# Banco Cooperativo Español, S.A. and Subsidiaries

**Consolidated Annual Accounts**
31 December 2016

**Consolidated Directors' Report**
2016

(With Auditor's Report Thereon)

(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails.)

**KPMG Auditores S.L.**
Paseo de la Castellana, 259 C
28046 Madrid

Independent Auditor's Report on the Consolidated Annual Accounts

(Translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails.)

To the Shareholders of
Banco Cooperativo Español, S.A.:

**Report on the Consolidated Annual Accounts**

We have audited the accompanying consolidated annual accounts of Banco Cooperativo Español, S.A. (the "Bank") and its subsidiaries (the "Group"), which comprise the consolidated balance sheet at 31 December 2016 and the consolidated income statement, consolidated statement of recognised income and expense, consolidated statement of total changes in equity and consolidated statement of cash flows for the year then ended, and consolidated notes.

*Directors' Responsibility for the Consolidated Annual Accounts*

The Directors of the Bank are responsible for the preparation of the accompanying consolidated annual accounts in such a way that they give a true and fair view of the consolidated equity, consolidated financial position and consolidated financial performance of Banco Cooperativo Español, S.A. and subsidiaries in accordance with International Financial Reporting Standards as adopted by the European Union and other provisions of the financial reporting framework applicable to the Group in Spain, specified in note 1 (b) to the accompanying consolidated annual accounts, and for such internal control that they determine is necessary to enable the preparation of annual accounts that are free from material misstatement, whether due to fraud or error.

*Auditor's Responsibility*

Our responsibility is to express an opinion on these consolidated annual accounts based on our audit. We conducted our audit in accordance with prevailing legislation regulating the audit of accounts in Spain. This legislation requires that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated annual accounts are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated annual accounts. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the consolidated annual accounts, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the preparation of the consolidated annual accounts by the Bank's Directors in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated annual accounts taken as a whole.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

*Opinion*

In our opinion, the accompanying consolidated annual accounts give a true and fair view, in all material respects, of the consolidated equity and consolidated financial position of Banco Cooperativo Español, S.A. and subsidiaries at 31 December 2016 and of their consolidated financial performance and consolidated cash flows for the year then ended, in accordance with International Financial Reporting Standards as adopted by the European Union and other provisions of the financial reporting framework applicable in Spain.

**Report on Other Legal and Regulatory Requirements**

The accompanying consolidated directors' report for 2016 contains such explanations as the Directors of the Bank consider relevant to the situation of the Group, its business performance and other matters, and is not an integral part of the consolidated annual accounts. We have verified that the accounting information contained therein is consistent with that disclosed in the consolidated annual accounts for 2016. Our work as auditors is limited to the verification of the consolidated directors' report within the scope described in this paragraph and does not include a review of information other than that obtained from the accounting records of Banco Cooperativo Español, S.A. and subsidiaries.

KPMG Auditores, S.L.

(*Signed on original in Spanish*)

Pedro González Millán

7 April 2017

## Consolidated balance sheets at 31 December 2016 and 2015 (Notes 1 to 4)

(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails.)

| (in thousands of Euros) | NOTE | | |
|---|---|---|---|
| ASSETS | | 2016 | 2015(*) |
| **CASH, CASH BALANCES WITH CENTRAL BANKS AND OTHER DEMAND DEPOSITS (**)** | **5** | **2,024,319** | **2,510,043** |
| **1. FINANCIAL ASSETS HELD FOR TRADING** | **6** | **2,645,735** | **2,792,309** |
| 1.1. Derivatives | | 558,226 | 497,846 |
| 1.2. Equity instruments | | - | - |
| 1.3. Debt securities | | 2,087,509 | 2,294,463 |
| 1.4. Loans and advances | | - | - |
| a) Central banks | | - | - |
| b) Credit institutions | | - | - |
| c) Other debtors | | - | - |
| *Memorandum item: loaned or pledged as collateral with the right to sell or pledge* | | 1,794,856 | 2,083,853 |
| **2. FINANCIAL ASSETS DESIGNATED AT FAIR VALUE THROUGH PROFIT OR LOSS** | | **-** | **-** |
| 2.1. Equity instruments | | - | - |
| 2.2. Debt securities | | - | - |
| 2.3. Loans and advances | | - | - |
| a) Central banks | | - | - |
| b) Credit institutions | | - | - |
| c) Other debtors | | - | - |
| *Memorandum item: loaned or pledged as collateral with the right to sell or pledge* | | - | - |
| **3. AVAILABLE-FOR-SALE FINANCIAL ASSETS** | **7** | **3,988,344** | **3,828,866** |
| 3.1. Equity instruments | | 24,487 | 17,175 |
| 3.2. Debt securities | | 3,963,857 | 3,811,691 |
| *Memorandum item: loaned or pledged as collateral with the right to sell or pledge* | | 3,175,536 | 3,442,294 |
| **4. LOANS AND RECEIVABLES** | **8** | **5,274,368** | **8,142,072** |
| 4.1. Debt securities | | 33,223 | 57,819 |
| 4.2. Loans and advances | | 5,241,145 | 8,084,253 |
| a) Central banks | | - | - |
| b) Credit institutions | | 4,130,741 | 7,088,910 |
| c) Other debtors | | 1,110,404 | 995,343 |
| *Memorandum item: loaned or pledged as collateral with the right to sell or pledge* | | 29,487 | 49,145 |
| **5. HELD-TO-MATURITY INVESTMENTS** | **9** | **90,014** | **115,454** |
| *Memorandum item: loaned or pledged as collateral with the right to sell or pledge* | | 69,747 | 51,150 |
| **6. DERIVATIVES - HEDGE ACCOUNTING** | **14** | **839** | **23** |
| **7. CHANGES IN THE FAIR VALUE OF THE HEDGED ITEMS IN PORTFOLIO HEDGES OF INTEREST RATE RISK** | | **-** | **-** |
| **8. INVESTMENTS IN JOINT VENTURES AND ASSOCIATES** | | **-** | **-** |
| 8.1. Jointly controlled entities | | - | - |
| 8.2. Associates | | - | - |
| **9. ASSETS COVERED BY INSURANCE OR REINSURANCE CONTRACTS** | | **-** | **-** |
| **10. TANGIBLE ASSETS** | **10** | **15,384** | **15,298** |
| 10.1. Fixed assets | | 15,384 | 15,298 |
| a) For own use | | 15,384 | 15,298 |
| b) Leased out under operating leases | | - | - |
| 10.2. Investment property | | - | - |
| a) Of which: leased out under operating leases | | - | - |
| *Memorandum item: acquired under a finance lease* | | - | - |
| **11. INTANGIBLE ASSETS** | **11** | **1,765** | **1,410** |
| 11.1. Goodwill | | - | - |
| 11.2. Other intangible assets | | 1,765 | 1,410 |
| **12. TAX ASSETS** | | **34,150** | **34,034** |
| 12.1. Current tax assets | | 9,433 | 6,513 |
| 12.2. Deferred tax assets | | 24,717 | 27,521 |
| **13. OTHER ASSETS** | **13** | **5,261** | **3,241** |
| 13.1. Insurance contracts linked to pensions | | - | - |
| 13.2. Inventories | | - | - |
| 13.3. Other assets | | 5,261 | 3,241 |
| **14. NON-CURRENT ASSETS AND DISPOSAL GROUPS CLASSIFIED AS HELD FOR SALE** | | **-** | **-** |
| TOTAL ASSETS | | **14,080,179** | **17,442,750** |

**Notes 1 to 35and Appendices I to III to the accompanying consolidated annual accounts form an integral part of the consolidated balance sheet at 31 December 2016.**

**(*) Presented solely and exclusively for comparison purposes**

**(**) See details in the Group's consolidated cash flow statement**

## Consolidated balance sheets at 31 December 2016 and 2015 (Notes 1 to 4)

(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails.)

| (in thousands of Euros) | NOTE | | |
|---|---|---|---|
| LIABILITIES | | 2016 | 2015(*) |
| **1. FINANCIAL LIABILITIES HELD FOR TRADING** | **6** | **817,055** | **625,034** |
| 1.1. Derivatives | | 582,782 | 430,012 |
| 1.2. Short positions | | 234,273 | 195,022 |
| 1.3. Deposits | | - | - |
| a) Central banks | | - | - |
| b) Credit institutions | | - | - |
| c) Other creditors | | - | - |
| 1.4. Debt securities issued | | - | - |
| 1.5. Other financial liabilities | | - | - |
| **2. FINANCIAL LIABILITIES DESIGNATED AT FAIR VALUE THROUGH PROFIT OR LOSS** | | **4,731** | **4,731** |
| 2.1. Deposits | | 4,731 | 4,731 |
| a) Central banks | | - | - |
| b) Credit institutions | | 4,731 | 4,731 |
| c) Other creditors | | - | - |
| 2.2. Debt securities issued | | - | - |
| 2.3. Other financial liabilities | | - | - |
| *Memorandum item: subordinated liabilities* | | - | - |
| **3. FINANCIAL LIABILITIES AT AMORTISED COST** | **12** | **12,660,214** | **16,283,167** |
| 3.1. Deposits | | 12,644,811 | 16,271,811 |
| a) Central banks | | 774,299 | 4,672,671 |
| b) Credit institutions | | 6,830,747 | 6,677,190 |
| c) Other creditors | | 5,039,765 | 4,921,950 |
| 3.2. Debt securities issued | | - | - |
| 3.3. Other financial liabilities | | 15,403 | 11,356 |
| *Memorandum item: subordinated liabilities* | | - | - |
| **4. DERIVATIVES - HEDGE ACCOUNTING** | **14** | **62,570** | **49,654** |
| **5. CHANGES IN THE FAIR VALUE OF THE HEDGED ITEMS IN PORTFOLIO HEDGES OF INTEREST RATE RISK** | | **-** | **-** |
| **6. LIABILITIES COVERED BY INSURANCE OR REINSURANCE CONTRACTS** | | **-** | **-** |
| **7. PROVISIONS** | **15** | **951** | **232** |
| 7.1. Pensions and other post-employment defined benefit obligations | | - | - |
| 7.2. Other long-term employee benefits | | - | - |
| 7.3. Outstanding legal proceedings and litigation in relation to taxes | | - | - |
| 7.4. Commitments and guarantees extended | | - | - |
| 7.5. Other provisions | | 951 | 232 |
| **8. TAX LIABILITIES** | | **9,379** | **7,752** |
| 8.1. Current tax liabilities | | 765 | 1,229 |
| 8.2. Deferred tax liabilities | | 8,614 | 6,523 |
| **9. SHARE CAPITAL REPAYABLE ON DEMAND** | | **-** | **-** |
| **10. OTHER LIABILITIES** | **13** | **45,310** | **41,129** |
| **11. LIABILITIES INCLUDED IN DISPOSAL GROUPS CLASSIFIED AS HELD FOR SALE** | | **-** | **-** |
| TOTAL LIABILITIES | | **13,600,210** | **17,011,699** |

**Notes 1 to 35 and Appendices I to III to the accompanying consolidated annual accounts form an integral part of the consolidated balance sheet at 31 December 2016.**
**(*) Presented solely and exclusively for comparison purposes**

## Consolidated balance sheets at 31 December 2016 and 2015 (Notes 1 to 4)

(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails.)

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| (in thousands of Euros) | NOTE | | |
|---|---|---|---|
| **EQUITY** | | **2016** | **2015(*)** |
| **1. SHAREHOLDERS' EQUITY** | **17** | **466,068** | **421,484** |
| 1.1. Capital | | 106,957 | 99,036 |
| a) Paid-in share capital | | 106,957 | 99,036 |
| b) Called-up unpaid share capital | | - | - |
| Memorandum item: uncalled capital | | - | - |
| 1.2. Share premium | **17** | 85,972 | 85,972 |
| 1.3. Equity instruments issued other than capital | | - | - |
| a) Equity component of compound financial instruments | | - | - |
| b) Other equity instruments issued | | - | - |
| 1.5. Other equity | | - | - |
| 1.6. Retained earnings | **18** | 224,228 | 192,560 |
| 1.7. Revaluation reserves | | 4,429 | 4,430 |
| 1.8. Other reserves | | (110) | 2,127 |
| a) Accumulated reserves or losses on investments in joint ventures and associates | | - | - |
| b) Other | | (110) | 2,127 |
| 1.9. (-) Own shares | | - | - |
| 1.10. Profit attributable to the owners of the Parent | **18** | 44,592 | 37,359 |
| 1.11. (-) Interim dividends | | - | - |
| **2. ACCUMULATED OTHER COMPREHENSIVE INCOME** | **16** | **13,831** | **9,497** |
| 2.1. Items that will not be reclassified to profit or loss | | - | - |
| a) Actuarial gains or losses on defined benefit pension plans | | - | - |
| b) Non-current assets and disposal groups classified as held for sale | | | |
| c) Share of other recognised income and expense arising from investments in joint ventures and associates | | - | - |
| d) Other valuation adjustments | | - | - |
| 2.2. Items that may be reclassified to profit or loss | | - | - |
| a) Hedges of net investments in foreign operations (effective portion) | | 13,831 | 9,497 |
| b) Translation of foreign currency | | - | - |
| c) Hedging derivatives. Cash flow hedges (effective portion) | | - | - |
| d) Available-for-sale financial assets | | (728) | 8 |
| - Debt instruments | | 14,559 | 9,489 |
| - Equity instruments | | 15,263 | 10,173 |
| e) Non-current assets and disposal groups classified as held for sale | | (704) | (684) |
| f) Share of other recognised income and expense arising from investments in joint ventures and associates | | - | - |
| **3. MINORITY INTERESTS (NON-CONTROLLING INTERESTS)** | | - | - |
| 3.1. Accumulated other comprehensive income | | | |
| 3.2. Other items | | **70** | **70** |
| | | - | - |
| | | 70 | 70 |
| **TOTAL EQUITY** | | **479,969** | **431,051** |
| **TOTAL LIABILITIES AND EQUITY** | | **14,080,179** | **17,442,750** |
| ***Memorandum item*** | | | |
| **GUARANTEES EXTENDED** | **20** | **110,498** | **87,996** |
| **CONTINGENT COMMITMENTS GIVEN** | **20** | **223,861** | **180,214** |

**Notes 1 to 35and Appendices I to III to the accompanying consolidated annual accounts form an integral part of the consolidated balance sheet at 31 December 2016.**

**(*) Presented solely and exclusively for comparison purposes**

## Consolidated Income Statements for the years ended 31 December 2016 and 2015 (Notes 1 to 4)

(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails.)

| (in thousands of Euros) | NOTE | 2016 | 2015(*) |
|---|---|---|---|
| Interest income | 23 | 82,451 | 103,356 |
| (Interest expense) | 24 | (21,679) | (39,956) |
| **INTEREST MARGIN** | | **60,772** | **63,400** |
| Dividend income | 25 | 458 | 264 |
| Fee and commission income | 26 | 54,112 | 52,805 |
| (Fee and commission expense) | 27 | (39,991) | (37,391) |
| Gains or losses on derecognition of financial assets and liabilities not measured at fair value through profit or loss, net | 28 | 3,066 | 3,941 |
| Gains or losses on financial assets and liabilities held for trading, net | 28 | 10,842 | 6,992 |
| Gains or losses on financial assets and liabilities designated at fair value through profit or loss, net | | | |
| Gains or losses on hedge accounting, net | 28 | 4 | - |
| Exchange differences, net | 28 | 11 | - |
| Other operating income | 28 | 426 | 696 |
| (Other operating expenses) | | 2,786 | 2,658 |
| | | (8,008) | (9,093) |
| **GROSS MARGIN** | | **84,478** | **84,272** |
| (Administrative expenses) | | (24,041) | (22,779) |
| (Personnel expenses) | | (15,287) | (14,176) |
| (Other administrative expenses) | 29 | (8,754) | (8,603) |
| (Depreciation and amortisation) | 30 | (1,467) | (1,398) |
| (Provisions or reversals of provisions) | 10 and | (739) | (31) |
| (Impairment or reversal of impairment on financial assets not measured at fair value through profit or | 11 | | |
| loss) | 15 and | 2,799 | (7,925) |
| (Financial assets carried at cost) | 34 | (3,918) | (3,900) |
| (Available-for-sale financial assets) | | 407 | (54) |
| (Loans and receivables) | | 6,310 | (3,971) |
| (Held-to-maturity investments) | 34 | - | - |
| **RESULTS FROM OPERATING ACTIVITIES** | | **61,030** | **52,139** |
| (Impairment or reversal of impairment on investments in joint ventures or associates) | | | |
| (Impairment or reversal of impairment on non-financial assets) | | - | - |
| (Tangible assets) | | - | - |
| (Intangible assets) | | - | - |
| (Other) | | - | - |
| Gains or losses on derecognition of non-financial assets and investments, net | | - | - |
| Negative goodwill recognised in profit or loss | | - | (1) |
| Gains or losses on non-current assets and disposal groups classified as held for sale not qualifying as discontinued operations | | - | - |
| | | (1) | - |
| **PROFIT OR LOSS BEFORE TAX FROM CONTINUING OPERATIONS** | | **61,029** | **52,138** |
| Income tax expense or income related to profit or loss from continuing operations | | 16,438 | 14,781 |
| **PROFIT OR LOSS AFTER TAX FROM CONTINUING OPERATIONS** | | **44,591** | **37,357** |
| Profit or loss after tax from discontinued operations | | - | - |
| **PROFIT FOR THE YEAR** | | **44,591** | **35,357** |
| Attributable to minority interests (non-controlling interests) | | (1) | (2) |
| Attributable to the owners of the Parent | | 44,592 | 37,359 |
| **EARNINGS PER SHARE (EUROS)** | | | |
| Basic | | - | - |
| Diluted | | - | - |

**Notes 1 to 35 and Appendices I to III to the accompanying consolidated annual accounts form an integral part of the consolidated income statement for 2016.**
**(*) Presented solely and exclusively for comparison purposes**

**CONSOLIDATED STATEMENT OF RECOGNISED INCOME AND EXPENSE**
**for the years ended 31 December 2016 and 2015 (Notes 1 to 4)**

(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails.)

| (in thousands of Euros) | NOTE | 2016 | 2015(*) |
|---|---|---|---|
| **PROFIT FOR THE YEAR** | | **44,591** | **37,357** |
| **OTHER COMPREHENSIVE INCOME** | | **4,334** | **(9,449)** |
| Items that will not be reclassified to profit or loss | | - | - |
| Actuarial gains or losses on defined benefit pension plans | | - | - |
| Non-current assets and disposal groups held for sale | | - | - |
| Share of other recognised income and expense arising from investments in joint ventures and associates | | - | - |
| Income tax on items that will not be reclassified | | - | - |
| Items that may be reclassified to profit or loss | 17 | 6,167 | (13,498) |
| Hedges of net investments in foreign operations (effective portion) | | - | - |
| Valuation gains or losses recognised in equity | | - | - |
| Amounts transferred to profit or loss | | - | - |
| Other reclassifications | | - | - |
| Translation of foreign currency | | - | - |
| Exchange gains or losses recognised in equity | | - | - |
| Amounts transferred to profit or loss | | - | - |
| Other reclassifications | | - | - |
| Cash flow hedges (effective portion) | | (1,052) | 11 |
| Valuation gains or losses recognised in equity | | (1,052) | 11 |
| Amounts transferred to profit or loss | | - | - |
| Amounts transferred to the initial carrying amount of hedged items | | - | - |
| Other reclassifications | | - | - |
| Available-for-sale financial assets | | 7,219 | (13,509) |
| Valuation gains or losses recognised in equity | | 10,287 | (9,357) |
| Amounts transferred to profit or loss | | (3,068) | (4,152) |
| Other reclassifications | | - | - |
| Non-current assets and disposal groups held for sale | | - | - |
| Valuation gains or losses recognised in equity | | - | - |
| Amounts transferred to profit or loss | | - | - |
| Other reclassifications | | - | - |
| Share of other recognised income and expense arising from investments in joint ventures and associates | | - | - |
| Income tax on items that may be reclassified to profit or loss | 17 | (1,833) | 4,049 |
| **TOTAL COMPREHENSIVE INCOME FOR THE YEAR** | | **48,925** | **27,908** |
| Attributable to minority interests (non-controlling interests) | | (1) | (2) |
| Attributable to the owners of the Parent | | 48,926 | 27,910 |

**Notes 1 to 35 and Appendices I to III to the accompanying consolidated annual accounts form part of the consolidated statement of recognised income and expense at 31 December 2016.**
**(*) Presented solely and exclusively for comparison purposes**

## CONSOLIDATED STATEMENTS OF TOTAL CHANGES IN EQUITY for the years ended 31 December 2016 and 2015 (Notes 1 to 4)

(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails.)

