06.1
A STRATEGIC PILLAR.

RISK MANAGEMENT IS ONE OF BANKIA'S STRATEGIC PILLARS AND IS CONDUCTED IN ACCORDANCE WITH INTERNATIONAL BEST PRACTICES, SUPPORTED BY A STRONG CORPORATE GOVERNANCE FRAMEWORK TO ENSURE THAT CONTROL MECHANISMS OPERATE EFFECTIVELY.

The main objective of risk management is to preserve the group's financial and capital strength, driving value creation and business development in accordance with the risk appetite and risk tolerance set by the group's governing bodies. For that purpose, the bank provides the means to efficiently assess, control and monitor requested and authorised risk, manage non-performing loans and recover defaulted risks.

GENERAL PRINCIPLES

The general principles on which risk management is based are as follows:

- Independent, group-wide risk function that provides the necessary information for decision making at all levels.
- Objective decision making, taking account of all the relevant risk factors (both quantitative and qualitative).
- Active risk management at every stage of the risk life cycle, from pre-approval credit analysis until the debt is extinguished.
- Clear processes and procedures subject to regular review in light of changing needs, with clearly defined lines of responsibility.
- Integrated management of all risks through risk identification and quantification, and homogeneous risk management based on a common measure (economic capital).
- Differentiated risk treatment, approval process and management procedures, based on risk characteristics.
- Development, implementation and diffusion of advanced risk management support tools, making effective use of new technologies.

- Decentralised decision making, using the available methodologies and tools.
- Risk variable to be included in business decisions in all areas: strategic, tactical and operational.

- The objectives of the risk function and risk management staff must be aligned with the objectives of the bank as a whole, so as to maximise value creation.

THE FOUNDATIONS: RISK APPETITE AND CAPITAL PLANNING

Bankia has a Risk Appetite Framework – approved by the Board of Directors – that defines the intensity and types of risk the bank is willing to assume in the course of its activity in order to achieve its objectives, always taking regulatory restrictions and commitments into account. The Risk Appetite Framework provides a comprehensive overview of the levels of appetite, tolerance and capacity for each of the risks considered, as well as a comparison of these risks with the bank's overall risk profile.

The second strategic driver of the bank's risk and capital management under normal business conditions is the Capital Planning Framework. This framework defines the processes that will enable the management bodies to ensure that the bank has the appropriate amount and composition of capital to sustain its business strategies in various scenarios.

Supplementing these two frameworks is the Recovery Plan, which establishes the measures to be taken in a hypothetical crisis situation. The plan is designed to be activated if the selected indicators cross certain thresholds, which are matched to the tolerance levels set in the Risk Appetite Framework.

During 2016 the Board of Directors approved a number of amendments to the risk appetite statement, aimed at improving the interaction between the Risk Appetite Framework, the Capital Planning Framework and the Recovery Plan and the relationship between these three and the bank's strategy, business model and budget. It also adapted the indicators to the requirements of the supervisor and the risk monitoring and control needs.

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THE IMPORTANCE OF CORPORATE GOVERNANCE

One of the most significant aspects of the European regulations implementing the Basel III capital accords is the acknowledgement of the fundamental role of corporate governance in risk management. Under Basel III, banks are required to have sound corporate governance systems, including a clear organisational structure, effective procedures for identifying, managing, controlling and reporting risks, appropriate internal control mechanisms, and compatible remuneration policies and practices.

Bankia fully adheres to the new regulations and gives its governing bodies responsibility for risk oversight and control, as shown in the following chart:

The **Board of Directors** is the most senior governing body. It determines and approves the general strategies and procedures for internal control and the policies for the assumption, management, control and reduction of the risks to which the group is exposed. To properly perform these functions it has created various internal support bodies:

