. Information on the Company—Business Overview—Supervision and Regulation—Capital Requirements, MREL and Resolution*" (including changes to the calculation of the Group's Operational Risk) could result in an increase of the Bank's and the Group's total RWAs and, therefore, could also result in a decrease of the Bank's and the Group's capital ratios. Likewise, the lack of uniformity in the implementation of the Basel III reforms across jurisdictions in terms of timing and applicable regulations could give rise to inequalities and competition distortions. Moreover, the lack of regulatory coordination, with some countries bringing forward the application of Basel III requirements or increasing such requirements, could adversely affect an entity with global operations such as the Group and could affect its profitability.

Additionally, should the Total Loss Absorbing Capacity (TLAC) requirements, currently only imposed upon financial institutions of global systemic importance ("**G-SIBs**"), be imposed on non-G-SIBs entities or should the Group once again be classified as a G-SIB, additional minimum requirements similar to MREL could in the future be imposed upon the Group.

There can be no assurance that the capital or MREL requirements will not adversely affect the Bank's or its subsidiaries' ability to make discretionary payments, or result in the cancellation of such payments (in whole or in part), or require the Bank or such subsidiaries to issue additional securities that qualify as eligible liabilities or regulatory capital, to liquidate assets, to curtail business or to take any other actions, any of which may have adverse effects on the Group's business, financial condition and results of operations. Furthermore, an increase in capital or MREL requirements could adversely affect the return on equity and other of the Group's financial results indicators. Moreover, the Bank's or the Group's failure to comply with their capital or MREL requirements could have a material adverse effect on the Group's business, financial condition and results of operations.

Lastly, the Group must also comply with liquidity and funding ratios. Several elements of the liquidity coverage ratio ("**LCR**") and net stable financing ratio ("**NSFR**"), as introduced by national banking regulators, may require implementing changes in some of its commercial practices, which could expose the Group to additional expenses (including an increase in compliance expenses), affect the profitability of its activities or otherwise lead to a material adverse effect on the Group's business, financial condition and results of operations. For information on the Group's requirements, see "*Item 5. Operating and Financial Review and Prospects—Liquidity and Capital Resources*".

The Group is exposed to tax risks that may adversely affect it

The size, geographic diversity and complexity of the Group and its commercial and financial relationships with both third parties and related parties result in the need to consider, evaluate and interpret a considerable number of tax laws and regulations, as well as any relevant interpretative materials, which in turn involve the use of estimates, the interpretation of indeterminate legal concepts and the determination of appropriate valuations in order to comply with the tax obligations of the Group. In particular, the preparation of the Group's tax returns and the process for establishing tax provisions involve the use of estimates and interpretations of tax laws and regulations, which are complex and subject to review by the tax authorities. Any error or discrepancy with tax authorities in any of the jurisdictions in which the Group operates may give rise to prolonged administrative or judicial proceedings that may have a material adverse effect on the Group's results of operations.

In addition, governments in different jurisdictions, including Spain, are seeking to identify new funding sources, and they have recently focused on the financial sector. The Group's presence in various jurisdictions increases its exposure to new laws and regulatory and interpretative changes, including in response to the demands of various political forces, which could, among other things, lead to (i) the creation of new taxes, such as (a) the temporary windfall tax applicable to credit institutions operating in Spain amounting to 4.8% of the net income from interest and commissions generated in Spain, which is currently intended to apply to the fiscal years 2023 and 2024, (b) the common financial transaction tax ("**FTT**") contemplated in the proposed Tax Directive of the European Commission for the Financial Transactions Tax (which would tax the acquisitions of certain securities, negotiated in markets where the Group operates), and (c) the Spanish FTT which came into effect in Spain in January 2021; (ii) an increase in the rates of existing taxes, such as the imposition, with effects as of January 1, 2022, of a minimum effective tax rate for purposes of the Spanish corporate income tax (set at 18%); and (iii) changes in the calculation of tax bases and exemptions therefrom, such as the recent limitation adopted in Spain with respect to the exemption for dividends and capital gains from domestic and foreign subsidiaries for purposes of the Spanish corporate income tax, pursuant to which 5% of the dividends and capital gains of Group companies in Spain will be subject to, and not exempt from, corporate tax. The increasing tax burden faced by the Group may have a material adverse effect on its business, financial condition and results of operations.