| Source of changes in equity | Capital | Share premium | Equity instruments issued other than capital | Other equity | Retained earnings | Revaluation reserves | Other reserves | Own shares | Profit attributable to the owners of the Parent | Interim dividends | Accumulated other comprehensive income | Minority interests | | TOTAL |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | | | | | Accumulated other comprehensive income | Other items | |
| 1. Opening balance 31/12/2015 (*) | **99,036** | **85,972** | **-** | **-** | **192,560** | **4,430** | **2,127** | **-** | **37,359** | **-** | **9,497** | **-** | **70** | **431,051** |
| 1.1 Effects of correction of errors | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| 1.2 Effects of changes in accounting policies | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| 2. Opening balance 31/12/2015 (*) | **99,036** | **85,972** | **-** | **-** | **192,560** | **4,430** | **2,127** | **-** | **37,359** | **-** | **9,497** | **-** | **70** | **431,051** |
| 3. Total comprehensive income for the year | - | - | - | - | - | - | - | - | 44,592 | - | 4,334 | - | (1) | 48,925 |
| 4. Other changes in equity | **7,921** | **-** | **-** | **-** | **31,668** | **(1)** | **(2,337)** | **-** | **(37,359)** | **-** | **-** | **-** | **-** | **(8)** |
| 4.1 Issuance of ordinary shares | 7,921 | - | - | - | (7,921) | - | - | - | - | - | - | - | - | - |
| 4.2 Issuance of preference shares | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| 4.3 Issuance of other equity instruments | | | | | | | | | | | | | | |
| 4.4 Conversion of debt to equity | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| 4.5 Capital reduction | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| 4.6 Dividends (or shareholder remuneration) (**) | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| 4.7 Purchase of own shares | - | - | - | - | (8) | - | - | - | - | - | - | - | - | (8) |
| 4.8 Sale or cancellation of own shares | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| 4.9 Reclassification of financial instruments from equity to liabilities | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| 4.10 Reclassification of financial instruments from liabilities to equity (***) | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| 4.11 Transfers between equity line items | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| 4.12 Increase or decrease in equity due to business combinations | - | - | - | - | 39,597 | (1) | (2,337) | - | (37,359) | - | - | - | - | - |
| 4.13 Share-based payments (****) | | | | | | | | | | | | | | |
| 4.14 Other increases or (decreases) in equity | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| 5. Closing balance 31/12/2016 | - | - | **-** | - | - | - | - | - | - | - | - | - | - | - |
| | **106,957** | **85,972** | - | **-** | **224,228** | **4,429** | **(110)** | **-** | **44,592** | **-** | **13,831** | **-** | **69** | **479,968** |

**(*) Presented solely and exclusively for comparison purposes (see note 1.4)**
**Notes 1 to 35 and Appendices I to III to the accompanying consolidated annual accounts form part of the consolidated statement of total changes in equity at 31 December 2016.**
**Unless stated otherwise, details of the main movements in shareholders' equity are provided in note 25 to the consolidated annual accounts.**
**The consolidated statement of recognised income and expense and the consolidated statement of total changes in equity of Banco Cooperativo Español make up the statement of changes in equity.**
**(**) See note 3. Proposed distribution of Profit and Earnings per Share.**
**(***) Primarily includes the distribution of profit for the year.**
**(****) See note 35 Administrative expenses. Personnel expenses.**

**CONSOLIDATED STATEMENTS OF TOTAL CHANGES IN EQUITY for the years ended 31 December 2015 and 2014 (Notes 1 to 4)**

(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails.)

| Source of changes in equity | Capital | Share premium | Equity instruments issued other than capital | Other equity | Retained earnings | Revaluation reserves | Other reserves | Own shares | Profit attributable to the owners of the Parent | Interim dividends | Accumulated other comprehensive income | Minority interests | | TOTAL |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | | | | | Accumulated other comprehensive income | Other items | |
| 1. Opening balance 31/12/2014 (*) | **91,009** | **85,972** | **-** | **-** | **154,130** | **4,431** | **2,275** | **-** | **46,321** | **-** | **18,945** | **-** | **159** | **403,243** |
| 1.1 Effects of correction of errors | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| 1.2 Effects of changes in accounting policies | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| 2. Opening balance 31/12/2014 (*) | **91,009** | **85,972** | **-** | **-** | **154,130** | **4,431** | **2,275** | **-** | **46,321** | **-** | **18,945** | **-** | **159** | **403,243** |
| 3. Total comprehensive income for the year | - | - | - | - | - | - | - | - | 37,359 | - | (9,448) | - | (2) | 27,909 |
| 4. Other changes in equity | **8,027** | **-** | **-** | **-** | **38,429** | **(1)** | **(149)** | **-** | **(46,321)** | **-** | **-** | **-** | **(87)** | **(102)** |
| 4.1 Issuance of ordinary shares | 8,027 | - | - | - | (8,027) | - | - | - | - | - | - | - | - | - |
| 4.2 Issuance of preference shares | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| 4.3 Issuance of other equity instruments | | | | | | | | | | | | | | |
| 4.4 Conversion of debt to equity | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| 4.5 Capital reduction | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| 4.6 Dividends (or shareholder remuneration) (**) | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| 4.7 Purchase of own shares | - | - | - | - | (15) | - | - | - | - | - | - | - | (87) | (102) |
| 4.8 Sale or cancellation of own shares | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| 4.9 Reclassification of financial instruments from equity to liabilities | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| 4.10 Reclassification of financial instruments from liabilities to equity (***) | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| 4.11 Transfers between equity line items | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| 4.12 Increase or decrease in equity due to business combinations | - | - | - | - | 46,471 | (1) | (149) | - | (46,321) | - | - | - | - | - |
| 4.13 Share-based payments (****) | | | | | | | | | | | | | | |
| 4.14 Other increases or (decreases) in equity | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| 5. Closing balance 31/12/2015 | | | | | | | | | | | | | | |
| | - | - | **-** | - | - | - | - | - | - | - | - | - | - | - |
| | **99,036** | **85,972** | - | **-** | **192,560** | **4,430** | **2,127** | **-** | **37,359** | **-** | **9,497** | **-** | **70** | **431,051** |

**Notes 1 to 35 and Appendices I to III to the accompanying consolidated annual accounts form part of the consolidated statement of total changes in equity at 31 December 2016.**
**Unless stated otherwise, details of the main movements in shareholders' equity are provided in note 25 to the consolidated annual accounts.**
**The consolidated statement of recognised income and expense and the consolidated statement of total changes in equity of Banco Cooperativo Español make up the statement of changes in equity.**
**(**) See note 3. Proposed distribution of Profit and Earnings per Share.**
**(***) Primarily includes the distribution of profit for the year.**
**(****) See note 35 Administrative expenses. Personnel expenses.**

**CONSOLIDATED CASH FLOW STATEMENTS**
**for the years ended 31 December 2016 and 2015 (Notes 1 to 4)**

(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails.)

| (in thousands of Euros) | 2016 | 2015(*) |
|---|---|---|
| **CASH FLOWS USED IN OPERATING ACTIVITIES** | **(148,256)** | **(60,530)** |
| Profit for the year | 44,591 | 37,357 |
| Adjustments to obtain cash flows from operating activities | 15,106 | 24,104 |
| Depreciation and amortisation | 1,467 | 1,398 |
| Other adjustments | 13,639 | 22,706 |
| Net increase/decrease in operating assets | 3,224,153 | 2,526,351 |
| Financial assets held for trading | 146,574 | 863,795 |
| Financial assets designated at fair value through profit or loss | - | - |
| Available-for-sale financial assets | (155,144) | 71,977 |
| Loans and receivables | 3,233,538 | 1,590,602 |
| Other operating assets | (815) | (23) |
| Net increase/decrease in operating liabilities | (3,418,016) | (2,623,345) |
| Financial liabilities held for trading | 192,021 | 70,515 |
| Financial liabilities designated at fair value through profit or loss | - | - |
| Financial liabilities at amortised cost | (3,622,953) | (2,710,183) |
| Other operating liabilities | 12,916 | 16,323 |
| Income tax received/paid | (14,090) | (24,997) |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | **21,395** | **11,177** |
| Payments | (4,044) | (17,357) |
| Tangible assets | (682) | (367) |
| Intangible assets | (1,226) | (667) |
| Investments in joint ventures and associates | - | - |
| Subsidiaries and other business units | - | - |
| Non-current assets and liabilities classified as held for sale | (1) | - |
| Held-to-maturity investments | - | - |
| Other payments relating to investing activities | (2,135) | (16,323) |
| Receipts | 25,439 | 28,534 |
| Tangible assets | - | - |
| Intangible assets | - | - |
| Investments in joint ventures and associates | - | - |
| Subsidiaries and other business units | - | - |
| Non-current assets and liabilities classified as held for sale | - | - |
| Held-to-maturity investments | 25,439 | 28,534 |
| Other receipts relating to investing activities | - | - |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | **4,172** | **12,267** |
| Payments | (9) | (102) |
| Dividends (**) | (9) | (102) |
| Subordinated liabilities | - | - |
| Redemption of own equity instruments | - | - |
| Acquisition of own equity instruments (**) | - | - |
| Other payments relating to financing activities | - | - |
| Receipts | 4,181 | 12,369 |
| Subordinated liabilities | - | - |
| Issuance of own equity instruments | - | - |
| Disposal of own equity instruments (**) | - | - |
| Other receipts relating to financing activities | 4,181 | 12,369 |
| **EFFECT OF EXCHANGE RATE FLUCTUATIONS** | **-** | **-** |
| **NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS** | **(122,689)** | **(37,086)** |
| **CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR** | **229,485** | **266,571** |
| **CASH AND CASH EQUIVALENTS AT YEAR END** | **106,796** | **229,485** |
| **MEMORANDUM ITEM** | | |
| **COMPOSITION OF CASH AND CASH EQUIVALENTS AT YEAR END** | | |
| Cash | 748 | 843 |
| Cash equivalents in central banks | 106,048 | 228,642 |
| Other financial assets | - | - |
| Less: bank overdrafts repayable on demand | - | - |
| **Total cash and cash equivalents at year end** | **106,796** | **229,485** |
| ***Of which: held by Group entities but not available to the Group*** | | |

**Notes 1 to 35 and Appendices I to III to the accompanying consolidated annual accounts form part of the consolidated cash flow statement at 31 December 2016.**
**(*) Presented solely and exclusively for comparison purposes**
**(**) See the consolidated statement of changes in equity**

## 1. Introduction, Basis of Presentation, Consolidation Principles and Other Information

### *a) Introduction*

Banco Cooperativo Español, S.A. (hereinafter the Bank or the Entity) is a private-law entity subject to the rules and regulations applicable to banks operating in Spain.

The Bank was incorporated on 31 July 1990. The share capital of the Bank is held by 38 Spanish credit cooperatives and a German bank. The Bank operates from two offices in Madrid.

The Bank contributes to the Credit Institution Deposit Guarantee Fund regulated by Royal Decree-Law 16/2011 of 14 October 2011). It has also been entered in the Bank of Spain's Special Registry of Banks and Bankers with number 0198.

The Bank is the parent company of a group of financial institutions that engage in various business activities, which it controls directly or indirectly and with which it forms the Banco Cooperativo Español Group (hereinafter the Group). After harmonisation of accounting principles, adjustments and consolidation eliminations, the Bank represents 99.8% of the Group's total assets at 31 December 2016 and 2015. It is therefore obliged to prepare the Group's consolidated annual accounts, in addition to its own individual annual accounts.

The balance sheets of Banco Cooperativo Español, S.A at 31 December 2016 and 2015 and the corresponding income statements, statements of recognised income and expense, statements of changes in equity and statements of cash flows for the years then ended are presented in Appendix I.

### *b) Basis of presentation of the consolidated annual accounts*

The consolidated annual accounts of the Bank and its subsidiaries have been prepared in accordance with the International Financial Reporting Standards adopted by the European Union (hereinafter EU-IFRS), taking into consideration Bank of Spain Circular 4/2004 of 22 December 2004 and subsequent amendments.

As permitted by IAS 1.81, the Group has opted to present separate statements, one displaying the components of consolidated profit or loss, entitled the "consolidated income statement", and another reflecting the components of other comprehensive income for the year, based on the consolidated profit or loss for the year, entitled the "consolidated statement of recognised income and expense", using the name given by Bank of Spain Circular 4/2004.

The Group's consolidated annual accounts have been prepared by the Bank's directors to present fairly the consolidated equity and consolidated financial position at 31 December 2016 as well as the results of its consolidated operations and consolidated cash flows for the year then ended.

These consolidated annual accounts have been prepared on the basis of the individual accounting records of the Entity and each of the subsidiaries which, together with the Entity, form the Group.

The consolidated annual accounts include certain adjustments and reclassifications necessary to harmonise the accounting and presentation criteria used by the companies forming the Group with those used by the Entity. The directors of the Entity consider that the consolidated annual accounts for 2016 and the individual accounts of the Bank and the subsidiaries will be approved by the shareholders at their respective annual general meetings with no significant changes.

The consolidated annual accounts for 2015 were approved by the shareholders at the annual general meeting held on 25 May 2016.

### c) *Significant accounting principles*

The generally accepted accounting principles and measurement criteria described in the note on "significant accounting principles were applied" in the preparation of the consolidated annual accounts. There are no mandatory accounting principles which have not been applied that would have a significant effect on preparation of the consolidated annual accounts.

In early 2016 the following amendments to IFRS and the related interpretations (IFRIC) came into force, with no significant impact on the accompanying consolidated financial statements of the Group:

- Amendments to IFRS 11 Joint Arrangements: Disclosures. The amendments to IFRS 11 introduce guidance on accounting for acquisitions of interests in joint operations in which the activity constitutes a business, stipulating that such interests should be accounted for applying the principles provided in IFRS 3 Business Combinations.

- Amendments to IAS 16 Property, Plant and Equipment and IAS 38 Intangible Assets. In general the amendments to IAS 16 and IAS 38 exclude revenue-based methods from the methods of depreciation and amortisation. This is because, bar highly exceptional cases, such methods do not reflect the entity's expected consumption of economic benefits.

- Amendments to IAS 27 Consolidated and Separate Financial Statements. The amendments to IAS 27 allow entities to use the equity method to account for their investments in subsidiaries, joint ventures and associates in their separate financial statements.

- The Annual Improvements to IFRSs 2012-2014 cycle introduces minor amendments to and clarifications of IFRS 5 Non-current Assets Held for Sale and Discontinued Operations, IFRS 7 Financial Instruments: Disclosures, IAS 19 Employee Benefits and IAS 34 Interim Financial Reporting.

- Amendments to IAS 1 Presentation of Financial Statements. The amendments to IAS 1 are designed to further encourage companies to apply professional judgement in determining what information to disclose in their financial statements, which line items should be disaggregated and which additional headings and subtotals should be included in the statement of financial position, the income statement and the statement of comprehensive income for the period, and in determining where and in what order information is presented in the financial disclosures.

- Amendments to IFRS 10 Consolidated Financial Statements, IFRS 12 Disclosure of Interests in Other Entities and IAS 28 Investments in Associates and Joint Ventures, which clarify the requirements for accounting for investment entities, in three aspects specifically:

  - A parent which is also a subsidiary of an investment entity may avail of the exemption from presenting consolidated financial statements.

- An investment entity which has a subsidiary that is not an investment entity and whose main purpose is to support the investment activities of its parent, by rendering services or performing activities related to the investment activity of the parent or third parties, must consolidate that subsidiary. However, the parent must account for that subsidiary at fair value through profit or loss if it is an investment entity.

- When applying the equity method, a non-investment entity investor must retain the fair value measurement applied by an associate or joint venture that is an investment entity to its interests in subsidiaries.

Standards and interpretations issued but not yet in force at 31 December 2016. At the date of authorisation of the accompanying consolidated financial statements, new International Financial Reporting Standards and interpretations thereof had been published, but were not mandatory at 31 December 2016. Although in some cases the IASB permits early application of the amendments, the Group has not yet introduced these, as it is currently analysing the impact they will have.

- IFRS 9 Financial Instruments. On 24 July 2014, the IASB issued IFRS 9, which will replace IAS 39 in the future and includes requirements for classification and measurement of financial assets and liabilities, impairment of financial assets, and hedge accounting. The classification of financial assets will depend on the entity's business model in which they are managed and the contractual cash flow characteristics. As a result, financial assets will be measured at amortised cost, at fair value through equity, or at fair value through profit or loss. The combined effect of applying the business model and the contractual cash flow characteristics may result in differences in the population of financial assets measured at amortised cost or at fair value with respect to IAS 39, although the Group does not expect any relevant changes to arise. The classification categories proposed in IFRS 9 for financial liabilities are similar to those already stipulated in IAS 39. As a result, there should be no significant differences, except for the requirement to recognise changes in fair value relating to own credit risk as a component of equity in the case of financial liabilities measured using the fair value option.

  The impairment requirements shall apply to financial assets measured at amortised cost and at fair value through equity, as well as to lease agreements and certain loan commitments and financial guarantee contracts. On initial recognition, a provision must be recognised for expected losses derived from impairment events that could arise within the coming 12 months ("12-month expected credit losses"). In the event of a significant increase in credit risk, a provision must be recognised for all possible impairment events expected to occur throughout the life of the financial instrument ("lifetime expected credit losses"). Credit risk must be assessed, for each reporting period, to determine any significant increases therein since initial recognition, considering variations in the risk of default over the remaining life of the financial instrument. The assessment of credit risk, and the estimation of expected credit losses, must result in a weighted and unbiased estimate, and must encompass all available information relevant to the assessment, including information on past events, current conditions, and reasonable and supportable forecasts of future events and economic conditions at the reporting date. The objective, therefore, is for the recognition and measurement of impairment to be more forward-looking and prospective than under the current incurred loss model of IAS 39. In principle, total impairment provisions look set to increase, inasmuch as all financial assets must have at least an associated provision for 12-month expected credit losses and the population of financial assets requiring a provision for lifetime expected credit losses is forecast to be greater than that for which there is objective evidence of impairment under IAS 39.

  The general hedge accounting requirements will also entail changes, as the approach of this standard differs to that of IAS 39 in force, in that it seeks to align hedge accounting more closely with risk management activities. Moreover, IFRS 9 will enable hedge accounting to be applied to a wider range of risks and hedging instruments. The standard does not address the accounting of so-called macro hedges. So as to avoid any conflicts between the present accounting model for macro hedges and the new general hedge accounting regime, IFRS 9 includes an accounting policy option whereby an entity may continue to apply hedge accounting as per IAS 39.

The IASB has established 1 January 2018 as the mandatory application date for IFRS 9, although entities may choose to apply the standard before then.

In 2015 and 2016, the Group analysed this new standard and the implications it will have in 2018 in terms of portfolio classification and the financial instrument measurement models, particularly those for calculating impairment of financial assets using expected loss models.

In 2017, the Group will continue to work on defining the accounting policies and implementing the standard, which will affect the consolidated financial statements, as well as operations (risk acceptance and monitoring, changes in systems, management metrics, etc.) and, ultimately, the presentation formats for the consolidated financial statements.

At the date on which the accompanying consolidated financial statements were authorised for issue, the quantitative impact of the entry into force of this standard at 1 January 2018 had not been estimated. The Group expects to obtain an estimate of this impact during 2017, enabling it to present the definitive figures at the date of first-time application of the standard and the corresponding comparison with the prior year.

- Amendments to IFRS 7 Financial Instruments. Disclosures. The IASB amended IFRS 7 in December 2011 to introduce new disclosure requirements relative to financial instruments, which entities must present in the year of first-time application of IFRS 9.

  The amendments introduce two options for addressing concerns that the financial statements of issuers of insurance contracts could be difficult to understand if IFRS 9 is applied before the forthcoming insurance contracts standard:

  - Overlay approach: an option for all issuers of insurance contracts within the scope of IFRS 4 to reclassify from profit or loss to other comprehensive income an amount equal to the difference between the amount reported in profit or loss for the year applying IFRS 9 and the amount that would have been reported under IAS 39. The financial assets eligible for this approach must be contracts that fall within the scope of IFRS 4 that are measured at fair value through profit or loss applying IFRS 9, and which would not have been measured at fair value through profit or loss had IAS 39 been applied. A company can choose to apply the overlay approach only when it first applies IFRS 9.

  - Temporary exemption: an optional temporary exemption from IFRS 9 for companies whose activity is predominantly the issuance of insurance contracts within the scope of IFRS 4, until the earlier of the application of the forthcoming insurance contracts standard or 1 January 2021. A company is required to assess whether its activity is predominantly the issuance of insurance contracts within the scope of IFRS 4 at the end of the last annual reporting period immediately before 1 April 2016, and the temporary exemption shall apply to annual periods beginning on or after 1 January 2018, i.e. as of the mandatory application date for IFRS 9.

- IFRS 15 Revenue from Contracts with Customers. IFRS 15 specifies the principles that an entity must apply to account for revenues and cash flows from contracts for the sale of goods or services to its customers. Under this standard, an entity must recognise revenues from a customer contract when it has satisfied its obligation by transferring goods or services to a customer, in accordance with the terms of that contract. Goods and services are considered to have been transferred when the customer obtains control thereof. The amount of revenue recognised is the amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

IFRS 15 replaces IAS 18 Revenue, IAS 11 Construction Contracts, IFRIC 13 Customer Loyalty Programmes, IFRIC 15 Agreements for the Construction of Real Estate, IFRIC 18 Transfers of Assets from Customers and SIC 31 Revenue - Barter Transactions Involving Advertising Services.

This standard will be effective for annual periods beginning on or after 1 January 2018, although early application is permitted.

IFRS 15 - Clarifications to IFRS 15 Revenue from Contracts with Customers. The amendments to IFRS 15 clarify how certain principles of the new standard are to be applied. Specifically:

- How to identify a performance obligation (a promise to transfer goods or services to a customer) in a contract;

- How to determine whether an entity is acting as a principal (the supplier of the goods or services) or an agent (it arranges for the other party to transfer those goods or services); and

- How to determine whether revenue from granting a licence should be recognised at a point in time or over time.

Two amendments are also included to reduce the cost and complexity of first-time application of the new standard. These amendments will be effective as of the same date as IFRS 15, i.e. for annual periods beginning on or after 1 January 2018, although early application is permitted.

- Amendments to IFRS 10 Consolidated Financial Statements and IAS 28 Investments in Associates and Joint Ventures. The amendments to IFRS 10 and IAS 28 provide that when an entity sells or contributes assets that constitute a business (including its consolidated subsidiaries) to one of its associates or joint ventures, the latter entities must recognise the resulting gain or loss in full. However, if the assets sold or contributed do not constitute a business, the gains or losses are to be recognised only in proportion to the stake held in the associate or joint venture by other investors not related to the entity.

  These amendments will be effective for annual periods beginning on or after the date of entry into force, which has yet to be determined, although early application is permitted.