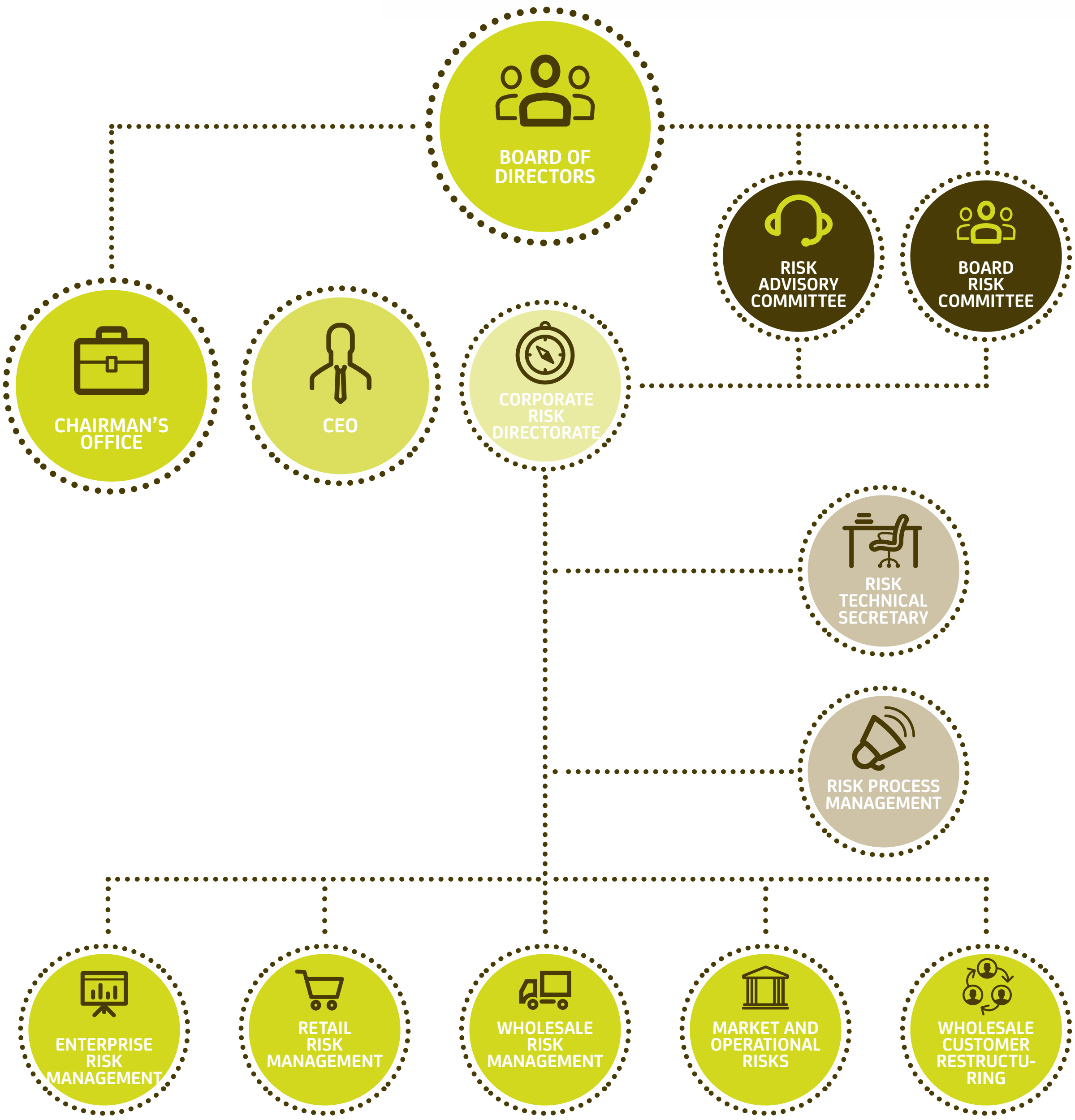
- **Audit and Compliance Committee.** This committee's core responsibility is to monitor the effectiveness of the bank's internal control, internal audit (where applicable) and risk management systems.

- **Risk Advisory Committee.** The main function of this committee is to advise the Board of Directors on the bank's overall risk propensity, current and future, and risk strategy. However, the Board of Directors retains overall responsibility.

- **Board Risk Committee.** This committee is responsible for approving risks within the scope of its authority and for overseeing and administering the exercise of delegated authority by lower-ranking bodies, all this without prejudice to the oversight authority exercised by the Audit and Compliance Committee.

The following chart gives an overview of the bank's organisational structure in relation to the Corporate Risk Directorate:

The Board of Directors is the most senior governing body. It determines and approves the general strategies and procedures for internal control and the policies for the assumption, management, control and reduction of the risks to which the group is exposed.



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A PROCESS OF CONTINUOUS IMPROVEMENT

During 2016, efforts continued to be focused on aligning the bank's risk function with industry best practices, in a process of continuous improvement.

The main activities carried out include the following:

- Improvement of risk management governance. To do this, the Risk Appetite Framework was expanded, the role of the control units was reinforced to give them the necessary independence in relation to the risk-taking units and specific pricing policies linked to the risk-adjusted return were approved.

- Improvement of risk management processes and diffusion of the risk culture. Both goals are addressed by the Closeness, Simplicity, Transparency project, which includes the initiatives launched under the 2016-2018 Transformation Plan and other new lines of work. The process improvements during 2016 affected mainly process documentation, systematisation and review. Initiatives to spread the risk culture included the creation of a risk culture space on the intranet, short-term assignments in risk centres for business managers, and greater emphasis on risk when setting business objectives.

THE CHALLENGES FOR 2017

The goal for 2017 is to continue to implement the work plan of the Closeness, Simplicity and Transparency project and complete the two transformation objectives undertaken last year.

The challenges as regards process improvement are to increase traceability, simplify and automate processes so as to reduce response times and increase the degree of specialisation of the risk function, as a lever for improving efficiency.

As regards spreading the risk culture, the challenge is to make risk policies, procedures and standards better known at all levels of the organisation, improve the quality of the credit proposals that are submitted and create a wider awareness of the entity's risk profile as established in the Risk Appetite Framework. The ultimate goal is to generate a profitable, high quality loan portfolio.

The goal for 2017 is to push ahead with the Closeness, Simplicity and Transparency project and complete the two transformation objectives started last year, while improving process traceability, simplicity and automation.

2016-2018 TRANSFORMATION PLAN

Apart from the Closeness, Simplicity, Transparency project, Bankia's risk management strategy is also guided by the principles of the 2016-2018 Transformation Plan. These principles are as follows:

- **An effective recoveries model.**
  The use of collection agencies will be intensified, loan processing will be centralised and sales of small portfolios will be systematised.

- **Promotion of sound lending.**
  Stimulus will be provided for the use of models to analyse the available information on customers and non-customers and to improve the credit rating system.

- **Early warning system.**
  The goal is to build the necessary infrastructure to detect potential impairments before they materialise, which will require developing specific tools.

- **Asset allocation.**
  The business must be oriented to maximising economic value, while respecting the risk levels set in the Risk Appetite Framework.

- **Culture and training.**
  The bank will promote a training plan focused on the risk profile (better knowledge of policies and tools) and data quality.

PRINCIPLES OF THE 2016-2018 TRANSFORMATION PLAN

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