The Group is exposed to compliance risks

The Group, due to its role in the economy and the nature of its activities, is singularly exposed to certain compliance risks. In particular, the Group must comply with regulations regarding customer conduct, market conduct, the prevention of money laundering and the financing of terrorist activities, the protection of personal data, the restrictions established by national or international sanctions programs and anti-corruption laws (including the US Foreign Corrupt Practices Act of 1977 and the UK Bribery Act of 2010), the violations of which could lead to very significant penalties. These anti-corruption laws generally prohibit providing anything of value to government officials for the purposes of obtaining or retaining business or securing any improper business advantage. As part of the Group's business, the Group directly or indirectly, through third parties, deals with entities whose employees are considered to be government officials. The Group's activities are also subject to complex customer protection and market integrity regulations.

Generally, these regulations require banking entities to, among other measures, use due diligence measures to manage compliance risk. Sometimes, banking entities must apply reinforced due diligence measures due to the nature of their activities (among others, private banking, money transfer and foreign currency exchange operations), as they may present a higher risk of money laundering or terrorist financing.

Although the Group has adopted policies, procedures, systems and other measures to manage compliance risk, it is dependent on its employees and external suppliers for the implementation of these policies, procedures, systems and other measures, and it cannot guarantee that these are sufficient or that the employees (115,675 as of December 31, 2022) or other persons of the Group or its business partners, agents and/or other third parties with a business or professional relationship with the Group do not circumvent or violate regulations or the Group's ethics and compliance regulations, acts for which such persons or the Group could be held ultimately responsible and/or that could damage the Group's reputation. In particular, acts of misconduct by any employee, and particularly by senior management, could erode trust and confidence and damage the Group's reputation among existing and potential clients and other stakeholders. Actual or alleged misconduct by Group entities in any number of activities or circumstances, including operations, employment-related offenses such as sexual harassment and discrimination, regulatory compliance, the use and protection of data and systems, and the satisfaction of client expectations, and actions taken by regulators or others in response to such misconduct, could lead to, among other things, sanctions, fines and reputational damage, any of which could have a material adverse effect on the Group's business, financial condition and results of operations.

Furthermore, the Group may not be able to prevent third parties outside the Group from using the banking network in order to launder money or carry out illegal or inappropriate activities. Further, financial crimes continually evolve and emerging technologies, such as cryptocurrencies and blockchain, could limit the Group's ability to track the movement of funds. Additionally, in adverse economic conditions, it is possible that financial crime attempts will increase significantly.

If there is a breach of the applicable regulations or the Group's ethics and compliance regulations or if the competent authorities consider that the Group does not perform the necessary due diligence inherent to its activities, such authorities could impose limitations on the Group's activities, the revocation of its authorizations and licenses, and economic penalties, in addition to having significant consequences for the Group's reputation, which could have a material adverse effect on the Group's business, financial condition and results of operations. Furthermore, the Group from time to time conducts investigations related to alleged violations of such regulations and the Group's ethics and compliance regulations, and any such investigation or any related proceedings could be time consuming and costly, and its results difficult to predict.

Further, the COVID-19 pandemic led to new specific regulations largely focused on consumer protection being adopted in many countries, mainly in 2020. The need to timely adapt the Group's processes and systems to these new regulations under the then prevailing circumstances has posed compliance risk. Likewise, the increase in remote account opening driven in part by the pandemic has resulted in increased money laundering risks. Additionally, criminals have sought to exploit the opportunities created by the pandemic across the globe, which has resulted in increased money laundering risks associated with counterfeiting of medical goods, investment fraud, cyber-crime scams and exploitation of economic stimulus measures put in place by governments. Increased strain on the Group's communications surveillance frameworks could raise the Group's market conduct risk.