- Amendments to IAS 12 Income Taxes. Recognition of Deferred Tax Assets for Unrealised Losses. The amendments to IAS 12 clarify the requirements on recognition of deferred tax assets for unrealised losses on debt instruments measured at fair value. Specifically, the following aspects are clarified:

  - An unrealised loss on a debt instrument measured at fair value shall give rise to a deductible temporary difference, irrespective of whether the holder expects to recover the carrying amount through the sale of the instrument or by holding it to maturity.

  - The entity shall assess the utilisation of a deductible temporary difference in combination with other deductible temporary differences. If tax law restricts the utilisation of losses, the entity shall assess their utilisation in combination with other temporary differences of the appropriate type.

  - The estimate of future taxable profit may include the recovery of assets for more than their carrying amount if there is sufficient evidence that it is probable that the asset will be recovered in such an amount.

- The estimate of future taxable profit excludes tax deductions resulting from the reversal of deductible temporary differences.

  These amendments will be effective for annual periods beginning on or after 1 January 2017, although early application is permitted.

- IFRS 16 Leases. On 13 January 2016, the IASB issued IFRS 16, which will replace IAS 17 Leases. The new standard introduces a single lessee accounting model and requires a lessee to recognise assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. A lessee is required to recognise a right-of-use asset representing its right to use the underlying leased asset and a lease liability representing its obligation to make lease payments.

  IFRS 16 substantially carries forward the lessor accounting requirements in IAS 17. Accordingly, a lessor continues to classify its leases as operating leases or finance leases, and to account for those two types of leases differently.

  This standard will be effective for annual periods beginning on or after 1 January 2019, although earlier application is permitted for entities that apply IFRS 15.

- IAS 7 Statement of Cash Flows. Disclosure initiative.

  The amendments to IAS 7 introduce new disclosure requirements in relation to changes in liabilities arising from financing activities, such that users of financial statements are able to evaluate the changes in those liabilities. These are as follows: changes from financing cash flows; changes arising from obtaining or losing control of subsidiaries or other businesses; the effect of changes in foreign exchange rates; changes in fair values; and other changes.

  Liabilities arising from financing activities are liabilities for which cash flows were, or future cash flows will be, classified in the statement of cash flows as cash flows from financing activities. In addition, the disclosure requirements also apply to changes in financial assets if cash flows from those financial assets were, or future cash flows will be, included in cash flows from financing activities.

  These amendments will be effective for annual periods beginning on or after 1 January 2017, although early application is permitted.

- IFRS 2 Classification and measurement of share-based payment transactions.

  The amendments to IFRS 2 stipulate the requirements for three aspects:

  - In the fair value measurement of a cash-settled share-based payment, vesting conditions that differ from market vesting conditions shall only be taken into consideration to adjust the number of shares to be included in the transaction amount.

  - When, in a transaction that would be described as an equity-settled share-based payment, an entity withholds a number of equity instruments equal to the monetary value of the statutory withholding tax obligation, the entire transaction shall be classified as an equity-settled share-based payment.

  - When a cash-settled share-based payment is reclassified as an equity-settled share-based payment, this modification shall be accounted for by derecognising the original liability and recognising in equity the fair value of the equity instruments awarded, for which goods or services have been received at the modification date. Any differences shall be recognised immediately in profit or loss.

These amendments will be effective for annual periods beginning on or after 1 January 2018, although early application is permitted.

All obligatory accounting principles and measurement criteria with a significant effect on the consolidated annual accounts have been applied.

### *d) Judgements and estimates used*

In the Group's consolidated annual accounts for 2016 senior management of the Group made estimates, which were later ratified by the directors, in order to quantify certain of the assets, liabilities, income, expenses and commitments reported herein. These estimates relate basically to the following:

- The impairment losses on certain assets (notes 7 ,8 and 9)
- The assumptions used in the actuarial calculation of post-employment benefit liabilities and commitments (note 2 n)
- The useful lives of tangible and intangible assets (notes 10 and 11)
- The fair value of certain financial assets not quoted on official markets (notes 6 and 7)
- Estimates used in the calculation of other provisions (note 15)
- Calculation of income tax and deferred tax assets and liabilities (note 19).

The above-mentioned estimates are based on the best information available at 31 December 2016 regarding the analysed events. However, events arising in the future could require these estimates to be significantly increased or decreased in coming years. Any required updates would be made prospectively in accordance with EU-IFRS, recognising the effect of the change in estimates in the consolidated income statement in the year in which they arose.

### *e) Consolidation principles*

The following accounting principles and measurement criteria, which reflect those set out in EU-IFRS, have been used in the preparation of the consolidated annual accounts of the Group for 2016:

I. Subsidiaries

Subsidiaries are those entities over which the Bank has control. An entity controls an investee when the investor is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

To be considered a subsidiary, the following must occur:

- Power: An investor has power over an investee when the investor has existing rights that give it the current ability to direct the relevant activities, i.e. the activities that significantly affect the investee's returns.

- Returns: An investor is exposed, or has rights, to variable returns from its involvement with the investee when the investor's returns from its involvement have the potential to vary as a result of the investee's performance. The investor's returns can be only positive, only negative or wholly positive and negative.

- Link between power and returns: An investor controls an investee if the investor not only has power over the investee and exposure or rights to variable returns from its involvement with the investee, but also has the ability to use its power to affect the investor's returns from its involvement with the investee.

The annual accounts of the subsidiaries are fully consolidated with those of the Bank. Accordingly, all material balances and transactions between consolidated entities and between consolidated entities and the Bank are eliminated on consolidation.

On acquisition of a subsidiary, its assets, liabilities and contingent liabilities are recognised at fair value at the date of acquisition. Any positive differences between the acquisition cost and the fair values of the identifiable net assets acquired are recognised as goodwill. Negative differences are charged to the income statement on the date of acquisition.

Third-party interests in the Group's equity are presented under "Minority interests" in the consolidated balance sheet and their share of the profit or loss for the year is presented under "Profit/(loss) attributable to minority interests" in the consolidated income statement.

The results of subsidiaries acquired during the year are included in the consolidated income statement from the date of acquisition to year end.

II. Interests in joint ventures

"Joint ventures" are deemed to be ventures that are not subsidiaries but which are jointly controlled by two or more unrelated entities. This is evidenced by contractual arrangements whereby two or more entities ("venturers") undertake a business activity which is subject to joint control so as to share the power to govern the financial and operating policies of an entity, or another business activity, in order to benefit from its operations. Therefore, any strategic financial or operating decision affecting the joint venture requires the unanimous consent of the venturers.

The financial statements of investees classified as joint ventures are proportionately consolidated with those of the Bank and, therefore, the aggregation of balances and subsequent eliminations are carried out only in proportion to the Group's ownership interest in the capital of these entities.

III. Associates

Associates are entities over which the Bank is in a position to exercise significant influence – but not control or joint control – usually because it holds 20% or more of the voting rights of the investee.

In the consolidated annual accounts, investments in associates are accounted for using the equity method, i.e. reflecting the Group's share of the investee's net assets, after taking into account the dividends received therefrom and other equity eliminations. In the case of transactions with an associate, the related profits or losses are eliminated to the extent of the Group's interest in the associate.

Relevant information on subsidiaries and associates is shown in Appendix II.

On 26 September 2014 the Bank acquired a 100% interest in the company Espiga Asesoramiento Sociedad Limitada, subsequently transferring 100% of this investment for an amount of Euros 3 thousand on 7 May 2015.

### *f) Comparative information*

The Group's consolidated annual accounts at 31 December 2016 have been prepared in accordance with the presentation formats stipulated by Spanish National Securities Market Commission (CNMV) Circular 5/2014 the purpose of which is to bring the content of the public financial information of credit institutions into line with the mandatory terminology and format for the financial statements required under European Union legislation applicable to credit institutions.

The information for the year ended 31 December 2015 included in the accompanying consolidated annual accounts for the year ended 31 December 2016 is presented solely for comparison purposes. Presentation of the consolidated financial statements in these new formats does not have a significant impact with respect to the format applied in the consolidated financial statements included in the annual accounts for the year ended 31 December 2015.

The main reclassification for presentation purposes was in balance sheet assets, specifically demand deposits at credit institutions. These have been reclassified from “Loans and receivables” to “Cash, cash balances with central banks and other demand deposits” in an amount of Euros 2,280,559 thousand at 31 December 2015 (Euros 3,845,157 thousand at 1 January 2015). Reclassifications between other line items of the annual accounts were not significant.

### *g) Capital management objectives, policies and processes*

Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms entered into force on 1 January 2014, together with European Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and their prudential supervision. These two texts transpose into European regulations the new capital adequacy standards known as BIS III, regulating solvency levels and the composition of the eligible capital that credit institutions must hold.

The new regulations impose more stringent capital adequacy requirements and, to prevent this reinforcement of solvency from having an excessively large impact on the real economy, the entry into force of certain aspects of the regulations will be phased in over several years. This transitory implementation phase mainly affects the definition of eligible capital, including any potential deductions, as well as the creation of capital buffers in excess of the minimum regulatory levels.

Banco de España published Circular 2/2014 of 31 January 2014 on various regulatory alternatives provided for in Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions, which was subsequently amended by Banco de España Circular 3/2014 of 30 July 2014. The Circular aims to establish which of the Regulation's alternatives available to national authorities must be complied with by consolidable groups of credit institutions and Spanish credit institutions immediately following the entry into force of the new solvency regulatory framework and their scope of application.

In addition, Law 10/2014 of 26 June 2014 on the organisation, supervision and solvency of credit institutions was published in 2014 with the main aim of adapting Spanish legislation to regulatory changes at EU and international level, continuing the transposition initiated in Royal Decree 14/2013 of 29 November 2013. This legislation combines the main organisational and disciplinary regulations for credit institutions in a single text.

Royal Decree 84/2015 of 13 February 2015, developing Law 10/2014, was published in 2015. It aims not only to complete the regulatory development of the aforementioned Law but also to combine in a single text all regulations pertaining to organisational and disciplinary regulations for credit institutions. To this end, the provisions regarding credit institutions contained in Royal Decree 216/2008 of 15 February 2008 on capital of financial institutions, which should continue to apply following the entry into force of Regulation (EU) No. 575/2013 and the provisions of Royal Decree 1245/1995 of 14 July 1995 on the formation of banks, cross-border activity and other issues relating to the legal regime for credit institutions, have been combined in a single text.

Banco de España Circular 2/2016 of 2 February 2016 on supervision and solvency was published on 9 February 2016 and completes the adaptation of Spanish legislation to Directive 2013/36/EU and Regulation (EU) No. 575/2013, with respect to the alternatives not addressed in Banco de España Circulars 2/2014 and 3/2014. Circular 2/2016 develops certain aspects of the transposition of Directive 2011/89/EU of the European Parliament and of the Council of 16 November 2011 as regards additional supervision by the competent authority, which may be the European Central Bank or Banco de España depending on the assignment and distribution of competencies established in Regulation (EU) No. 1024/2013, which is completed by Regulation (EU) No. 468/2014 of 16 April 2014 of the European Central Bank.

All of the above constitute the legislation which regulates the minimum capital requirements of Spanish credit institutions, how such capital should be determined, the different capital self-assessment processes to be implemented by the institutions and the public information these institutions should submit to the market.

The capital management principle established by the Bank's board of directors consists of operating at a level of solvency above that stipulated in the applicable regulations, and which is appropriate to the risks inherent in its business and the environment in which it operates. The objective is to maximise capital management efficiency so that capital consumption can be considered, alongside other return and risk variables, as a fundamental parameter in analyses associated with the Group's investment decisions.

The Group has implemented a number of capital management policies and processes to meet this objective, with the following main characteristics:

- The board of directors and senior management take an active role in the strategies and policies that affect the Group's capital management. The objective is to maintain robust solvency ratios of an appropriate quality that are consistent with the Group's risk profile and business model.

- The Group has a comprehensive risk management unit that monitors and controls solvency ratios to guarantee compliance with applicable legislation and the consistency of decisions made by the different areas and units of the Bank with the objectives set, to ensure that minimum capital requirements are met. Contingency plans are in place to ensure compliance with the limits stipulated in the applicable legislation.

- The impact of these units on the Group's eligible capital base and the return-risk ratio are considered a key decision-making factor in the Group's strategic and commercial planning and in the analysis and monitoring of Group transactions.

- Pursuant to the provisions of the solvency regulations, the Group has a capital self-assessment process in place. This process comprises a set of solid, comprehensive strategies and procedures that enable the Group to continuously assess and maintain the amounts, types and allocation of capital to cover all the risks to which it is or may be exposed, according to their nature and level.

As part of its risk management, the Group continuously identifies, measures, monitors and mitigates the risks to which its activity is subject, incorporating the findings into the capital self-assessment process. This process entails estimating current and future eligible capital and capital requirements (under different scenarios) according to the risks inherent in its business, the economic environment in which it operates, risk governance, management and control systems, its strategic business plan, the quality or composition of available capital and actual opportunities for raising more capital, should it prove necessary. To that end, once the Group has calculated its capital requirements under Basel's Pillar 1, it reviews and assesses the other risks and factors not considered therein which should be taken into account due to their importance, and it estimates the capital needed to cover all the risks while maintaining an adequate buffer with respect to the legal minimum capital requirements under Pillar 1.

This process ensures an adequate relationship between the risk profile of the entities making up the Group and the capital they effectively hold, both in absolute terms and in terms of its composition and distribution among the various legally separate entities.

The minimum solvency ratio under the new regulations is calculated as the quotient of the eligible capital maintained by the Group and its risk-weighted assets. The definition of eligible capital has been made more stringent under the new regulations, essentially because new capital deductions have been added, and because certain instruments cease to be considered as capital since they do not meet the new criteria for absorbing losses.

Higher quality capital instruments are known as CET1 (Common Equity Tier 1) and essentially comprise capital and reserves, from which several items are deducted, including intangible assets and a specific amount from investments in financial sector entities as well as deferred tax assets contingent on future profits.

Ranking behind CET1, AT1 (Additional Tier 1 Capital) essentially comprises certain instruments with a high capacity for loss absorption as they are only ranked ahead of ordinary shareholders in the event of liquidation.

Last comes T2 (Tier 2 capital), whose elements consist of instruments that absorb losses, ranking behind those eligible as Tier 1 capital but subordinate to common creditors, as well as provision surpluses eligible as Tier 2 capital under Regulation (EU) No. 575/2013.

Greater details of the characteristics of these instruments, including their capacity for absorbing losses, availability, permanence and order of preference in the event of liquidation, are set out in the Information of Prudential Relevance report, which is available on the Bank's corporate website. This report also contains a reconciliation of book equity and eligible capital.

Risk-weighted assets are determined according to the Group's exposure to credit and dilution risk (based on the assets, commitments and other off-balance sheet items associated with these risks, and in line with their amounts, characteristics, counterparties, guarantees, etc.), counterparty, position and settlement risk relating to items held for trading, exchange rate and gold position risk (based on the global net position in foreign currency and the net position in gold) and operational risk.

In addition, the Regulation establishes limits for risk concentration and certain compulsory aspects relating to the Bank's corporate governance. It also includes two new ratios concerning the Entity's liquidity and a leverage ratio. The Liquidity Coverage Ratio (LCR) is intended for measuring the Bank's short-term liquidity and will be introduced in 2015, whilst the Net Stable Funding Ratio (NSFR), which measures its level of stable funding in the medium term, is still in the process of being calibrated. The leverage ratio is aimed at limiting excessive leverage and ensuring that institutions hold assets that are proportionate with their capital level to try to avoid traumatic deleveraging during recessions. This ratio is also at the calibration stage, although banks will be obliged to publish it from 2015 onwards.

Banco de España (BdE) announced its decision regarding prudential capital requirements applicable to the Bank following the Supervisory Review and Evaluation Process (SREP). This decision requires the Group to maintain a phased-in common equity tier 1 (CET1) capital ratio of 10,13% at consolidated level.

Consolidated capital at 31 December 2016 and 2015 and the related capital ratios are shown in the following table:

| | Thousands of Euros | |
|---|---|---|
| | **2016** | **2015** |
| Capital | 106,957 | 99,036 |
| Reserves | 361,376 | 285,304 |
| Deductions | (1,765) | (1,410) |
| **Common Equity Tier 1 (CET1) capital** | **466,568** | **382,930** |
| Additional CET1 elements | -- | -- |
| **Tier 1 Capital** | **466,568** | **382,930** |
| Collective provision | 13,340 | 11,214 |
| Other elements | -- | -- |
| **Tier 2 Capital** | 13,340 | **11,214** |
| **Total eligible capital** | **479,908** | **394,144** |
| | | |
| For credit, counterparty, dilution and delivery risk | 104,351 | 99,125 |
| For price, currency and commodity position risk | 34,612 | 18,354 |
| Operational risk and other | 36,231 | 32,792 |
| **Total minimum capital requirement** | **175,194** | **150,271** |
| **Surplus** | **304,714** | **243,873** |
| **Capital ratio (%)** | **21.9** | **21.0** |
| **Tier 1 capital (%)** | **21.3** | **20.4** |

Consequently, at 31 December 2016 and 2015, and during both years, the eligible capital of the Group and Group entities subject to this requirement, considered on an individual basis, exceeded the requirements of the aforementioned Circular.

### *h) Deposit Guarantee Fund for Credit Institutions, National Resolution Fund and Single Resolution Fund*

Deposit Guarantee Fund for Credit Institutions

The Bank contributes to the Deposit Guarantee Fund for Credit Institutions (hereinafter DGFCI). In 2016 and 2015 the expense incurred for ordinary, additional and extraordinary contributions to this fund amounted to Euros 50 thousand and Euros 92 thousand, respectively, and was recognised under “Other operating expenses” in the accompanying consolidated income statement.

With respect to ordinary contributions, Royal Decree 1012/2015 of 6 November 2015, which develops Law 11/2015 of 18 June 2015 on the recovery and resolution of credit institutions and investment firms, was published on 7 November 2015. This legislation amends Royal Decree 2606/1996 of 20 December 1996 on deposit guarantee funds for credit institutions. The amendments include a change in the definition of assets of the DGFCI, indicating that the Management Committee will determine the annual contributions of the institutions that participate in the fund based on the criteria established in Article 6 of Royal Decree-Law 16/2011 of 14 October 2011 on the formation of the DGFCI.

In 2016, pursuant to Royal Decree-Law 16/2011 and Royal Decree 2606/1996, the Management Committee of the Deposit Guarantee Fund for Credit Institutions set the contribution applicable to all institutions participating in the deposit guarantee segment at 1.6 per mil of the amount of deposits guaranteed at 30 June 2016. Each institution's contribution was calculated on the basis of the guaranteed deposits and their risk profile, taking into account indicators such as capital adequacy, asset quality and liquidity pursuant to Banco de España Circular 5/2016 of 27 May 2016. The contribution to the securities guarantee segment was set at 2 per mil of 5% of the amount of the securities and other financial instruments guaranteed at 31 December 2016.

In accordance with IFRIC 21, the contributions are recognised when the payment obligation arises, which in this case is 31 December each year.

The calculation bases for the amounts to be contributed by the institutions to each sub-fund are as follows:

- In the case of contributions to the deposit guarantee sub-fund, the deposits covered by the guarantee as defined in Article 4.1 of Royal Decree 2606/1996.

- In the case of contributions to the securities guarantee sub-fund, 5% of the list price on the corresponding secondary market on the last trading day of the year of the securities covered by the guarantee and held at the end of the year, as defined in Article 4.2., when these include securities and financial instruments not traded on secondary markets, either in Spain or abroad, the calculation basis will be their par value or redemption value, whichever is more appropriate for the type of financial instrument, unless a more relevant value is known or published for the purposes of its deposit or recognition.

National Resolution Fund

As part of the process for the creation of an internal banking services market in the European Union, Directive 2014/59/EU has established a centralised supervision framework, the first stage of which was the creation of the Single Supervisory Mechanism through Council Regulation (EU) No. 1024/2013 (hereinafter SSM), which aims to ensure that the EU's policies on the prudential supervision of credit institutions are applied consistently and efficiently, to promote the uniform application of the single rulebook for financial services to credit institutions in Eurozone member states and non-Eurozone member states that choose to adhere to the SSM and to ensure that these credit institutions are subject to the highest level of supervision.

As part of this integration process of the supervision and resolution of credit institutions, Regulation (EU) No. 806/2014 of the European Parliament and of the Council establishes a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism (SRM), which strengthens the image of solvency of these types of institutions at European level.

The fundamental instrument for the proper functioning of the SRM is the Single Resolution Fund (hereinafter SRF), which was created through Regulation (EU) No. 806/2014. This fund was initially set up using annual ex-ante contributions from the institutions subject to the supervisory framework of the SSM.

Delegated Regulation (EU) 2015/63 developed a uniform methodology for calculating contributions to the SRF. These contributions are annual and the amounts to be contributed are determined by the competent resolution authority in each member state based on the institution's size and risk profile.

All of the aforementioned EU legislation has been transposed to Spanish Law through Law 11/2015 of 18 June 2015 on the recovery and resolution of credit institutions and investment firms. Among other matters, this Law appoints the Spanish Fund for Orderly Bank Restructuring (hereinafter the FROB) as the competent resolution authority in Spain. The FROB is therefore the entity in charge of calculating and collecting contributions to the SRF from Spanish credit institutions and certain investment firms subject to the aforementioned legislation, through the National Resolution Fund (hereinafter NRF).

During 2015, the Group recognised an expense of Euros 8,826 thousand under “Other operating expenses” in the accompanying consolidated income statement in respect of contributions for the 2015 contribution period.

On 21 September, 14 October, 10 November and 24 November 2015, the Bank sent a request to the FROB for it to consider the specific aspects of the relationship between the Bank and rural savings banks with a view to these being included in the regulations, thereby solving the problem foreseen with respect to the calculation of ex-ante contributions; or for the FROB, when calculating these contributions, to consider eliminating any liabilities arising from operations between the Bank and rural savings banks and to take into account the low risk profile of the Entity and its low probability of being subject to resolution, for the purposes of applying the risk-based adjustment to the annual contribution.

The FROB denied the Bank's requests, thereby requiring it to include the liabilities between the Bank and the rural savings banks, which have been reported for the purposes of calculating contributions to the NRF.

On 29 January 2016 the Bank filed an appeal for judicial review against the resolution of 21 January 2016 and, by extension, against the agreement of 26 November 2015, both issued by the Governing Committee of the FROB, regarding the 2015 ex-ante contributions to the NRF. This appeal remained unresolved at the date of these annual accounts.

<u>Single Resolution Fund</u>

Article 67 of Regulation (EU) No. 806/2014 of the European Parliament and of the Council of 15 July 2014 provides for the creation of the Single Resolution Fund as a key component of the Single Resolution Mechanism (SRM), initiated in Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014.

This Fund began to operate on 1 January 2016 and is managed by the Single Resolution Board, which is also in charge of calculating the contributions to be made by the credit institutions and investment firms defined in Article 2 of the Regulation. The contributions are to be calculated in accordance with the rules defined in Commission Delegated Regulation (EU) 2015/63 of 21 October 2014, which completes Directive 2014/59/EU of the European Parliament and of the Council with regard to ex-ante contributions to the financing mechanisms of the resolution.

In accordance with Article 103 of Directive 2014/59/EU, the available financial means to be taken into account to reach the target level for the Single Resolution Fund may include irrevocable payment commitments which are fully backed by collateral of low-risk assets unencumbered by any third-party rights, at the free disposal and earmarked for exclusive use by the resolution authorities for the purposes specified in the Directive. The share of irrevocable payment commitments shall not exceed 30% of the total amount of ex-ante contributions raised.

In 2016, the Group's contribution amounted to Euros 9,079 thousand, of which Euros 7,750 thousand was recognised under “Other operating expenses” in the accompanying income statement and Euros 1,329 thousand took the form of an irrevocable commitment.

On 11 December 2015, the FROB notified the Group in writing that in view of the Single Resolution Fund (SRF) coming into service on 1 January 2016, as of that date the Single Resolution Board (SRB) would be responsible both for administering that Fund and for calculating the contributions thereto.

On 1 February 2016, through the FROB, the Group informed the SRB in writing of the items and balances vis-à-vis its shareholder rural savings banks which the Group considered should be taken into account (i.e. should be eliminated) when determining its ex ante contribution to the SRF for 2016. The arguments supporting the request to eliminate these balances were similar to those put forward with respect to the contribution to the NRF for 2015.

On 26 April 2016, the Group received notice, through the FROB, of the SRB's decision in relation to the Group's ex ante contribution to the SRF for 2016.

The balances whose elimination was requested in the Group's written request of 1 February 2016 were not taken into account in calculating this contribution. Therefore, on 29 June 2016, the Group lodged an appeal with the Court of Justice of the European Union's General Court in Luxembourg requesting annulment of the SRB's decision regarding the settlement for the Bank's ex ante contribution for 2016. At the date of these annual accounts, the General Court has not yet handed down its resolution on this appeal.

The Group has also filed appeals for judicial review with the Central Economic-Administrative Tribunal in connection with the levies on the activities carried out by the FROB, as the resolution authority, for 2015 and 2016, inasmuch as the calculation basis for these levies were the ex ante contributions to the NRF and the SRF, respectively, settled by the Group in 2015 and 2016. At the date of these annual accounts, a resolution is also pending on these appeals for judicial review.

### *i) Minimum reserves*

The amendment to the regulations applicable to minimum reserves came into force in January 2012, increasing the ratio from 1% to 2%.

At 31 December 2016, as well as throughout 2016, the Group complied with the minimum reserves stipulated in applicable Spanish legislation, based on Regulation (EC) No 1745/2003 of 12 September 2003.

### *j) Environmental impact*

In view of the business activity carried out by the Group, it does not have any environmental liabilities, expenses, assets, provisions or contingencies that might be material with respect to its equity, financial position or consolidated results. Therefore, no specific disclosures relating to environmental issues are included in these notes to the consolidated annual accounts.

### *k) Subsequent events*

Notwithstanding the comments in these notes to the consolidated annual accounts, no significant events which should be included in the consolidated annual accounts in order to present fairly the consolidated equity, consolidated financial position and consolidated results of the Group occurred subsequent to 31 December 2016 and prior to the date on which the consolidated annual accounts were authorised for issue by the board of directors of the Bank.

## 2. Significant Accounting Principles

The accounting principles and measurement criteria applied in preparing the Group’s consolidated annual accounts are as follows:

### *a) Definitions and classification of financial instruments*

#### I. Definitions

A “financial instrument” is any contract that gives rise to a financial asset in one entity and to a financial liability or equity instrument in another entity.

An “equity instrument” is any agreement that evidences a residual interest in the assets of the issuing entity after deducting all of its liabilities.

A “financial derivative” is a financial instrument the value of which fluctuates in response to changes in an observable market variable (such as an interest rate, foreign exchange rate, financial instrument price or market index), for which the initial investment is very small compared with other financial instruments with a similar response to changes in market factors, and which is generally settled at a future date.

"Hybrid financial instruments" are contracts that simultaneously include a non-derivative host contract together with a derivative, known as an embedded derivative, that is not separately transferable and has the effect that some of the cash flows of the hybrid contract vary in a way similar to a stand-alone derivative.

"Compound financial instruments" are contracts that simultaneously create for their issuer a financial liability and an own equity instrument (such as convertible bonds, which entitle their holders to convert them into equity instruments of the issuer).

The following transactions are not treated for accounting purposes as financial instruments:

- Investments in joint ventures and associates.
- Rights and obligations under employee benefit plans (see note 2 n)
- Rights and obligations under insurance contracts

II. Recognition and classification of financial assets for measurement purposes

Financial assets are initially recognised at fair value, which is taken to be the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Subsequent to initial recognition, financial assets are included for measurement purposes in one of the following categories:

- Financial assets at fair value through profit and loss
    - Financial assets held for trading: comprise financial assets acquired for the purpose of generating a profit in the short term from fluctuations in their prices, and financial derivatives that are not designated as hedging instruments.
    - Financial assets designated at fair value throught profit or loss: Comprise financial assets designated as such on initial recognition for which the fair value can be reliably estimated and which meet at least one of the following conditions:
        - When, in the case of hybrid financial instruments for which the embedded derivative must be separated from the host contract, it is not possible to reliably estimate the fair value of the embedded derivative or derivatives.
        - In the case of hybrid financial instruments for which the embedded derivative must be separated, the hybrid financial instrument as a whole has been classified in this category on initial recognition, provided they met the conditions specified in prevailing accounting standards whereby the embedded derivative significantly changes the cash flows that would have been associated with the host financial instrument had it been considered separately from the embedded derivative, and whereby the embedded derivative must be separated from the host financial instrument for accounting purposes.
        - When more relevant information is obtained through classification of a financial asset in this category, as such classification eliminates or significantly reduces recognition or measurement inconsistencies (also known as accounting mismatches) that would otherwise arise from using different criteria to measure assets and liabilities or recognise the gains and losses thereon.

        - When more relevant information is obtained through classification of a financial asset in this category, as a group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided on that basis to the Group's key management personnel.

- Held-to-maturity investments

  This category includes debt securities traded on organised markets with fixed maturity and fixed or determinable cash flows, which the Group has the positive intention and ability to hold to maturity.

- Loans and receivables

  This category consists of unquoted debt instruments, financing granted to third parties in connection with ordinary lending activities carried out by the consolidated entities, and receivables from purchasers of goods and users of services. This category also includes finance leases in which the consolidated entities act as lessors.

- Available-for-sale financial assets.

  This category includes Group debt instruments not classified as held-to-maturity investments, loans and receivables, or at fair value through profit and loss, as well as Group equity instruments related to entities which are not subsidiaries, joint ventures or associates and which have not been classified at fair value through profit and loss.

<u>III. Recognition and classification of financial liabilities for measurement purposes</u>

Financial liabilities are initially recognised at fair value.

Subsequent to initial recognition, financial liabilities are classified for measurement purposes into one of the following categories:

- Financial liabilities at fair value through profit and loss

    - Financial liabilities held for trading: Comprise financial liabilities issued with the intention to repurchase them in the near future or which form part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking; short positions deriving from the sale of assets purchased under obligatory resale agreements or borrowed and derivatives not designated as hedging instruments, including separated hybrid financial instruments, pursuant to IAS 39.

    - Other financial liabilities at fair value through profit and loss comprise financial liabilities designated as such on initial recognition, the fair value of which can be reliably estimated, and which meet any of the following conditions:

        - When, in the case of hybrid financial instruments for which the embedded derivative must be separated from the host contract, it is not possible to reliably estimate the fair value of the embedded derivative or derivatives.

- In the case of hybrid financial instruments for which the embedded derivative must be separated, the hybrid financial instrument as a whole has been classified in this category on initial recognition, provided they met the conditions specified in prevailing accounting standards whereby the embedded derivative significantly changes the cash flows that would have been associated with the host financial instrument had it been considered separately from the embedded derivative, and whereby the embedded derivative must be separated from the host financial instrument for accounting purposes.

- When more relevant information is obtained through classification of a financial liability in this category, as such classification eliminates or significantly reduces recognition or measurement inconsistencies (also known as accounting mismatches), that would otherwise arise from using different criteria to measure assets or liabilities or recognise gains or losses thereon.

- When more relevant information is obtained through classification of a financial liability under this category, as a group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided on that basis to the Group's key management personnel.

- Financial liabilities at amortised cost

Financial liabilities not included in any of the above categories which arise from the ordinary deposit-taking activities carried out by financial institutions, irrespective of their nature and maturity.

IV. Reclassifications between financial instrument portfolios

Financial instruments are only reclassified between portfolios in the following cases:

- Items classified as financial instruments at fair value through profit or loss can only be reclassified into or out of this financial instrument category after they are acquired, issued or assumed in the event of the exceptional circumstances described in section d) of this note.

- If a financial asset ceases to be classified as held to maturity due to a change in intention or financial ability, it is reclassified to "Available-for-sale financial assets". In this case, all financial assets classified as held to maturity are treated similarly, except where reclassification falls within one of the scenarios permitted by applicable legislation (sales close to maturity or when practically the entire principal of the financial asset has been collected, etc.).

  In 2016 and 2015 no items have been reclassified as described in the preceding paragraph.

- Financial assets (debt instruments) classified as available-for-sale financial assets can be reclassified to held to maturity due to a change in intention or financial ability of the Group, or upon expiry of the two-year penalty period established under prevailing legislation for the sale of financial assets held to maturity. In this case, the fair value of these instruments at the transfer date is considered as the new amortised cost and the difference between this amount and the recoverable amount is recognised in the consolidated income statement over the residual life of the instrument using the effective interest method.

In 2016 and 2015 no items have been reclassified as described in the preceding paragraph.

- As mentioned in preceding sections, financial assets that are not derivative financial instruments can be reclassified from held for trading if they are no longer held for the purpose of being sold or repurchased in the near term, provided that one of the following circumstances arise:

    - In rare and exceptional circumstances, except in the case of assets eligible for classification as loans and receivables. Rare and exceptional circumstances are those arising from a particular event which is unusual, and which is highly unlikely to reoccur in the foreseeable future.

    - When the entity has the intention and financial ability to hold the financial asset in the foreseeable future or to maturity, provided that it meets the definition of loans and receivables on initial recognition.

  Should these circumstances arise, the asset is reclassified at its fair value at the reclassification date, with no reversal of results, and this value is considered as the asset's amortised cost. Assets reclassified in this way may not be further reclassified as "Financial assets held for trading".

***b) Measurement and recognition of financial assets and liabilities***

In general, financial instruments are initially recognised at fair value which, in the absence of evidence to the contrary, is deemed to be their acquisition cost, and are subsequently measured at each year end as follows:

I. Measurement of financial assets

Financial assets are measured at fair value, without deducting any transaction costs that may be incurred on their sale or other form of disposal, except for loans and receivables, held-to-maturity investments, equity instruments for which the fair value cannot be determined in a sufficiently objective manner and financial derivatives that have those equity instruments as their underlying asset and are settled by delivery of those instruments.

The fair value of a financial instrument on a given date is taken to be the amount for which it could be exchanged on that date between two knowledgeable, willing parties in an arm's length transaction. The most objective and common reference for the fair value of a financial instrument is the price that would be paid for it on an organised, transparent and deep market (quoted price or market price).

If there is no market price for a given financial instrument, its fair value is estimated on the basis of the price established in recent transactions involving similar instruments and, in the absence thereof, based on proven valuation techniques used by the international financial community, taking into account the specific features of the instrument to be measured and, particularly, the various types of risk associated with it. However, the inherent limitations of the valuation techniques used and the possible inaccuracies of the assumptions made under these techniques may result in a fair value of a financial instrument which does not exactly reconcile with the price at which the instrument could be bought or sold at the measurement date.

"Loans and receivables" and "Held-to-maturity investments", are measured at amortised cost using the effective interest method. Amortised cost is understood to be the acquisition cost of a financial asset or liability plus or minus, as appropriate, the principal repayments and the cumulative amortisation (as reflected in the consolidated income statement) of the difference between the initial cost and the maturity amount. In the case of financial assets, amortised cost also includes any reductions for impairment. In the case of loans and receivables hedged in fair value hedges, the changes in the fair value of the assets related to the risk or risks being hedged are recognised.

The effective interest rate is the discount rate that exactly matches the initial amount of a financial instrument to its estimated cash flows during its estimated life, based on the contractual terms, without taking into account future losses on credit exposure. For fixed rate financial instruments, the effective interest rate coincides with the contractual interest rate established on the acquisition date plus, where applicable, the fees that can be equated with a rate of interest, in light of their nature. In the case of floating rate financial instruments, the effective interest rate coincides with the rate of return prevailing until the date on which the reference interest rate will be revised.

Equity instruments of other entities whose fair value cannot be determined in a sufficiently objective manner and financial derivatives that have those instruments as their underlying asset and are settled by delivery of those instruments are measured at acquisition cost adjusted, where appropriate, for any related impairment loss.

II. Measurement of financial liabilities

In general, financial liabilities are measured at amortised cost, as defined above, except for those included under financial liabilities at fair value through profit or loss, which are measured at fair value.

III. Measurement techniques

General measurement bases

A summary of the various techniques used by the Group to measure the financial instruments included in the financial assets held for trading, available-for-sale financial assets, and financial liabilities held for trading categories at 31 December 2016 and 2015 is as follows:

| | % | | | |
|---|---|---|---|---|
| | **2016** | | **2015** | |
| | **Assets** | **Liabilities** | **Assets** | **Liabilities** |
| Quoted price in active markets | 85.9 | 28.7 | 84.7 | 31.2 |
| Internal measurement models | 14.1 | 71.3 | 15.3 | 68.8 |
| | **100.0** | **100.0** | **100.0** | **100.0** |

The main techniques used in the internal measurement models are as follows:

- The present value method is used to measure financial instruments which enable static hedging (mainly forwards and swaps).
- The Black-Scholes model is applied to certain plain vanilla derivative products (calls, puts, caps/floors).
- The Monte Carlo simulation method is used for the remaining derivative financial instruments.
- The effect of credit risk on fair value is calculated based on the credit curves for issuers with different credit ratings and economic sectors.

Credit Valuation Adjustments (hereinafter “CVA”) and Debit Valuation Adjustments (hereinafter “DVA”) are included in the measurement of both asset and liability derivative products to reflect the impact on fair value of counterparty credit risk and the Group's own risk, respectively.

The adjustments to be performed are calculated by estimating exposure at default, the probability of default and loss given default for all derivative products with any underlying, by legal entity (i.e. all counterparties under the same ISDA/CMOF contract) to which the Bank is exposed.

In general, the CVA is calculated by multiplying expected positive exposure by the counterparty's probability of default. The DVA is calculated by multiplying the expected negative exposure by the probability of default, then multiplying the result by the Bank's loss given default. Both calculations encompass the entire duration of the potential exposure.

The information required to calculate the probability of default and the loss given default is obtained from credit markets (Credit Default Swaps or iTraxx indices), applying the Entity's own information if available. If information is not available, a process based on sector, rating and location is applied to assign both probabilities of insolvency and expected losses in the event of insolvency, calibrated directly to market or through the adjustment to market of the probabilities of insolvency and historical expected losses.

The Bank's directors consider that financial assets and financial liabilities in the consolidated balance sheet and gains and losses on these financial instruments are reasonable and reflect their market value (see note 22).

IV. Recognition of changes in fair value

As a general rule, changes in the fair value of financial instruments are recognised in the consolidated income statement, distinguishing those arising from the accrual of interest or dividends, which are recognised under “Interest income”, “Interest expense” and “Dividend income”, as appropriate, from those arising on impairment of an asset’s credit rating or for other reasons, which are recognised at their net amount under “Gains/losses on financial assets and liabilities” in the accompanying consolidated income statement.

Adjustments due to changes in fair value arising from available-for-sale financial assets are recognised temporarily under “Accumulated other comprehensive income” in consolidated equity, unless they relate to exchange differences on monetary financial assets, in which case they are recognised in the consolidated income statement. Items debited or credited to “Accumulated other comprehensive income” remain in the Group’s consolidated equity until the asset giving rise to them is removed from the consolidated balance sheet, or when it is considered that the asset is impaired, at which time they are recognised in the consolidated income statement.

V. Hedging transactions

The Group measures and recognises individual hedges (which are designated to hedge a specifically identified risk) depending on their classification, based on the following criteria:

- Fair value hedges: hedge of the exposure to changes in fair value. The gains or losses attributable to both the hedging instrument and the hedged item are recognised directly in the consolidated income statement.

- Cash flow hedges: hedge of the exposure to variations in cash flows that is attributable to a particular risk associated with an asset or liability or a forecast transaction. The gain or loss attributable to the portion of the hedging instrument that qualifies as an effective hedge is recognised temporarily under “Accumulated other comprehensive income” in consolidated equity at the lower of the cumulative gain or loss on the hedging instrument from the inception of the hedge and the cumulative change in the present value of expected future cash flows of the hedged item from the inception of the hedge.

  The cumulative gains or losses on each hedge are taken to the consolidated income statement in the periods in which the hedged items affect the income statement, unless the hedge relates to a forecast transaction that results in the recognition of a non-financial asset or liability, in which case the gains or losses are included in the cost of that asset or liability.

- Hedge of a net investment in a foreign operation: hedge of the foreign currency risk on an investment in subsidiaries, associates, joint ventures and branches of the Entity whose activities are based or conducted in a country or functional currency other than that of the reporting Entity. Gains or losses attributable to the portion of the hedging instrument that qualifies as an effective hedge are recognised directly in "Accumulated other comprehensive income" under consolidated equity until the instruments are disposed of or derecognised, at which time they are recognised in the consolidated income statement. The rest of the gain or loss is recognised directly in the consolidated income statement.

Derivatives embedded in other financial instruments or in other host contracts are accounted for separately as derivatives if their risks and characteristics are not closely related to those of the host contracts, provided that the host contracts are not classified as "Financial assets and liabilities designated at fair value through profit or loss" or as "Financial assets held for trading".

Financial derivatives that do not qualify for hedge accounting are treated for accounting purposes as trading derivatives.

### *c) Derecognition of financial assets and liabilities*

The accounting treatment of transfers of financial assets depends on the extent to which the risks and rewards associated with the transferred assets are transferred to third parties:

I. When substantially all the risks and rewards are transferred to third parties, the transferred financial asset is derecognised and any right or obligation retained or created in the transfer is recognised separately.

II. When substantially all the rights and rewards associated with the transferred financial asset are retained, the transferred financial asset is not derecognised and continues to be measured by the same criteria used before the transfer. However:

   - An associated financial liability is recognised for an amount equal to the consideration received. This liability is subsequently measured at amortised cost.

   - The income from the transferred financial asset not derecognised and any expense incurred on the new financial liability are recognised in the consolidated income statement.

III. When substantially all the risks and rewards associated with the transferred financial asset are neither transferred nor retained, the following distinction must be made:

   - If the transferor does not retain control, the transferred financial asset is derecognised and any right or obligation retained or created in the transfer is recognised separately.

   - If the transferor retains control, it continues to recognise the transferred financial asset for an amount equal to its exposure to changes in value and recognises a financial liability associated with the transferred financial asset. The net carrying amount of the transferred asset and the associated liability is the amortised cost of the rights and obligations retained, if the transferred asset is measured at amortised cost, or the fair value of the rights and obligations retained, if the transferred asset is measured at fair value.

### d) *Impairment of financial assets*

To calculate impairment losses, the Group monitors receivables on an individual basis when they are deemed significant, while groups of financial assets with similar credit risk characteristics that are indicative of the debtors' ability to pay the amounts due are monitored on a collective basis.

1. Classification on the basis of credit risk attributable to insolvency:

<u>I. Debt instruments measured at amortised cost</u>

The Group has defined criteria that enable it to identify borrowers that show weaknesses or objective evidence of impairment, and to classify them on the basis of their credit risk. The classification principles and methodology used by the Group are described below.