BBVA's financial statements are based in part on assumptions and estimates which, if inaccurate, could cause material misstatement of the results of its operations and financial condition

The preparation of financial statements in compliance with IFRS-IASB requires the use of estimates. It also requires management to exercise judgment in applying relevant accounting policies. The key areas involving a higher degree of judgment or complexity, or areas where assumptions are significant to the consolidated and individual financial statements, include the classification, measurement and impairment of financial assets, particularly where such assets do not have a readily available market price, the assumptions used to quantify certain provisions and for the actuarial calculation of post-employment benefit liabilities and commitments, the useful life and impairment losses of tangible and intangible assets, the valuation of goodwill and purchase price allocation of business combinations, the fair value of certain unlisted financial assets and liabilities, the recoverability of deferred tax assets and the exchange and inflation rates of Venezuela. There is a risk that if the judgment exercised or the estimates or assumptions used subsequently turn out to be incorrect then this could result in significant loss to the Group beyond that anticipated or provided for, which could have a material adverse effect on the Group's business, financial condition and results of operations.

Observable market prices are not available for many of the financial assets and liabilities that the Group holds at fair value and a variety of techniques to estimate the fair value are used. Should the valuation of such financial assets or liabilities become observable, for example as a result of sales or trading in comparable assets or liabilities by third parties, this could result in a materially different valuation to the current carrying value in the Group's financial statements.

The further development of standards and interpretations under IFRS-IASB could also significantly affect the results of operations, financial condition and prospects of the Group.

OPERATIONAL RISKS

Attacks, failures or deficiencies in the Group's procedures, systems and security or those of third parties to which the Group is exposed could have a material adverse effect on the Group's business, financial condition and results of operations, and could be detrimental for its reputation

The Group's activities depend to a large extent on its ability to process and report effectively and accurately on a high volume of highly complex transactions with numerous and diverse products and services (by their nature, generally ephemeral), in different currencies and subject to different regulatory regimes. Therefore, it relies on highly sophisticated information technology ("**IT**") systems for data transmission, processing and storage. However, IT systems are vulnerable to various problems, such as hardware and software malfunctions, computer viruses, hacking, and physical damage to IT centers. BBVA's exposure to these risks has increased significantly in recent years due to the Group's implementation of its ambitious digital strategy. Digital services, as well as other alternatives that BBVA offers users to become BBVA customers, have become even more important after the COVID-19 outbreak and the ensuing restrictions on mobility in the countries in which the Group operates. Currently, one in two new clients chooses digital channels to start their relationship with BBVA. The Group suffers cybersecurity incidents and system failures from time to time, and any such incident or failure could have a material adverse effect on the Group's business, financial condition and results of operations, and could be detrimental for its reputation.

Any attack, failure or deficiency in the Group's systems could, among other things, lead to the misappropriation of funds of the Group's clients or the Group itself and the unauthorized disclosure, destruction or use of confidential information, as well as prevent the normal operation of the Group, and impair its ability to provide services and carry out its internal management. In addition, any attack, failure or deficiency could result in the loss of customers and business opportunities, damage to computers and systems, violation of regulations regarding data protection and/or other regulations, exposure to litigation, fines, sanctions or interventions, loss of confidence in the Group's security measures, damage to its reputation, reimbursements and compensation, and additional regulatory compliance expenses and could have a material adverse effect on the Group's business, financial condition and results of operations. Furthermore, it is possible that such attacks, failures or deficiencies will not be detected on time or ever. The Group is likely to be forced to spend significant additional resources to improve its security measures in the future. As cyber-attacks are becoming increasingly sophisticated and difficult to prevent, the Group may not be able to anticipate or prevent all possible vulnerabilities, nor to implement preventive measures that are effective or sufficient.

Customers and other third parties to which the Group is significantly exposed, including the Group's service providers (such as data processing companies to which the Group has outsourced certain services), face similar risks. Any attack, failure or deficiency that may affect such third parties could, among other things, adversely affect the Group's ability to carry out operations or provide services to its clients or result in the unauthorized disclosure, destruction or use of confidential information. Furthermore, the Group may not be aware of such attack, failure or deficiency in time, which could limit its ability to react. Moreover, as a result of the increasing consolidation, interdependence and complexity of financial institutions and technological systems, an attack, failure or deficiency that significantly degrades, eliminates or compromises the systems or data of one or more financial institutions could have a significant impact on its counterparts or other market participants, including the Group.