2. Definition of the classification categories:

Debt instruments not included in financial assets held for trading and off-balance sheet exposures are classified in terms of credit risk attributable to insolvency as one of the following:

- Standard exposures:
  - Transactions that do not meet the requirements for them to be classified in other categories.
  - Standard exposures under special monitoring: transactions that, while not meeting the criteria for individual classification as doubtful or write-off, present weaknesses that may lead to the incurrence of losses exceeding those on other similar transactions classified as standard exposures.
- Doubtful exposures:
  - As a result of borrower arrears: transactions any part of whose principal, interest or contractually agreed expenses is, in general, more than 90 days past-due, unless such instruments should be classified as being written off. This category also includes guarantees given if the guaranteed party has fallen into in arrears in the guaranteed transaction. Furthermore, it includes the amounts of all a borrower's transactions if the transactions with amounts generally more than 90 days past-due, as indicated previously, exceed 20% of outstandings.
  - For reasons other than borrower arrears: transactions which are not classifiable as write-off or doubtful due to borrower arrears, but for which there are reasonable doubts about their full repayment under the contractual terms. Also included are off-balance-sheet exposures not classified as doubtful due to borrower arrears whose payment by the Group is likely but whose recovery is doubtful.
- Write-off:
  - The Group derecognises transactions when individual analysis indicates that their recovery is very unlikely. This category includes exposures of customers subject to bankruptcy proceedings with an application for liquidation, and transactions classified as doubtful due to arrears that have been in this category for more than four years, except those with sufficient effective collateral. It also includes transactions that are not in either of the two preceding situations, but whose solvency has undergone a manifest and irreversible deterioration.

- In the aforementioned situations, the Group derecognises any amount recognised together with the corresponding provision, without prejudice to any initiatives that may be undertaken to seek collection of the amount receivable until contractual rights are extinguished by expiry of the statute-of-limitations period, pardoning of debt or any other cause.

3. Transaction classification criteria:

The Group applies a range of criteria to classify borrowers and transactions into different categories on the basis of their credit risk. These include:

- Automatic criteria;
- - Specific criteria for refinancing; and
- - Indicator-based criteria.

Applying these procedures, the Group classifies its borrowers as standard exposures under special monitoring, doubtful as a result of borrower arrears or doubtful for reasons other than borrower arrears, or it leaves them as standard exposures.

Unless reasons for continuing to classify them as doubtful exposures persist, transactions classified as doubtful are reclassified as standard exposures when the reasons for classifying them as doubtful cease to exist, following collection of a portion or all of the past-due amounts in the case of receivables that are doubtful as a result of borrower arrears, or the cure period having elapsed in the case of receivables that are doubtful for reasons other than borrower arrears.

Individual classification:

The Group has defined an exposure threshold above which borrowers are considered significant, based on exposure at default (EAD).

A system of indicators has been devised for significant borrowers enabling weaknesses or indications of impairment to be identified. The team of expert risk analysts at the Entity analyses borrowers and, using the indicators, concludes on the existence of weaknesses or objective evidence of impairment. Where there is evidence of impairment, the team analyses whether the loss event(s) has an impact on the estimated future cash flows of the financial asset or group of assets.

To this end, the Group has defined a number of circumstances that are considered to be indications of impairment. These circumstances also include automatic classification factors.

Each year the Group reviews the reasonableness of the thresholds and the individually calculated allowances and provisions resulting from applying these thresholds.

Based on the levels defined, a certain volume of borrowers enabling a reasonable coverage ratio vis-à-vis the total credit risk exposure is positioned above the materiality threshold, and is thus subject to individual expert analysis.

Collective classification:

In calculating allowances and provisions, the Group considers borrowers on a collective basis when they do not exceed the materiality threshold.

4 Calculation of allowances and provisions:

The Group applies the criteria described below when calculating allowances and provisions for credit risk losses.

In the case of transactions identified as being of negligible risk (essentially, those conducted with central banks, government agencies, public enterprises and financial institutions, all within the European Union or in certain countries deemed to present no risk), a provisioning percentage of 0% is applied, with the exception of transactions classified as doubtful, for which impairment is estimated on an individual basis. This estimation process entails a calculation of the allowance and provision needed for credit risk attributable to the borrower and also for country risk. If there are reasons for simultaneously recording allowances or provisions for both credit risk attributable to the borrower and for country risk, the most demanding impairment recognition criteria are applied.

When calculating allowances and provisions, the Group considers as a measurement of exposure the balances currently drawn down and the amount of the expected disbursement in the event that off-balance sheet exposures were to fall into arrears, estimated using a credit conversion factor (CCF).

For transactions classified as doubtful, an estimate is made of the incurred losses, defined as the difference between the gross carrying amount of the exposure and the present value of the estimated future cash flows, as described later on.

The different methodologies used by the Group are described below.

<u>Individualised estimates of allowances and provisions</u>

The following are estimated individually:

- Allowances and provisions for doubtful transactions of individually significant borrowers.

- Any transactions or borrowers whose characteristics do not allow for collective calculation of impairment.

- Allowances and provisions for transactions identified as being of negligible risk, classified as doubtful, whether on account of arrears or for other reasons.

The Group has developed a methodology for estimating these allowances and provisions, calculating the difference between the gross carrying amount of the transaction and the present value of the estimated cash flows expected to be collected, discounted using the effective interest rate. For this purpose, the effective guarantees received are taken into account.

There are three main methods for calculating the recoverable amount of assets analysed on an individual basis:

- Discounted cash flow approach: receivables for which the borrower is expected to be able to generate future cash flows by conducting their own business, enabling repayment of part or all of the debt through their activity and the economic and financial structure of the company. This entails estimating the cash flows obtained by the borrower in conducting their business.

- Recovery through collateral approach: receivables for which the borrower is unable to generate cash flows by conducting their own business and must therefore liquidate assets to repay their debt. This entails estimating cash flows obtainable by enforcing the collateral.

- Mixed approach: receivables for which the borrower is expected to be able to generate future cash flows, and where assets not required in the ordinary course of business also exist. The cash flows may be supplemented with the potential sale of assets not required by the borrower to conduct their business, thus generating future cash flows.

Collective estimates of allowances and provisions

The following are estimated collectively:

- Exposures classified as standard (including those classified as under special monitoring) for which the Bank considers that a loss has been incurred but not reported (IBNR), as no impairment has come to light in individually analysed transactions.

- Exposures classified as doubtful and not assessed through the individual estimation of allowances and provisions.

In 2016, the Group has taken Banco de España Circular 4/2016 into consideration in its methodology for calculating credit risk provisions. This has entailed a reversal of impairment for financial assets not measured at fair value through profit or loss in an amount of approximately Euros 10,900 thousand, with no significant impact on the Group's impaired assets.

In calculating the collective impairment loss, the Bank takes into account all credit risk exposures and uses the methods and the percentages for allowances and provisions stipulated by the Banco de España based on data and statistical models that reflect the average performance of institutions in the Spanish banking sector in aggregate.

Classification of and allowances and provisions for credit risk attributable to country risk:

Country risk is understood as the risk associated with counterparties resident in a specific country due to circumstances other than normal commercial risk (sovereign risk, transfer risk and other risks arising from international financial activity). The Bank classifies transactions conducted with third parties in different groups on the basis of the economic performance of the countries, the political situation, the regulatory and institutional framework, and the payment capacity and record, allocating a loan loss provisioning percentage to each one pursuant to the legislation in force.

Doubtful assets due to country risk are deemed to be those transactions with ultimate obligors resident in countries that have had long-standing difficulties in servicing their debt, the possibility of recovering such debt being considered as doubtful; and off-balance sheet exposures, recovery of which is considered a remote possibility due to circumstances attributable to the country.

The allowances and provisions for this item are not significant relative to the allowances and provisions the Group has recognised for impairment.

5 Collateral/guarantees:

Collateral and personal guarantees the Group is able to show are valid as a means of mitigating credit risk are considered effective. The analysis of effectiveness of collateral/guarantees takes into account, inter alia, the time needed to realise them, the Group’s ability to do so, and its past experience thereof.

Under no circumstances are collateral/guarantees whose effectiveness depends substantially upon the credit quality of the debtor, or of any economic group to which the debtor may belong, admissible as effective collateral/guarantees.

In accordance with these conditions, the following types of collateral/guarantees may be considered effective:

- Real estate mortgages, provided they are the first mortgage:

  - ✓ Completed buildings and parts thereof:
    - Housing.
    - Offices and commercial premises and multi-purpose industrial buildings.
    - Other buildings, such as non-multi-purpose industrial buildings and hotels.
  - ✓ Urban land and regulated building land.
  - ✓ Other real estate.

- Financial instruments pledged as security:
  - ✓ Money deposits.
  - ✓ Variable interest instruments in listed entities and debt securities issued by creditworthy issuers.

- Other collateral:
  - ✓ Personal property received as collateral.
  - ✓ Subsequent mortgages on properties.

- Personal guarantees that entail the direct and joint liability of the customer's new guarantors, these being persons or entities whose solvency is sufficiently demonstrated as to ensure the full repayment of the transaction under the agreed terms.

The Group's collateral measurement criteria for assets located in Spain are in accordance with the legislation in force. In particular, the Group applies criteria for the selection and contracting of appraisers that are geared towards assuring the independence of the appraisers and the quality of the appraisals. All of these appraisal companies and agencies are registered in the Banco de España’s Official Register of Appraisal Companies and valuations are conducted in accordance with Ministerial Order ECO/805/2003 on rules for the appraisal of real estate and of certain rights for financial purposes.

Real estate collateral for credit transactions, and properties, are appraised upon transfer or recognition. In the case of properties, this is through purchase, foreclosure or dation in payment and when there is a significant drop in the asset's value. Moreover, minimum discounting criteria are applied so as to guarantee annual frequency in the case of impaired assets (under special monitoring, doubtful, and real estate foreclosed or received in payment of debt) or every three years in the case of debts for a large amount classed as standard exposures and showing no signs of underlying risk. The appraisals of the aforementioned assets are discounted using statistical methodologies only when the level of exposure and risk is low, although a complete appraisal in accordance with the ministerial order is carried out at least every three years.

Assets located elsewhere in the European Union are appraised in accordance with Royal Decree 716/2009 of 24 April 2009, while in the rest of the world appraisals are performed by companies and/or experts with accredited capacity and experience in the country in question.

<u>II. Debt or equity instruments classified as available for sale</u>

Impairment losses on these instruments are the difference between the acquisition cost of the instruments (net of any principal repayment in the case of debt instruments) and their fair value less any impairment loss previously recognised in the income statement.

The Bank tests relevant instruments for impairment on an individual basis. However, the Bank's accounting policies stipulate that, in any case, a prolonged or significant decline in the fair value of the instrument below cost constitutes objective evidence of impairment, and impairment must therefore be recognised for the difference between the cost and the fair value of the instrument in question. Specifically, in the case of quoted equity instruments, the accounting policy considers that a decline is prolonged when the fair value of the instrument has been below cost for more than 18 months, and that the decline is significant when it represents more than 40% of the cost.

When there is objective evidence that the losses arising on measurement of these instruments are due to impairment, they are no longer recognised in equity under "Accumulated other comprehensive income" – Available-for-sale financial assets" and are recorded in the income statement. If all or part of the impairment losses are subsequently reversed, the reversed amount would be recognised in the income statement for the year in which the reversal occurred (under "Accumulated other comprehensive income" – Available-for-sale financial assets" in the balance sheet in the case of equity instruments).

III. Equity instruments measured at cost

The impairment loss on equity instruments measured at cost is the difference between the carrying amount and the present value of the expected future cash flows discounted at the market rate of return for similar securities.

Impairment losses are recognised in the income statement for the period in which they arise as a reduction in the cost of the instrument. These losses can only be reversed subsequently if the assets are sold.

### *e) Repurchase and resale agreements*

Purchases of financial instruments with an obligatory resale commitment at a determined price are recognised as financing granted under "Loans and advances - Credit institutions" or "Loans and advances - Other debtors", as applicable. Sales of financial instruments with an obligatory repurchase commitment at a determined price are recognised as financing received under ("Deposits - Credit institutions" or "Deposits - Other creditors").

The difference between the purchase and sales price is recognised as interest over the life of the contract.

### *f) Tangible assets*

Tangible assets for own use are measured at cost, revalued as permitted by specific legislation and the new accounting standards, less accumulated depreciation and any impairment losses.

Depreciation of tangible assets is provided on a straight-line basis over their estimated useful lives. The land on which the buildings and other structures stand is deemed to have an indefinite life and, therefore, is not depreciated.

Depreciation is recognised in the consolidated income statement and is calculated using the following rates (based on the average years of estimated useful life of the various assets):

| | **% annual** | **Estimated useful life (years)** |
|---|---|---|
| Real estate | 2 | 50 |
| Furniture and fixtures | 6-10 | 16.7-10 |
| IT equipment | 16-33 | 6.3-3 |

Depreciation methods and useful lives of each tangible asset are reviewed at least at the end of each financial year.

The cost of maintenance and repairs of tangible assets which do not improve the related assets or lengthen their useful lives are charged to the consolidated income statement when incurred.

### *g) Intangible assets*

Intangible assets are identifiable non-monetary assets with no physical substance, arising as a result of a legal transaction or which have been developed internally by the consolidated entities. Only assets whose cost can be estimated reliably and from which the consolidated entities consider it probable that future economic benefits will be generated are recognised.

Intangible assets are recognised initially at cost of acquisition or production and are subsequently measured at cost less any accumulated amortisation and impairment losses.

### *h) Leases*

I. Finance leases

Finance leases are leases that transfer to the lessee substantially all the risks and rewards incidental to ownership of the leased asset.

When the consolidated entities act as lessors of an asset, the sum of the present value of the lease payments receivable from the lessee plus the guaranteed residual value, which is generally the exercise price of the purchase option available to the lessee at the end of the lease term, is recognised as financing to third parties and is therefore included under “Loans and advances” in the consolidated balance sheet.

When the consolidated entities act as lessees, they recognise the cost of the leased assets in the consolidated balance sheet according to the nature of the asset that is the subject matter of the contract, and simultaneously recognise a liability for the same amount (which is the lower of the fair value of the leased asset and the sum of the present value of the lease payments to be made to the lessor, plus the exercise price of the purchase option, where applicable). The depreciation policy for these assets is consistent with that for tangible assets for own use.

In both cases, the finance income and finance expense arising from these contracts is credited or debited, respectively, to the consolidated income statement so as to achieve a constant rate of return over the life of the lease contracts.

II. Operating leases

In operating leases ownership of the leased asset and substantially all the risks and rewards incidental to it remain with the lessor.

When the consolidated entities act as lessors, they recognise the acquisition cost of the leased assets under “Tangible assets” in the consolidated balance sheet. The depreciation policy for these assets is consistent with that for similar tangible assets for own use and income from operating leases is recognised in the consolidated income statement on a straight-line basis.

When the consolidated entities act as lessees, lease expenses, including any incentives granted by the lessor, are charged to the consolidated income statement on a straight-line basis.

### *i) Financial guarantees and related provisions made*

A contract is considered a financial guarantee if it requires an entity to pay specific amounts on behalf of a third party in the event that the latter is unable to do so, irrespective of the manner in which the obligation is instrumented: guarantee deposits, financial guarantee deposit, irrevocable documentary credit issued or confirmed by the entity, etc.

In accordance with EU-IFRS and as a general rule, the Group considers contracts for financial guarantees extended to third parties as financial instruments within the scope of IAS 39 and 37.

On initial recognition, the Group records financial guarantees extended as a liability at fair value plus directly attributable transaction costs, which is generally equivalent to the premium received plus the present value of any fees and commissions and returns to be received throughout the term of these contracts, with a balancing entry under assets equivalent to the amount of fees and commissions and similar income collected at the outset of operations and the present value of fees and commissions and similar income receivable. Subsequently, these contracts are recognised under liabilities at the higher of the following amounts:

- The amount determined in accordance with IAS 37, whereby financial guarantees, irrespective of the holder, arrangement or any other circumstances, are analysed periodically to determine the credit risk to which they are exposed and, where applicable, to estimate the provisions required. This amount is calculated applying criteria similar to those used to quantify impairment losses arising on debt instruments measured at amortised cost.

- The amount at which these instruments are initially recognised, less amortisation which, as established by IAS 18, is calculated on a straight-line basis over the term of these contracts.

Provisions made for these instruments, are recorded under - “Provisions - Commitments and guarantees extended” in the consolidated balance sheet. Allowances and reversals of these provisions are recognised with a balancing entry under the income statement caption “Provisioning expense (net)”.

In the event that provisions are required for these financial guarantees, based on the above, unaccrued commissions on these operations, which are recognised under -“Provisions or reversals of provisions”, are reclassified to the corresponding provision.

### *j) Foreign currency transactions*

I. Functional currency

The Group’s functional currency is the Euro. Therefore, all balances and transactions denominated in currencies other than the Euro are deemed to be denominated in foreign currency.

II. Translation of foreign currency balances

Foreign currency balances are translated as follows:

- Monetary assets and liabilities, at the average exchange rate prevailing on the Spanish spot foreign exchange market at year-end.

- Income and expenses, at the exchange rate on the transaction date.

III. Recognition of exchange differences

Exchange differences arising on the translation of foreign currency balances are recognised in the consolidated income statement (see notes 28 and 34).

### *k) Equity instruments*

Instruments issued by the Bank are only considered as own equity when the following conditions are met:

- They do not include any type of obligation that requires the issuing entity to:

    - deliver cash or any other financial asset to a third party; or

    - exchange financial assets or financial liabilities with a third party under conditions that are potentially unfavourable to the Entity.

- If they may or will be settled in the issuing entity's own equity instruments:

  - in the case of a non-derivative financial instrument, the Entity is not obliged to deliver a variable number of its own equity instruments; or

  - in the case of a derivative, it must be settled by the exchange of a fixed amount of cash or another financial asset for a fixed number of the Entity's own equity instruments.

A financial instrument that will or may result in the future receipt or delivery of the issuer's own equity instruments, but does not meet the conditions described in the two preceding paragraphs, is not an equity instrument.

Business carried out with own equity instruments, including issuance and redemption, is recognised directly in equity of the Entity. No profit or loss on own equity instruments can be recognised. Costs of transactions with own equity instruments are deducted directly from equity, after deduction of any associated tax effect.

Changes in value of instruments classified as own equity are not recognised in the financial statements. Consideration received or conveyed in exchange for these instruments is added to or deducted directly from equity of the Entity.

### *l) Recognition of income and expense*

The most significant criteria used by the Group to recognise income and expenses are summarised as follows:

<u>I. Interest income, interest expenses and similar items</u>

As a general rule, interest income, interest expenses and similar items are recognised on the basis of their period of accrual using the effective interest method. Dividends received from other companies are recognised as income when the consolidated entities' right to receive them arises.

<u>II. Commissions, fees and similar items</u>

Fee and commission income and expenses are recognised in the consolidated income statement using criteria that vary according to their nature. The most significant fee and commission items are as follows:

- Those relating to financial assets and financial liabilities at fair value through profit or loss, which are recognised when collected.

- Those arising from transactions or services that are provided over a period of time, which are deferred over the life of these transactions or services.

- Those relating to the provision of a service in a single act, which are recognised when the single act is carried out.

<u>III. Non-finance income and expenses</u>

These items are recognised for accounting purposes on an accruals basis.

### *m) Assets under management*

Assets owned by third parties and managed by the consolidated entities are not disclosed in the consolidated balance sheet. Management fees are included in "Fee and commission income" in the consolidated income statement (see note 26). The details of third-party assets managed by the Group at 31 December 2016 and 2015 are disclosed in note 21.

### *n) Post-employment benefits*

The Group recognises the present value of defined benefit pension commitments, net, as explained below, of the fair value of any assets considered to constitute pension plan or "past service cost" assets, the recognition of which is deferred, as explained below, in "Provisions - Pensions and other post-employment defined benefit obligations" under liabilities in the consolidated balance sheet (or under assets in "Other assets – Insurance contracts linked to pensions", depending on whether the difference is negative or positive and subject to compliance with the criteria for recognition set out in Banco de España Circular 5/2013).

Plan assets are assets linked to a specific defined benefit commitment that will be used to directly settle these obligations. They have the following characteristics: they are not owned by the Group, but rather by a legally separate third party not related to the Group; they are only available to settle or finance post-employment benefits payable to employees; they can only be returned to the Group when the remaining assets in the plan are sufficient to meet all obligations of the plan or the Entity relating to current or former employee benefits or to reimburse employee benefits already settled by the Group.

If the Group is able to demand payment from an insurer of part or all of the disbursement required to settle the defined benefit obligation, and it is practically certain that the insurer will reimburse some or all of the disbursements required to settle the obligation, but the insurance policy does not meet the conditions to be considered a plan asset, the Group recognises this reimbursement right in "Insurance contracts linked to pensions", under assets in the balance sheet. This right is treated as a plan asset in all other respects.

The Group recognises any actuarial gains and losses arising on post-employment commitments with employees in the year in which they are generated or incurred, with a debit or credit to the consolidated income statement.

The cost of past services, incurred due to modifications to existing post-employment benefits or on the introduction of new benefits, is recognised in the income statement on a straight-line basis over the period between the date the new commitments arise and the date these benefits are vested.

Post-employment benefits are recognised in the income statement as follows:

- Current service costs, defined as the increase in the present value of the obligations resulting from employee service in the current period, are recorded under "Administrative expenses - Personnel expenses".

- Interest costs, defined as the increase during the year in the present value of the obligations as a result of the passage of time, are recognised under "Interest expense". When the obligations are presented in liabilities net of the plan assets, the cost of the liabilities recognised in the income statement relates solely to the obligations recognised under liabilities.

- The expected return on plan assets and gains or losses on the value of the plan assets, less any plan administration costs and any applicable taxes, is recorded under "Interest income".

Under the collective labour agreement currently in force, the Bank has undertaken to supplement the public social security system benefits accruing to certain employees, and to their beneficiary right holders, for retirement, permanent disability, death of spouse or death of parent, and other benefits.

In accordance with Royal Decree 1588/1999, in 2000 the Bank externalised its pension commitments through an insurance contract with Seguros Generales Rural, S.A. de Seguros y Reaseguros.

Details of the present value of the Group's post-employment benefit obligations at 31 December 2016 and 2015 are as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2016** | **2015** |
| Present value of obligations | 1,338 | 1,198 |
| Fair value of plan assets | 1,445 | 1,400 |
| **Positive difference** | **107** | **202** |

The amount of the obligations was determined by independent actuaries using the following actuarial techniques:

1. *Valuation method:* Projected unit credit method, which considers each year of service as giving rise to an additional unit of benefit entitlement and measures each unit separately.

2. *Actuarial assumptions used:* unbiased and mutually compatible. Specifically, the most significant actuarial assumptions used in the calculations were as follows:

| | **2016** | **2015** |
|---|---|---|
| Technical interest rate | 1.4% | 1.8% |
| Mortality tables | PERM/F 2000P | PERM/F 2000P |
| Cumulative annual CPI growth | 1.4% | 1.5% |
| Annual salary increase rate | 2.5% | 2.5% |
| Annual Social Security pension increase rate | 1.5% | 1.8% |

In 2014 the Group implemented a defined contribution supplementary benefits scheme through a pension plan arranged with the insurance firm Seguros Generales Rural, S.A. de Seguros y Reaseguros, as stipulated in article 36.7 of the 22nd collective bargaining agreement for the banking sector. This scheme is addressed to employees hired as of 8 March 1980 and who have accumulated at least two years' service. The minimum annual contribution is Euros 300, with profit-sharing rights in favour of the employee should he or she leave the Bank for reasons other than retirement.

### o) Termination benefits

In accordance with prevailing legislation, the Group pays compensation to those employees whose services are discontinued without just cause. Indemnities are accounted for as a provision for pensions and similar obligations and as personnel expenses when the Entity has clearly undertaken a commitment to dismiss an employee or group of employees before their retirement date or to compensate an employee or group of employees to encourage their voluntary departure from the company.

### *p) Income tax*

The current income tax expense is recognised in the consolidated income statement, except when it results from a transaction recognised directly in consolidated equity, in which case the related income tax charge is also recognised in consolidated equity.

The current income tax expense is calculated as the tax payable with respect to the taxable profit for the year, adjusted for the amount of the changes in the year arising from temporary and permanent differences and from tax credits and tax loss carryforwards.

Deferred tax assets and liabilities include the temporary differences, identified as the amounts expected to be paid or recovered for the differences between the carrying amount of the assets and liabilities and their related tax bases (tax value).

Deferred tax assets, tax credits and tax loss carryforwards are only recognised when it is probable that the consolidated entities will obtain sufficient future taxable profit against which they can be utilised.

Deferred tax assets and liabilities are quantified by applying the expected recovery or settlement tax rate to temporary differences or credits.

Deferred tax liabilities are always recognised, except when goodwill is recognised or when they arise in accounting for investments in subsidiaries, associates or joint ventures where the investor is able to control the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the future. Nevertheless, deferred tax assets and liabilities are not recognised if they arise from the initial recognition of an asset or liability other than a business combination that at the time of recognition affects neither accounting profit nor taxable profit.

The deferred tax assets and liabilities recognised are reassessed at year end in order to ascertain whether they still exist, and the appropriate adjustments are made on the basis of the findings of the analyses performed.

Income and expenses recognised directly in consolidated equity are accounted for as temporary differences.

### *q) Consolidated statement of cash flows*

The Group reports its consolidated cash flows using the indirect method, using the following expressions and classification criteria:

- Cash flows: inflows and outflows of cash and cash equivalents, the latter being short-term, highly liquid investments subject to a low risk of changes in value.

- Operating activities: typical activities of credit institutions and other activities that cannot be classified as investing or financing.

- Investing activities: the acquisition, sale or other disposal of non-current assets and other investments not included in cash and cash equivalents.

- Financing activities: activities that result in changes in the size and composition of consolidated equity and of liabilities that do not form part of operating activities.

For the preparation of the consolidated statement of cash flows, “Cash and cash equivalents in central banks” have been considered as cash and cash equivalents.

### *r) Consolidated statement of recognised income and expense*

This statement includes income and expenses generated or incurred by the Group during the year in the ordinary course of business, distinguishing between amounts recognised in the consolidated income statement for the year and those recognised directly in consolidated equity, in accordance with prevailing legislation.

This statement therefore comprises the following:

a) Consolidated profit for the year

b) Net income and expenses recognised temporarily as valuation adjustments in consolidated equity.

c) Net income and expenses recognised permanently in consolidated equity.

d) Accrued income tax payable in respect of the items mentioned in points b) and c) above, except on valuation adjustments arising from interests in associates or jointly controlled entities accounted for using the equity method, which are disclosed as net balances.

e) Total consolidated recognised income and expense calculated as the sum of the preceding points, presenting the amounts attributable to the Parent and to minority interests separately.

Any type of income and expenses attributable to entities accounted for using the equity method recognised directly in equity is disclosed in this statement under “Entities accounted for using the equity method”.

Changes in income and expenses recognised in consolidated equity during the year, such as valuation adjustments, are disclosed as follows:

a) Revaluation gains/ (losses) reflect income, net of expenses incurred during the year, recognised directly in consolidated equity. Amounts recognised in this caption during the year continue to be carried at the initial value of other assets or liabilities, even when they are transferred to the consolidated income statement in the same year, or they are reclassified to another caption.

b) Amounts transferred to the income statement reflect revaluation gains or losses previously recognised in consolidated equity, even in the same year, which are accounted for in the consolidated income statement.

c) Amounts transferred to the initial carrying amount of hedged items comprise valuation gains or losses previously recognised in consolidated equity, even in the same year, which are accounted for in the initial value of assets or liabilities as a result of cash flow hedges.

d) Other reclassifications reflect transfers between valuation adjustments during the year in accordance with criteria established under prevailing legislation.

Amounts disclosed in these captions are gross and the associated tax effect is recognised in “Income tax”, except in the case of valuation adjustments of entities accounted for using the equity method, as mentioned previously.

### s) *Consolidated statement of total changes in equity*

This consolidated statement of total changes in equity presents all changes, including those arising from changes in accounting principles and corrections of errors. This statement therefore shows a reconciliation of the opening and closing carrying amounts of all items comprising consolidated equity, grouping movements according to their nature, as follows:

a) Adjustments for changes in accounting principles and corrections of errors reflect changes in consolidated equity due to the retrospective restatement of balances in the financial statements as a result of changes in accounting principles or corrections of errors.

b) Consolidated income and expenses recognised during the year comprise the aggregate amount of the aforementioned items recognised in the consolidated statement of recognised income and expense.

c) Other changes in equity comprise the remaining items recognised in consolidated equity, such as increases or decreases in share capital, distribution of profit or application of losses, transactions with own equity instruments, equity-settled payments, transfers between consolidated equity items and any other increases or decreases in consolidated equity.

## 3. Distribution of Profit and Earnings per Share

### *Distribution of profit*

The board of directors will propose for approval by the shareholders at the annual general meeting that the Bank's net profit for 2016 be distributed as follows:

| | Thousands of Euros |
|---|---|
| Net profit for 2016 | 40,322 |
| Reserves | |
| Legal | 1,584 |
| Voluntary | 38,738 |

The distribution of the Bank's net profit for 2015, approved by the shareholders at their annual general meeting held on 25 May 2016, was as follows:

| | Thousands of Euros |
|---|---|
| Net profit for 2015 | 35,387 |
| Distribution: | |
| Reserves | |
| Legal | 1,605 |
| Voluntary | 33,782 |

### *Earnings per share*

Earnings per share are calculated by dividing the net profit attributable to the Group by the number of ordinary shares of the Bank outstanding during the year.

| | Thousands of Euros | |
|---|---|---|
| | **2016** | **2015** |
| Net profit attributable to the Group (thousands of Euros) | 44,592 | 37,359 |
| Number of shares outstanding (note 17) | 1,779,645 | 1,647,851 |
| Earnings per share (Euros) | 25.06 | 22.67 |

## 4. Information on Directors and Senior Management

### *Remuneration of directors*

Details of gross remuneration received by members of the Bank's board of directors for allowances in 2016 and 2015 are as follows:

| | Thousands of Euros | | |
|---|---|---|---|
| **Consejeros** | **2016** | **2015** | |
| Mr. José Luis García Palacios (President) | 31 | 32 | |
| Mr. José Luis García-Lomas Hernández (Vice-president 1º) | 12 | 11 | |
| Mr. Pedro García Romera (Vice-president 2º) | 10 | 10 | |
| Mr. Ignacio Arrieta del Valle (1) | 13 | 12 | |
| Mr. Nicanor Bascuñana Sanchez | 9 | 10 | Director since 26/10/2016 |
| Mr. Luis Esteban Chalmovsky | 7 | 10 | |
| Mr. Carlos Martínez Izquierdo | 11 | 10 | |
| Mr. Carlos de la Sierra Torrijos | 10 | 10 | |
| Mr. Jose Antonio Alayeto Aguarón | - | 5 | Director since 16/07/2015 |
| Mr. Dimas Rodríguez Rute (2) | 12 | 12 | |
| Mr. Cipriano García Rodríguez (3) | 12 | 12 | |
| Ms. Dagmar Werner | 9 | 11 | |
| Mr. José María Quirós Rodriguez | 12 | 11 | |
| Mr. Fernando Berge Royo | 10 | 10 | |
| Mr. Jesús Méndez Alvarez-Cedrón (4) | 12 | 12 | |
| | | | |
| **Totales** | **170** | **178** | |

(1) A portion of the allowances received by Caja Rural de Navarra, SCC (Euros 7 thousand).
(2) Allowances received by Caja Rural de Granada, SCC
(3) Allowances received by Caja Rural de Zamora, SCC
(4) Allowances received by Caixa Rural Galega, SCC

### *Public liability insurance*

The directors and executives of the Group have a public liability insurance policy, for which the premium is borne by the Spanish Association of Rural Savings Banks. In 2016 and 2015, this item had no impact on the Group's income statement.

### *Loans*

The Group has extended no loans to the Bank's directors at 31 December 2016 or 2015.

### *Conflicts of interest concerning the directors.*

The directors of the Bank and their related parties have had no conflicts of interest requiring disclosure in accordance with articles 228 and 229 of the Revised Spanish Companies Act, amended by Law 31/2014 of 24 December 2014.

***Remuneration of senior management***

For the purposes of preparing the accompanying consolidated annual accounts, senior management comprises the 12 members of the Bank's steering committee in 2016 and 13 members in 2015, considered to be key management personnel within the Group.

Details are as follows:

| | Short-term remuneration Thousands of Euros | | | | | |
|---|---|---|---|---|---|---|
| | **Fixed** | | **Variable** | | **Total** | |
| | **2016** | **2015** | **2016** | **2015** | **2016** | **2015** |
| Senior management | 1,771 | 1,794 | 514 | 525 | 2,285 | 2,319 |

***Gender distribution of the board of directors***

At 31 December 2016 the board of directors was formed by 12 male members and one female member. At 31 December 2015 was formed by 13 male members and one female member.

## 5. Cash, cash balances with central banks and other demand deposits

Details are as follows:

| | **Thousands of Euros** | |
|---|---|---|
| | **2015** | **2015** |
| Cash | 748 | 843 |
| Bank of Spain | | |
| Current account | 106,048 | 228,642 |
| other demand deposits | 1,917,523 | 2,280,558 |
| **Total** | **2,024,319** | **2,510,043** |

*(*) Presented solely and exclusively for comparison purposes.*

Amounts deposited in central banks at 31 December 2016 and 2015 earned interest at an average rate of 0.01% and 0.05%, respectively.

Details of residual maturity and the interest rate repricing matrix for the items recorded in this caption of the consolidated balance sheet are provided under Risk Management (see note 34).

## 6. Financial Liabilities and assets held for trading

Information on credit, liquidity and market risks assumed by the Bank in relation to financial assets included in this category is provided under Risk Management in note 34, and certain information on the fair value of these assets is provided in note 22.

Details of financial assets and financial liabilities held for trading by counterparty and type of instrument are as follows:

| | Thousands of Euros | | | |
|---|---|---|---|---|
| | Assets | | Liabilities | |
| | **2016** | **2015** | **2016** | **2015** |
| **Counterparty** | | | | |
| Credit institutions | 644,874 | 744,925 | 503,330 | 545,879 |
| Resident general government | 1,736,647 | 1,719,227 | -- | -- |
| Other resident sectors | 263,573 | 320,059 | 313,725 | 79,155 |
| Other non-resident sectors | 641 | 8,098 | -- | -- |
| **Total** | **2,645,735** | **2,792,309** | **817,055** | **625,034** |
| **Instrument** | | | | |
| Debt securities | 2,087,509 | 2,294,463 | -- | -- |
| Other equity instruments | -- | -- | -- | -- |
| Trading derivatives | 558,226 | 497,846 | 582,782 | 430,012 |
| Short positions | -- | -- | 234,273 | 195,022 |
| **Total** | **2,645,735** | **2,792,309** | **817,055** | **625,034** |

Loaned or pledged securities amount to Euros 1,794,856 thousand at 31 December 2016 (Euros 2,083,853 thousand at 31 December 2015).

### *Financial assets held for trading. Debt securities*

Details are as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2016** | **2015** |
| Spanish government debt securities | 1,736,647 | 1,719,227 |
| Issued by credit institutions | 320,718 | 452,738 |
| Other Spanish fixed-income securities | 29,504 | 114,400 |
| Other non-resident fixed-income securities | 640 | 8,098 |
| **Total** | **2,087,509** | **2,294,463** |

Debt securities held for trading earned interest at an average annual rate of 0.02% in 2016 (0.39% in 2015).

### *Financial assets held for trading. Trading derivatives*

Details of the fair value of trading derivatives at 31 December 2016 and 2015, by type of instrument, are as follows:

| | Miles de euros | | | |
|---|---|---|---|---|
| | Activo | | Pasivo | |
| | **2016** | **2015** | **2016** | **2015** |
| Purchase of foreign currencies | 9,190 | 5,494 | 6,976 | 5,075 |
| Interest rate derivatives | 514,006 | 454,951 | 540,546 | 363,198 |
| Equity price risk derivatives | 35,030 | 37,401 | 34,428 | 40,277 |
| Other risk derivatives | -- | -- | 832 | 21,462 |
| **Total** | **558,226** | **497,846** | **582,782** | **430,012** |

The notional values of derivatives held for trading at 31 December 2016 and 2015, by maturity date, are as follows:

| | 2016 | | | |
|---|---|---|---|---|
| | Thousands of Euros | | | |
| | Up to 1 year | 1 to 5 years | Over 5 years | Total |
| Purchase of foreign currencies | 409,234 | 25,748 | -- | 434,982 |
| Interest rate derivatives | 6,927,466 | 10,102,531 | 18,493,852 | 35,523,849 |
| Equity price risk derivatives | 896,816 | 1,269,225 | 34,093 | 2,200,134 |
| Other risk derivatives | -- | 125,000 | 288,338 | 413,338 |
| **Totales** | **8,233,516** | **11,522,504** | **18,816,283** | **38,572,303** |

| | 2015 | | | |
|---|---|---|---|---|
| | Thousands of Euros | | | |
| | Up to 1 year | 1 to 5 years | Over 5 years | Total |
| Purchase of foreign currencies | 422,489 | 13,674 | -- | 436,163 |
| Interest rate derivatives | 5,197,498 | 3,104,019 | 17,436,014 | 25,737,530 |
| Equity price risk derivatives | 887,401 | 1,388,494 | 160,695 | 2,436,589 |
| Other risk derivatives | -- | 125,000 | 260,000 | 385,000 |
| **Total** | **6,507,387** | **4,631,187** | **17,856,709** | **28,995,283** |

***Financial liabilities held for trading Short positions***

Details are as follows:

| | Thousands of Euros | |
|---|---|---|
| | 2016 | 2015 |
| **Counterparty** | | |
| Credit institutions | 234,273 | 195,022 |
| **Total** | **234,273** | **195,022** |
| **Instrument** | | |
| Short positions | 234,273 | 195,022 |
| **Total** | **234,273** | **195,022** |

## 7. Available-for-sale financial assets

Details of available-for-sale financial assets, based on the nature of the operations, are as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2016** | **2015** |
| **Counterparty** | | |
| Credit institutions | 18,935 | 148,592 |
| Resident general government | 3,737,179 | 3,596,219 |
| Non resident general government | | |
| Other resident sectors | 123,823 | 65,055 |
| Other non-resident sectors | 61,796 | 19,909 |
| Impairment losses | (559) | (909) |
| **Total** | **3,988,344** | **3,828,866** |
| **Instrument** | | |
| Debt securities | 3,963,857 | 3,811,691 |
| Spanish government debt securities | 3,737,179 | 3,596,219 |
| Other non resident government debt securities | 47,170 | -- |
| Issued by credit institutions | 16,106 | 145,746 |
| Other Spanish fixed-income securities | 104,080 | 53,952 |
| Other non-resident fixed-income securities | 59,881 | 16,683 |
| Impairment losses | (559) | (909) |
| Other equity instruments | 24,487 | 17,175 |
| Shares in credit institutions | 2,829 | 2,846 |
| Shares in Spanish companies | 14,689 | 11,103 |
| Shares in foreign companies | 1,915 | 65 |
| Mutual fund units | 5,054 | 3,161 |
| **Total** | **3,988,344** | **3,828,866** |

Available-for-sale debt securities earned interest at an average rate of 0.29% in 2016 (0,79% in 2015).

Loaned or pledged debt securities amounted to Euros 3,175,536 thousand at 31 December 2015 (Euros 3,442,294 thousand in 2015).

Information on credit, liquidity and market risks assumed by the Bank in relation to financial assets included in this category is provided under Risk Management in note 34, whereas certain information on the fair value of these assets is provided in note 22.

***Portfolio of assets available for sale. Past-due impaired assets***

At 31 December 2016 there were individual available-for-sale financial assets that could have been considered impaired in 3,918 thousand of Euros. At the 2015 year end, impairment of Euros 3,900 thousand had been recognised on equity instruments in the accompanying consolidated income statement with a direct charge to the acquisition cost of these instruments (see note 34.1.6).

## 8. Loans and receivables

Details of loans and receivables by type of instrument are as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2016** | **2015(*)** |
| Debt securities | 33,223 | 57,819 |
| Loans and advances to credit institutions | 4,130,741 | 7,088,910 |
| Loans and advances to other debtors | 1,110,404 | 995,343 |
| **Total** | **5,274,368** | **8,142,072** |

*(*) Presented solely and exclusively for comparison purposes*

Information on credit, liquidity and market risks assumed by the Group in relation to financial assets included in this category is provided under Risk Management in note 34, whereas certain information on the fair value of these assets is provided in note 22.

### *Loans and receivables. Debt Securities*

Details of loans and receivables by type of instrument are as follows:

| | Miles de euros | |
|---|---|---|
| | **2016** | **2015** |
| Spanish general government | 29,556 | 49,269 |
| Others resident sectors | 4,527 | 11,400 |
| **Sum** | **34,083** | **60,669** |
| impairment losses | (860) | (2,850) |
| **Total** | **33,223** | **57,819** |

These financial instruments accrued interest at an average annual rate of 3.21% in 2016 (3.28% in 2015).Loans and receivables. Loans and advances to credit institutions

Details by instrument are as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2016** | **2015** |
| **Instrument** | | |
| Time deposits | 355,124 | 4,124,287 |
| Reverse repos | 3,747,982 | 2,930,520 |
| Other accounts | 27,272 | 30,602 |
| **Subtotal** | **4,130,378** | **7,085,409** |
| Valuation adjustments | 363 | 3,501 |
| **Total** | **4,130,741** | **7,088,910** |

Loans and advances to credit institutions earned interest at an average annual rate of 0.04% in 2016 (0.13% in 2015).

***Loans and receivables. Loans and advances to other debtors***

Details by instrument, status and borrower sector are as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2016** | **2015** |
| **Instrument and status** | | |
| Commercial credit | 25,388 | 29,082 |
| Secured loans | 112,865 | 112,011 |
| Other term loans | 840,622 | 797,435 |
| Finance leases | 6,792 | 2,289 |
| Receivable on demand and others | 5,283 | 8,648 |
| Other accounts | 149,992 | 79,842 |
| Doubtful assets (Note 34.1.5) | 5,259 | 9,109 |
| **Subtotal** | **1,146,201** | **1,038,416** |
| Impairment losses | (36,118) | (43,296) |
| Other valuation adjustments | 321 | 223 |
| **Total** | **1,110,404** | **995,342** |
| **Counterparty** | | |
| Spanish general government | 661,325 | 657,705 |
| Other resident sectors | 472,666 | 334,738 |
| Other non-resident sectors | 12,210 | 45,973 |
| **Subtotal** | **1,146,201** | **1,038,416** |
| Impairment losses | (36,118) | (43,296) |
| Other valuation adjustments | 321 | 223 |
| **Total** | **1,110,404** | **995,342** |

Loans and advances to other debtors earned interest at an average annual rate of 1.71% in 2016 (1.92% en 2015).

## 9. Held-to-maturity investments

Details of held-to-maturity investments, based on the nature of the operations, are as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2016** | **2015** |
| **Instrument** | | |
| Debt securities: | | |
| Spanish government debt securities | 80,166 | 97,283 |
| Issued by credit institutions | 9,848 | 18,171 |
| Impairment losses | -- | -- |
| **Total** | **90,014** | **115,454** |

At 31 December 2016 and 2015 there were no individual assets in this portfolio which could have been considered impaired due to credit risk.

Loaned or pledged debt securities amount to Euros 69.747 thousand at 31 December 2016 (Euros 51,150 thousand in 2015).

Held-to-maturity investments earned interest at an average annual rate of 3.07% in 2016 (3.15% in 2015).

Information on credit, liquidity and market risks assumed by the Bank in relation to financial assets included in this category is provided under Risk Management in note 34, whereas certain information on the fair value of these assets is provided in note 22.

## 10. Tangible assets

Movement in 2016 and 2015 is as follows:

| | Thousands of Euros | | | |
|---|---|---|---|---|
| | **Real estate** | **Furniture and fixtures** | **IT equipment** | **Total** |
| **Cost** | | | | |
| Balance at 31 December 2014 | 17,749 | 3,901 | 2,864 | 24,514 |
| Additions | -- | 193 | 174 | 367 |
| Disposals | -- | (2) | -- | (2) |
| Balance at 31 December 2015 | 17,749 | 4,092 | 3,038 | 24,879 |
| Additions | -- | 259 | 422 | 681 |
| Disposals | -- | -- | -- | -- |
| Balance at 31 December 2016 | 17,749 | 4,351 | 3,460 | 25,560 |
| **Accumulated depreciation** | | | | |
| Balance at 31 December 2014 | (3,559) | (2,845) | (2,610) | (9,014) |
| Additions | (228) | (200) | (141) | (569) |
| Disposals | -- | 2 | -- | 2 |
| Balance at 31 December 2015 | (3,787) | (3,043) | (2,751) | (9,581) |
| Additions | (226) | (209) | (160) | (595) |
| Disposals | -- | -- | -- | -- |
| Balance at 31 December 2016 | (4,013) | (3,252) | (2,911) | (10,176) |
| **Net tangible assets** | | | | |
| **Balance at 31 December 2015** | **13,962** | **1,049** | **287** | **15,298** |
| **Balance at 31 December 2016** | **13,736** | **1,099** | **549** | **15,384** |

In accordance with EU-IFRS, the Group revalued its real estate in an amount of Euros 6,638 thousand, An appraisal at 1 January 2004, prepared by an independent surveyor, was used as the fair value for this revaluation, The resulting adjustments were recognised under “Accumulated reserves” (Euros 4,466 thousand) and “Tax liabilities” (Euros 2,172 thousand) (see note 18).

At 31 December 2016 and 2015 the cost of fully-depreciated tangible assets for own use in service amounts to Euros 5,394 thousand and Euros 4,517 thousand, respectively.

At 31 December 2016 and 2015, the Bank has no tangible assets on which there are any ownership restrictions or which are pledged as collateral, Neither does it have any commitments to acquire tangible assets from third parties, No compensation or indemnities for the impairment or decline in value of tangible assets for own use were received from third parties in those years, nor are they expected to be received.

## 11. Intangible Assets

Movement in 2016 and 2015 is as follows:

| | Thousands of Euros |
|---|---|
| **Cost** | **Other intangible assets** |
| Balance at 31 December 2014 | 10,842 |
| Additions | 668 |
| Disposals | -- |
| Balance at 31 December 2015 | 11,510 |
| Additions | 1,227 |
| Disposals | -- |
| Balance at 31 December 2016 | 12,737 |
| **Accumulated amortisation** | |
| Balance at 31 December 2014 | (9,270) |
| Additions | (830) |
| Disposals | -- |
| Balance at 31 December 2015 | (10,100) |
| Additions | (872) |
| Disposals | -- |
| Balance at 31 December 2016 | (10,972) |
| **Net intangible assets** | |
| **Balance at 31 December 2015** | **1,410** |
| **Balance at 31 December 2016** | **1,765** |

At 31 December 2016 and 2015 the cost of fully-amortised intangible assets for own use in service amounts to Euros 9,496 thousand and Euros 8,588 thousand, respectively.

## 12. Financial liabilities at amortised cost

Details by type of counterparty are as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2016** | **2015** |
| Deposits from central banks | 774,299 | 4,672,671 |
| Deposits from credit institutions | 6,830,747 | 6,677,190 |
| Deposits from other creditors | 5,039,765 | 4,921,950 |
| Other financial liabilities | 15,403 | 11,356 |
| **Total** | **12,660,214** | **16,283,167** |

Details of residual maturity and the interest rate repricing matrix for the items recorded in this caption of the consolidated balance sheet are provided under Risk Management (see note 34).

Note 22 includes information on the fair value of financial instruments included in this caption.

*Deposits from central banks and from credit institutions*

Details of these liabilities by nature are as follows:

| | Thousands of Euros | | | | | |
|---|---|---|---|---|---|---|
| | Deposits from central banks | | Deposits from credit institutions | | Total | |
| | 2016 | 2015 | 2016 | 2015 | 2016 | 2015 |
| **Nature** | | | | | | |
| Time deposits | 662,369 | 4,321,790 | 833,342 | 1,157,423 | 1,495,711 | 5,479,213 |
| Repurchase agreements | 111,930 | 347,902 | 3,452,195 | 1,782,162 | 3,564,125 | 2,130,064 |
| Other accounts | -- | -- | 2,539,584 | 3,731,205 | 2,539,584 | 3,731,205 |
| Valuation adjustments | -- | 2,979 | 5,626 | 6,400 | 5,626 | 9,379 |
| **Total** | **774,299** | **4,672,671** | **6,830,747** | **6,677,190** | **7,605,046** | **11,349,861** |

At 31 December 2016 time deposits include Euros 41,230 thousand (Euros 67,153 thousand in 2015) for intermediary loans received from the Spanish Official Credit Institute.

These instruments accrued interest at an average rate of 0.08% in 2016 (0.14% in 2015).

*Deposits from other creditors*

Details by nature and currency are as follows:

| | Thousands of Euros | |
|---|---|---|
| | 2016 | 2015 |
| **Nature** | | |
| Demand deposits | 629,202 | 663,714 |
| Time deposits | 10,051 | 8,646 |
| Repurchase agreements | 4,400,990 | 4,249,591 |
| Valuation adjustments | (478) | (1) |
| **Total** | **5,039,765** | **4,921,950** |

These instruments accrued interest at an average rate of 0.00% in 2016 (0.02% in 2015).

*Other financial liabilities*

Details are as follows:

| | Thousands of Euros | |
|---|---|---|
| | 2016 | 2015 |
| Obligations payable | 595 | 580 |
| Collateral received | 10,333 | 4,246 |
| Tax collection accounts | 901 | 1,454 |
| Special accounts | 2,562 | 4,117 |
| Financial guarantees | 49 | 181 |
| Other | 963 | 778 |
| **Total** | **15,403** | **11,356** |

*Information on deferred payments to suppliers, Third Additional Provision of Law 15/2010 of 5 July 2010: "Reporting Obligation"*

In accordance with Law 15/2010 of 5 July 2010, amending Law 3/2004 of 29 December 2004, which introduces measures to combat late payments in commercial transactions, as developed by the resolution issued by the Spanish Accounting and Auditing Institute (ICAC) on 29 January 2016 on disclosures in the notes to the consolidated annual accounts of late payments to suppliers in commercial transactions, the following should be noted:

- Details of late payments to suppliers by the Group are as follows:

| | 2016 | 2015 |
|---|---|---|
| | Days | |
| Average supplier payment period | 29.5 | 30.9 |
| Transactions paid ratio | 29.7 | 31.1 |
| Transactions payable ratio | 8.8 | 27.7 |
| | (Thousands of Euros) | |
| **Total payments made** | 34,809 | 27,075 |
| **Total payments outstanding** | 407 | 580 |

- In light of the activities in which the Group is engaged, the information on late payments disclosed in this note therefore primarily reflects payments to service providers and sundry suppliers, rather than payments to depositors and holders of securities issued by the Group, which have been settled in strict compliance with the legal and contractual terms established in each case, for both on-demand and deferred payments.

- "Average supplier payment period" is understood as the time elapsed between the delivery of goods or the provision of services by the supplier and the effective payment of the operation.

## 13. Other Assets and Liabilities

Details are as follows:

| | **Thousands of Euros** | |
|---|---|---|
| | **Other assets** | |
| | **2016** | **2015** |
| Prepayments and accrued income | 2,661 | 2,213 |
| Other | 2,600 | 1,028 |
| **Total** | **5,261** | **3,241** |

| | **Other liabilities** | |
|---|---|---|
| | **2016** | **2015** |
| Accrued expenses and deferred income: Accrued expenses | 25,336 | 24,028 |
| Other | 19,974 | 17,101 |
| **Total** | **45,310** | **41,129** |

## 14. Hedging derivatives

The fair value of hedging derivatives is as follows:

| | **2016** | | **2015** | |
|---|---|---|---|---|
| | **Assets** | **Liabilities** | **Assets** | **Liabilities** |
| Fair value hedges: | | | | |
| Hedging derivatives | 839 | 62,570 | 23 | 49,654 |

The Group hedges interest rate risk deriving from fixed-rate financial instruments, The purpose of this hedge is to maintain the fair value of hedged operations, which comprise fixed-income securities. At 31 December 2016 and 2015 the nominal amount of derivatives contracted to hedge interest rates amounted to Euros 2,601,883 and Euros 3,127,883 thousand, respectively.

Gains or losses on hedging instruments and the hedged item attributable to the hedged risk are not significant in 2016 and 2015 and are recognised under "Gains or losses on hedge accounting, net" – Hedge accounting not included in interest" (see note 28).

## 15. Provisions

This item comprises provisions for contingent commitments and guarantees extended, Movement during 2016 and 2015 is as follows:

| | Thousands of Euros | |
|---|---|---|
| | 2016 | 2015 |
| **Opening balance** | **232** | **221** |
| Net allowances charged to the income statement | 739 | 31 |
| Applications | (19) | (20) |
| Other movement | (1) | -- |
| **Closing balance** | **951** | **232** |

## 16. Valuation Adjustments (Equity)

"Accumulated other comprehensive income", in the consolidated balance sheets include the amounts, net of the related tax effect, of adjustments to the assets and liabilities recorded temporarily in equity through the statement of total changes in equity until they are realised or extinguished, at which point they are transferred to shareholders' equity in the income statement. Amounts deriving from subsidiaries and associates are disclosed on a line-by-line basis according to their nature.

This item reflects the net amount of unrealised changes in the fair value of assets included for measurement purposes in available-for-sale financial assets, and changes derived from cash flow hedges.

Movement during 2016 and 2015 is as follows:

| | Thousands of Euros | | | | | |
|---|---|---|---|---|---|---|
| | Assets available for sale | | Cash flow hedges | | Total | |
| | 2016 | 2015 | 2016 | 2015 | 2016 | 2015 |
| **Opening balance** | **9,489** | **18,946** | **8** | **--** | **9,497** | **18,946** |
| Net revaluation gains/(losses) | 10,287 | (9,357) | (1,052) | 11 | 9,235 | (9,346) |
| Amounts transferred to the income statement | (3,068) | (4,152) | -- | -- | (3,068) | (4,152) |
| Income tax | (2,149) | 4,052 | 316 | (3) | (1,833) | 4,049 |
| **Closing balance** | **14,559** | **9,489** | **(728)** | **8** | **13,831** | **9,497** |

## 17. Share Capital and Share Premium

### *17.1 Share Capital*

At 31 December 2015, the share capital of the Bank was represented by 1,647,851 registered shares of Euros 60.10 par value each, subscribed and fully paid.

At their general meeting held on 25 May 2016, the Bank's shareholders agreed to increase capital with a charge to voluntary reserves, with an optional scrip dividend scheme. The board of directors was tasked with taking all the necessary steps to formally execute this scheme.

The capital increase of 131,794 shares with a par value of Euros 60.10 each charged to voluntary reserves was executed in a public deed on 20 June 2016. As such, at 31 December 2016 capital was represented by 1,779.645 shares, all subscribed and fully paid in.

Shareholders holding more than 10% of share capital at 31 December 2016 and 2015 are as follows:

| | % ownership | |
|---|---|---|
| **Entity** | **2016** | **2015** |
| Caja Rural de Navarra, S. Coop de Crédito | 15.44 | 15.45 |
| DZ Bank AG | 12.02 | 12.02 |
| Caja Rural de Albacete, Ciudad Real y Cuenca, S. Coop. Credito | 11.09 | 11.09 |
| Caja Rural del Sur, S. Coop de Crédito | 10.99 | 10.99 |

The Bank held no treasury shares at 31 December 2016 or 31 December 2015.

*17.2 Share premium*

This item reflects the amount disbursed by the shareholders over the par value of the shares when subscribing capital. At 31 December 2016 and 2015 the share premium amounts to Euros 85,972 thousand.

## 18. Reserves and Profit and Loss attributable to the Group

### *Definition*

“Shareholders' equity - Retained earnings” in the consolidated balance sheets include the net amount of the accumulated profit and loss recognised in the consolidated income statement in previous years that was assigned to consolidated equity in the distribution of the profit, "Equity – Reserves of entities accounted for using the equity method" in the consolidated balance sheets include the net amount of the accumulated profit and loss generated in previous years by entities accounted for using the equity method and recognised in the consolidated income statement.

### *Breakdown*

Details of these items at 31 December 2016 and 2015 are as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2016** | **2015** |
| **Accumulated reserves** | | |
| Legal reserves | 19,807 | 18,202 |
| Other reserves | 181,920 | 156,225 |
| Revaluation reserves (note 11) | 4,429 | 4,430 |
| Consolidation reserves attributable to the Bank | (48) | (45) |
| Reserves in subsidiaries | 22,343 | 20,305 |
| **Total** | **228,547** | **199,117** |

### *Movement*

Details of changes in this caption of consolidated equity in 2016 and 2015 are shown in the consolidated statement of total changes in equity.

### *Legal reserve*

Under the Revised Spanish Companies Act, entities must transfer 10% of profit for each year to their legal reserve until such reserve reaches an amount equal to 20% of the share capital of the entity, The legal reserve can be used to increase share capital provided that the remaining reserve balance is at least equal to 10% of the nominal value of the total share capital after the increase.

Except for the aforementioned purpose, unless the legal reserve exceeds 20% of the share capital it may only be used to offset losses if no other reserves are available.

### *Reserves (losses) of fully-consolidated entities*

Details are as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2016** | **2015** |
| Rural Informática, S.A. | 6,595 | 6,236 |
| Gescooperativo, S.A., S.G.I.I.C. | 12,050 | 10,668 |
| Espiga Capital Gestión, S.G.C.R., S.A. | 51 | 154 |
| Rural Inmobiliario, S.L. | 2,358 | 2,134 |
| BCE Formación, S.A. | 715 | 577 |
| Rural Renting, S.A. | 574 | 536 |
| **Total** | **22,343** | **20,305** |

### *Profit and loss attributable to the Group*

Details of profit and loss attributable to the Group, taking into account consolidation adjustments, are as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2016** | **2015** |
| Banco Cooperativo Español, S.A. | 40,308 | 33,150 |
| Rural Informática, S.A. | 438 | 391 |
| Rural Inmobiliario, S.L. | 216 | 189 |
| Gescooperativo, S.A., S.G.I.I.C. | 3,357 | 3,382 |
| BCE Formación, S.A. | 259 | 218 |
| Espiga Capital Gestión, S.A. | (3) | (8) |
| Rural Renting, S.A. | 17 | 37 |
| **Total** | **44,592** | **37,359** |

## 19. Taxation

Tax assets and liabilities

Details at 31 December 2016 and 2015 are as follows:

| | Thousands of Euros | | | |
|---|---|---|---|---|
| | Current | | Deferred | |
| | 2016 | 2015 | 2016 | 2015 |
| Tax assets | | | | |
| Temporary differences | -- | -- | 24,717 | 27,521 |
| VAT | 420 | 276 | -- | -- |
| Other | 9,013 | 6,237 | -- | -- |
| **Total** | **9,433** | **6,513** | **24,717** | **27,521** |
| Tax liabilities | | | | |
| Temporary differences (liabilities) | -- | -- | 8,614 | 6,523 |
| Income tax | 107 | 338 | -- | -- |
| VAT | 238 | 355 | -- | -- |
| Other | 420 | 536 | -- | -- |
| **Total** | **765** | **1,229** | **8,614** | **6,523** |

The balance of tax assets reflects the amounts to be recovered within the next 12 months ("Tax assets - current") and the tax to be recovered in future years, including amounts arising from unused tax credits and deductions ("Tax assets - deferred"). Tax liabilities include all tax liabilities, which are broken down between current and deferred.

Royal Decree-Law 14/2013 on urgent measures to adapt Spanish law to European Union legislation on the supervision and solvency of financial institutions introduced certain measures aimed at allowing for some deferred tax assets to continue to be classed as capital, in line with legislation in force in other European Union member states. These include the amendment to the Revised Corporate Income Tax Law, approved by Royal Legislative Decree 4/2004 of 5 March 2004, which provides for the conversion of deferred tax assets into receivables from the taxation authorities; and Law 27/2014 of 27 November 2014 (for 2015 and subsequent years), which establishes a regime aimed at allowing for certain deferred tax assets to continue to be classed as prudential capital within the global regulatory framework for more resilient banks and banking systems (the Basel III Accord), pursuant to the implementing legislation of this Accord, i.e. Regulation (EU) No. 575/2013 and Directive 2013/36/EU, both dated 26 June 2013 (hereinafter CRD IV).

The regulations on prudential requirements provide that deferred tax assets the use of which is contingent upon obtaining future profits should be deducted from regulatory capital, although consideration must be given to whether they are derived from tax losses and deductions or from temporary differences. Deferred tax assets arising from temporary differences, including those derived from loan losses, foreclosures, obligations for pensions and early retirement, are not considered to be contingent upon obtaining future profits, as under certain circumstances they may be converted into receivables from the taxation authorities and, therefore, they are not deducted from regulatory capital (hereinafter monetisable tax assets).

The regulations on monetisable tax assets generated prior to 2016 were completed in 2015 through the introduction of a financial contribution that could entail an annual payment of 1.5% to retain the right to monetise. This 1.5% financial contribution will be applied to the amount of monetisable tax assets generated between 2008 and 2015 that exceeds the aggregate amount of income tax payable for 2008 to 2015.

The Bank has estimated an amount of Euros 9,863 thousand and Euros 12,919 thousand at 31 December 2016 and 2015, respectively, which could be considered receivables from the taxation authorities. If the aggregate income tax payable for 2008 to 2015 exceeds the amount of monetisable tax assets, the Bank will not be required to pay the 1.5% financial contribution in order for the tax assets to be considered monetisable as provided for in articles 11.12, 130, additional provision 13 and transitional provision 33 of Income Tax Law 27/2014.

For these purposes, deferred tax assets and liabilities at 31 December 2016 and 2015 are as follows:

| | Thousands of Euros | | | |
|---|---|---|---|---|
| | **2016** | **2015** | **2016** | **2015** |
| **Temporary differences** | | | | |
| Pension obligations | 431 | 443 | -- | -- |
| Impairment losses on bad debts | 9,432 | 12,477 | -- | -- |
| Other items | 13,142 | 13,146 | 1,083 | 1,020 |
| Temporary differences recognised under Equity - Financial instruments | 1,712 | 1,455 | 7,531 | 5,503 |
| **Unused tax deductions** | -- | -- | -- | -- |
| **Tax loss carryforwards** | -- | -- | -- | -- |
| **Total tax assets/liabilities** | **24,717** | **27,521** | **8,614** | **6,523** |

Movement in deferred tax assets and liabilities in 2016 and 2015 is as follows:

| | Thousands of Euros | |
|---|---|---|
| | **Assets** | **Liabilities** |
| **Balance at 31 December 2014** | **13,564** | **10,414** |
| Recognised | 14,136 | 47 |
| Derecognised | (179) | (3,939) |
| **Balance at 31 December 2015** | **27,521** | **6,523** |
| Recognised | 4,093 | 2,476 |
| Derecognised | (6,897) | (385) |
| **Balance at 31 December 2016** | **24,717** | **8,614** |

Deferred tax assets recognised are mainly non-deductible provisions for bad debts, pension obligations, portfolio impairment and the tax effect of decreases in the value of assets at fair value through equity and other non-deductible provisions. Deferred tax assets derecognised reflect the reversal of non-deductible provisions for bad debts and pension obligations, the reversal of amortisation/depreciation considered non-deductible for tax purposes, the reversal of asset valuation adjustments, other non-deductible provisions and income that is not eligible for tax purposes deriving from prepaid fees and commissions (see note 2-p).

Deferred tax liabilities recognised mainly reflect the tax effect of increases in the value of liabilities at fair value through equity, while those derecognised are essentially the tax effect of decreases in the value of liabilities at fair value through equity (see note 2-p).

As indicated in note 2, the Group recognises deferred tax assets inasmuch as their future recovery is deemed probable based on existing forecasts of future taxable profits. Following an analysis of the likelihood that taxable profits will be generated in the future against which deferred tax assets can be utilised, based on the business plan for the coming years the Bank's directors envisage the generation of taxable profit against which to offset these assets.

***Income tax***

Profits, determined in accordance with tax legislation, are subject to tax at a rate of 30%, pursuant to Income Tax Law 27/2014 and the Revised Income Tax Law previously in force.

A reconciliation of accounting profit for 2016 and 2015 with the taxable income that the Group expects to declare after approval of the consolidated annual accounts is as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2016** | **2015** |
| Accounting profit for the year before income tax | 61,029 | 52,138 |
| Permanent differences | | |
| Donations and non-deductible expenses | 82 | 133 |
| Capitalisation reserve | (4,600) | (2,884) |
| Taxable accounting income | 56,511 | 49,387 |
| Temporary differences | | |
| Provision for bad debts and pension obligations | (10,189) | 3,600 |
| Portfolio impairment, amortisation/depreciation and other | 385 | 3,579 |
| Valuation adjustments | (8,600) | (12,258) |
| Other adjustments to the tax base with no effect on the income tax expense | (5,525) | (10,168) |
| Taxable income | 32,582 | 34,140 |
| Tax at 30% | 9,775 | 10,242 |
| Withholdings and payments on account | (9,035) | (7,312) |
| Deductions and credits with effect on the income tax expense | (35) | (31) |
| Other deductions with no effect on the income tax expense | (340) | (2,462) |
| Effect of the Group's share in net profit/loss of associates | (253) | (99) |
| **Income tax payable/(recoverable)** | **112** | **338** |

Permanent differences in taxable income reflect expenses for:

- Donations to non-profit entities and non-deductible penalties.

- Reduction in the tax base for amounts taken to the capitalisation reserve pursuant to article 25 of the Income Tax Law, as a result of the increase in the Group's shareholders' equity in 2016 due to the application of 2015 profit approved by the shareholders at their general meeting on 25 May 2016. In 2016, the Group's shareholders' equity increased by Euros 37,974 thousand. Therefore, based on the limit established for the reduction of the tax base by up to 10% of the increase in shareholders' equity, the potential reduction in the tax base was Euros 3,797 thousand, of which Euros 4,600 thousand were applied to reduce the taxable income for 2016 in line with the reduction limit of 10% of the taxable income prior to the reduction, leaving Euros 198 thousand to be applied in future years.

Temporary differences primarily include tax adjustments to the general provision for the year, the non-deductible provision for substandard loans, the non-deductible specific provision for doubtful loans, the reversal of deferred fees and commissions on first-time application of Circular 4/2004, the adjustment of provisions for pension obligations, adjustments for portfolio impairment, reversal of adjustments derived from the limit on the tax deductibility of amortisation and depreciation expenses in 2013 and 2014, and the partial reversal in 2016 of the asset valuation adjustment resulting from the tax assessment issued on 4 November 2015.

Other adjustments to the tax base and deductions with no effect on the income tax expense reflect the recognition of tax losses amounting to Euros 5,525 thousand and deductions totalling Euros 340 thousand derived from investments in three economic interest groupings (EIG), in accordance with the terms of article 36 of Income Tax Law 27/2014. The Bank forms part of three EIGs that invest in film production, which in compliance with current tax regulations, allocate positive or negative tax bases, tax withholdings and tax credits to the members according to their respective ownership interest. The economic impact of the investments has been considered as an investment for accounting purposes and has therefore been recognised as income under "Interest and similar income" in the income statement. This item forms part of the tax base and is therefore included in the income tax expense.

The reductions in income tax payable having an effect on the income tax expense are due to deductions for international double taxation and donations to non-profit entities.

The income tax expense for the year is calculated as follows:

| | **Thousands of Euros** | |
|---|---|---|
| | **2016** | **2015** |
| Income tax expense for the year: | | |
| Taxable accounting income at 30% | 16,953 | 14,816 |
| Credits and deductions | (35) | (31) |
| Effect of the Group's share in net profit/loss of associates | (253) | (99) |
| Prior years' tax adjustments | (238) | 89 |
| **Income tax expense** | **16,427** | **14,775** |
| Foreign tax expense | 11 | 6 |
| **Total** | **16,438** | **14,781** |

Prior years' tax adjustments reflect differences between accounting balances recorded at 31 December each year and the tax returns filed, owing to adjustments.

In accordance with current legislation, taxes cannot be considered definitive until they have been inspected and agreed by the taxation authorities or before the inspection period of four years has elapsed. At 31 December 2016 the Group has open to inspection by the taxation authorities all the main applicable taxes since 2012.

Due to the various possible interpretations of the tax regulations applicable to the operations performed by the Group, certain contingent tax liabilities could arise for the years pending inspection that cannot be objectively quantified. However, the Bank's directors consider that the likelihood of these contingent liabilities materialising as a result of a future inspection is remote and that, in any case, the tax debt which could be incurred as a result would not significantly affect these consolidated annual accounts.

Nonetheless, on 12 February 2015 the taxation authorities commenced verification and investigation proceedings of the Bank's income tax, value added tax and withholdings and payments on account of personal income tax for 2011 and 2012. On 4 November 2015 the taxation authorities notified the Bank of the assessment decisions, which were signed in acceptance and have been paid at 31 December 2015. A charge of Euros 1,897 thousand has been recognised in the consolidated income statement as a result of these assessments.

The different tax benefits applied in the calculation of income tax payable for 2016 and 2015 are as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2016** | **2015** |
| Income tax payable: | | |
| Deductions for double taxation | 10 | 6 |
| Deduction for R&D&I expenses | -- | -- |
| Deduction for donations | 25 | 25 |
| **Total** | **35** | **31** |

The Group made an extraordinary gain of Euros 32 thousand on the sale of computer software on 26 December 2011 and availed of tax relief for reinvestment in an amount of Euros 4 thousand, in accordance with article 42 of Royal Decree 4/2004 of 5 March 2004, which approved the Revised Income Tax Law. The proceeds from the sale amounted to Euros 73 thousand. In 2011 the Group reinvested Euros 502 thousand in new computer software which was recognised under intangible assets.

Independently of income tax recognised in the consolidated income statement, the Group has recognised taxes relating to valuation adjustments to available-for-sale financial assets directly in equity, until these assets are sold, amounting to Euros 1,712 thousand and Euros 1,455 thousand at 31 December 2016 and 2015, respectively.

At 31 December 2016, the Group's balance sheet includes certain tangible assets for own use that were revalued in 2005 at Euros 6,638 thousand, in accordance with the First Transitional Provision of Banco de España Circular 4/2004 (see note 11). Pursuant to article 122 of the Income Tax Law, this amount has not been included in the taxable income for 2016 and 2015.

## 20. Off-Balance Sheet Items

Off-balance sheet items comprise rights, obligations and other legal situations that in the future may have an impact on net assets, as well as any other balances necessary to reflect all transactions entered into by the consolidated entities, even where these do not impinge on their net assets.

### *a) Guarantees extended*

Contingent liabilities include all transactions under which the consolidated entities guarantee the obligations of a third party and which result from financial guarantees granted by the entities or from other types of contract, Contingent liabilities comprise the following items:

- Financial guarantees

Financial guarantees are the amounts that would be payable by the consolidated entities on behalf of third parties as a result of the commitments assumed by those entities in the course of their ordinary business, if the parties who are originally liable to pay fail to do so.

Details of contingent commitments at 31 December 2016 and 2015 are as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2016** | **2015** |
| Financial guarantees | 40,796 | 31,764 |
| Irrevocable documentary credits | 58,674 | 47,473 |
| Other bank guarantees and indemnities provided | 11,028 | 8,759 |
| **Total** | **110,498** | **87,996** |

A significant part of these amounts will expire without generating any obligations for the consolidated companies, and therefore the total balance of these commitments cannot be considered a requirement for future financing or cash to be extended to third parties.

Income from guarantee instruments is recognised under "Fee and commission income" in the consolidated income statements and is calculated by applying the rate established in the related contract to the nominal amount of the guarantee (see note 26).

***b) Contingent commitments***

Contingent commitments include those irrevocable commitments that could give rise to the recognition of financial assets.

Details of contingent commitments at 31 December 2016 and 2015 are as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2016** | **2015** |
| Drawable by third parties | 103,714 | 174,961 |
| Regular way financial asset purchase contracts | 116,694 | 2,988 |
| Unpaid subscribed capital | 90 | 2 |
| Securities placement and subscription commitments | 2,033 | 2,263 |
| Other contingent commitments | 1,330 | -- |
| **Total** | **223,861** | **180,214** |

## 21. Off-Balance Sheet Funds Under Management

Details of off-balance sheet funds managed by the Group at 31 December 2016 and 2015 are as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2016** | **2015** |
| Investment companies and mutual funds | 3,700,707 | 3,586,527 |
| Customer portfolios managed on a discretionary basis | 1,221,604 | 1,181,836 |
| Marketed but not managed by the Group | 429,210 | 385,673 |
| **Total** | **5,351,521** | **5,154,036** |

## 22. Financial and Non-financial Assets and Liabilities Not Carried at Fair Value

***a) Fair value of financial assets and financial liabilities***

At 31 December 2016 and 2015 the fair value of the Group's financial instruments, by type of financial asset and financial liability and level, is as follows:

- Level 1: financial instruments with fair value based on their quoted price in active markets, without making any modifications to these assets.

- Level 2: Financial instruments with fair value estimated on the basis of their quoted price in organised markets for similar instruments or through other valuation techniques in which all significant inputs are based on directly or indirectly observable market data.

- Level 3: Instruments with fair value estimated through valuation techniques in which certain significant input is not based on observable market data.

Input is considered significant if it is important in determining the fair value as a whole.

**2016**

**Thousands of Euros**

| **Financial assets** | **Financial assets held for trading** | | **Available-for-sale financial assets** | | **Held-to-maturity investments** | | **Loans and receivables** | | **Total** | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **Carrying amount** | **Fair value** | **Carrying amount** | **Fair value** | **Carrying amount** | **Fair value** | **Carrying amount** | **Fair value** | **Carrying amount** | **Fair value** |
| **Nivel 1**: | | | | | | | | | | |
| Debt securities | 1,776,811 | 1,776,811 | 3,947,912 | 3,947,912 | 90,014 | 99,956 | -- | -- | 5,814,737 | 5,824,679 |
| Equity instruments | -- | -- | 8,957 | 8,957 | -- | -- | -- | -- | 8,957 | 8,957 |
| **Nivel 2**: | | | | | | | | | | |
| Debt securities | 310,698 | 310,698 | 15,945 | 15,945 | -- | -- | 29,096 | 30,230 | 355,739 | 356,873 |
| Deposits with credit institutions and central banks | -- | -- | -- | -- | -- | -- | 4,130,741 | 4,130,480 | 4,130,741 | 4,130,480 |
| Loans and advances to other debtors | -- | -- | -- | -- | -- | -- | 1,110,404 | 1,184,622 | 1,110,404 | 1,184,622 |
| Derivatives | 522,220 | 522,220 | -- | -- | -- | -- | -- | -- | 522,220 | 522,220 |
| **Nivel 3**: | -- | -- | | | | | | | | |
| Debt securities | -- | -- | -- | -- | -- | -- | 4,127 | 4,127 | 4,127 | 4,127 |
| Equity instruments | -- | -- | 15,530 | 15,530 | -- | -- | -- | -- | 15,530 | 15,530 |
| Derivatives | 36,006 | 36,006 | -- | -- | -- | -- | -- | -- | 36,006 | 36,006 |
| **Total** | **2,645,735** | **2,645,735** | **3,988,344** | **3,988,344** | **90,014** | **99,956** | **5,274,368** | **5,349,459** | **11,998,461** | **12,083,494** |

**Thousands of Euros**

| **Financial liabilities** | **Financial liabilities held for trading** | | **Financial liabilities designated at fair value through profit or loss** | | **Financial liabilities at amortised cost** | | **Hedging derivatives** | | **Total** | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **Valor en libros** | **Valor razonable** | **Valor en libros** | **Valor razonable** | **Valor en libros** | **Valor razonable** | **Valor en libros** | **Valor razonable** | **Valor en libros** | **Valor razonable** |
| **Nivel 1**: | | | | | | | | | | |
| Short positions | 234,273 | 234,273 | -- | -- | -- | -- | -- | -- | 234,273 | 234,273 |
| **Nivel 2**: | | | | | | | | | | |
| Deposits from central banks and credit institutions | -- | -- | 4,731 | 4,731 | 7,605,046 | 7,609,261 | -- | -- | 7,609,777 | 7,613,992 |
| Deposits from other creditors | -- | -- | -- | -- | 5.039.765 | 5.041.580 | -- | -- | 5.039.765 | 5.041.580 |
| Derivatives | 546,764 | 546,764 | -- | -- | -- | -- | 62,570 | 62,570 | 609,334 | 609,334 |
| Other financial liabilities | -- | -- | -- | -- | 15,403 | 15,403 | -- | -- | 15,403 | 15,403 |
| **Nivel 3**: | | | | | | | -- | | | |
| Derivatives | 36,018 | 36,018 | -- | -- | -- | -- | -- | -- | 36,018 | 36,018 |
| **Total** | **817,055** | **817,055** | **4,731** | **4,731** | **12,660,214** | **12,666,244** | **62,570** | **62,570** | **13,544,570** | **13,550,600** |

**2015**

| Financial assets | Financial assets held for trading | | Available-for-sale financial assets | | Held-to-maturity investments | | Loans and receivables | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **Thousands of Euros** | | | | | | | | | |
| | Carrying amount | Fair value | Carrying amount | Fair value | Carrying amount | Fair value | Carrying amount | Fair value | Carrying amount | Fair value |
| **Level 1**: | | | | | | | | | | |
| Debt securities | 1,820,932 | 1,820,932 | 3,785,354 | 3,785,354 | 115,454 | 128,593 | 46,900 | 50,937 | 5,768,640 | 5,785,816 |
| Equity instruments | -- | -- | 8,734 | 8,734 | -- | -- | -- | -- | 8,734 | 8,734 |
| **Level 2:** | | | | | | | | | | |
| Debt securities | 473,531 | 473,531 | 26,337 | 26,337 | -- | -- | 10,919 | 11,858 | 510,787 | 511,726 |
| Deposits with credit institutions and central banks | -- | -- | -- | -- | -- | -- | 7,088,911 | 7,090,691 | 7,088,911 | 7,090,691 |
| Loans and advances to other debtors | -- | -- | -- | -- | -- | -- | 995,342 | 1,074,393 | 995,342 | 1,074,393 |
| Derivatives | 457,292 | 457,292 | -- | -- | -- | -- | -- | -- | 457,292 | 457,292 |
| **Level 3:** | | | | | | | | | | |
| Equity instruments | -- | -- | 8,441 | 8,441 | -- | -- | -- | -- | 8,441 | 8,441 |
| Derivatives | 40,554 | 40,554 | -- | -- | -- | -- | -- | -- | 40,554 | 40,554 |
| **Total** | **2,792,309** | **2,792,309** | **3,828,866** | **3,828,866** | **115,454** | **128,593** | **8,142,072** | **8,227,879** | **14,878,701** | **14,977,647** |

| Financial liabilities | Financial liabilities held for trading | | Financial liabilities designated at fair value through profit or loss | | Financial liabilities at amortised cost | | Hedging derivatives | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **Thousands of Euros** | | | | | | | | | |
| | Carrying amount | Fair value | Carrying amount | Fair value | Carrying amount | Fair value | Carrying amount | Fair value | Carrying amount | Fair value |
| **Level 1**: | | | | | | | | | | |
| Short positions | 195,022 | 195,022 | -- | -- | -- | -- | -- | -- | 195,022 | 195,022 |
| **Level 2**: | | | | | | | | | | |
| Deposits from central banks and credit institutions | -- | -- | 4,731 | 4,731 | 11,349,861 | 11,357,986 | -- | -- | 11,354,592 | 11,362,717 |
| Deposits from other creditors | -- | -- | -- | -- | 4,921,950 | 4,922,054 | -- | -- | 4,921,950 | 4,922,054 |
| Derivatives | 389,496 | 389,496 | -- | -- | -- | -- | 49,654 | 49,654 | 439,150 | 439,150 |
| Other financial liabilities | -- | -- | -- | -- | 11,356 | 11,356 | -- | -- | 11,356 | 11,356 |
| **Level 3**: | | | | | | | | | | |
| Derivatives | 40,516 | 40,516 | -- | -- | -- | -- | -- | -- | 40,516 | 40,516 |
| **Total** | **625,034** | **625,034** | **4,731** | **4,731** | **16,283,167** | **16,291,396** | **49,654** | **49,654** | **16,962,586** | **16,970,815** |

The methodology used to calculate the fair value of each class of financial asset and financial liability is as follows:

Trading derivatives and hedging derivatives

- The fair value of a financial derivative traded on an organised, transparent and deep market is equivalent to its daily quotation price and if, for exceptional reasons, its quotation price on a given date could not be established, methods similar to those used to measure derivatives not traded on organised markets are applied.

- The fair value of derivatives not traded on organised markets, or traded on organised but less deep and transparent markets, is equivalent to the sum of future cash flows originating from the instrument, discounted at the measurement date ("present value" or "notional close"); using methods recognised by the financial markets : "net present value" (NPV), option pricing models, etc., specifically:

    - Interest rate derivatives: for financial instruments besides options, primarily swaps, the fair value has been determined by discounting future cash flows using implicit money market curves and the swap curve, while in the case of interest rate options it has been determined using generally accepted valuation techniques based on Black-Scholes and implied volatility matrices.

    - Derivatives on equity instruments or stock market indices and currency derivatives: the fair value is determined using the Monte Carlo method, which consists of random sampling of underlying inputs, taking into account their probability distribution. The factors used in the simulation are: price of underlying asset, currency interest rates, currency exchange rates, dividends paid out by the underlying asset, its volatility and the level of correlation.

- Credit Valuation Adjustments (hereinafter "CVA") and Debit Valuation Adjustments (hereinafter "DVA") are included in the measurement of both asset and liability derivative products to reflect the impact on fair value of counterparty credit risk and the Group's own risk, respectively.

  The adjustments to be performed are calculated by estimating exposure at default, the probability of default and loss given default for all derivative products with any underlying, by legal entity (i.e. all counterparties under the same ISDA/CMOF contract) to which Banco Cooperativo Español is exposed.

  In general, the CVA is calculated by multiplying expected positive exposure by the counterparty's probability of default. The DVA is calculated by multiplying the expected negative exposure by the probability of default, then multiplying the result by the Bank's loss given default. Both calculations encompass the entire duration of the potential exposure.

  The information required to calculate the probability of default and the loss given default is obtained from credit markets (Credit Default Swaps or iTraxx indices), applying the Entity's own information if available. If information is not available, a process based on sector, rating and location is applied to assign both probabilities of insolvency and expected losses in the event of insolvency, calibrated directly to market or through the adjustment to market of the probabilities of insolvency and historical expected losses.

  At 31 December 2016 and 2015 the Group held positions in OTC derivatives, primarily interest rate swaps, equity options and securities swaps, mainly as a result of services provided to rural savings banks involving intermediation between the banks and market counterparties and asset securitisation funds (back-to-back operations). These instruments do not offer predetermined cash flows, but rather their cash flows depend upon the performance of certain market risk factors (interest rates, exchange rates, share prices, etc.) leading to changes in their fair value which could, at any time, fluctuate between a positive value (exposure to counterparty risk) or a negative value (exposure to own credit risk).

According to the Group's calculations, the net impact of the measurement of credit risk positions under assets (“Credit Valuation Adjustment” - CVA) and liabilities (“Debt Valuation Adjustment” - DVA), is net income of Euros 7,534 thousand (Euros 6,496 thousand in 2015), which has been recognised under “Gains or losses on financial assets and liabilities designated at fair value held for trading” in the accompanying income statement.

Debt securities

- Quoted debt instruments: the fair value of these instruments has been determined on the basis of the quoted price in official markets, the Banco de España Book-Entry System (“Central de Anotaciones”), the Spanish Fixed Income Market (AIAF), etc., or using the prices obtained from information service providers, primarily Bloomberg and Reuters, based on the prices notified to these agencies by contributors.

- Unquoted debt instruments: the fair value of these instruments has been determined in the same way as the value of loans and receivables.

Equity instruments

- Quoted equity instruments: the fair value of these instruments has been determined taking into account the quoted price on official markets.

- Unquoted equity instruments: the fair value of these instruments has been determined taking into consideration independent expert valuations based, amongst other factors, on the following:

    - Discounted cash flows (operating free cash flow or dividends), brought up to date using a discount rate associated with the operational and financial risk of each investee, calculated on the basis of the risk-free rate, including a market-adjusted risk premium.

    - Multiples of comparable listed companies (EV/EBITDA, PER, price-to-book ratio, Price/Premium), less an illiquidity discount.

    - Adjusted net asset value (NAV): obtained by adding gains, calculated as the difference between the assets' market value and their carrying amount, to shareholders' equity as per the accounts. In the case of venture capital firms, the NAV has been calculated by the management company, and the estimate generally takes into account European Private Equity and Venture Capital Association (EVCA) standards and the provisions of Spanish National Securities Market Commission (CNMV) Circular 5/2000 of 19 September 2000.

    - The price obtained through market transactions conducted or purchase offers received at a time close to the valuation date.

Loans and receivables – Loans and advances to other debtors

The fair value of these instruments has been obtained by applying the discounted cash flow model, using interest rates based on directly or indirectly observable market data when calculating the discount rate, and inputs that are not observable in the market, such as credit risk associated with the portfolio, when estimating future cash flows.

Financial liabilities at amortised cost

The fair value of these liabilities has been obtained by applying the discounted cash flow model, using interest rates based on directly or indirectly observable market data.

***b) Fair value of tangible assets***

Tangible assets are carried at their appraisal value at 1 January 2004 (see note 10), The fair value is based on external appraisals and internal appraisals contrasted with market data and is not considered to differ significantly from the carrying amount at 31 December 2016 and 2015.

## 23. Interest Income

Interest and similar income comprises the interest accrued in the year on all financial assets with an implicit or explicit return, calculated by applying the effective interest method, irrespective of measurement at fair value, Interest is recognised gross, without deducting any tax withheld at source.

Details of the main interest and similar income earned by the Group in 2016 and 2015 are as follows:

| | **Thousands of Euros** | |
|---|---|---|
| | **2016** | **2015** |
| Balances with central Banks (note 5) | 35 | 177 |
| Loans and advances to credit institutions (note 8) | 12,382 | 20,139 |
| Loans and advances to other debtors (note 8) | 25,376 | 26,114 |
| Debt securities (note 7 and 9) | 27,047 | 53,631 |
| Doubtful assets | 2 | 1 |
| Rectifications as a result of hedging transactions (note 14) | (10,451) | (4,700) |
| Other interest | 28,060 | 7,994 |
| **Total** | **82,451** | **103,356** |

## 24. Interest expense and similar charges

Interest expense and similar charges include the interest accrued during the year on all financial liabilities with an implicit or explicit return, calculated by applying the effective interest method, irrespective of measurement at fair value,

Details of the main items of interest expense and similar charges accrued by the Group in 2016 and 2015 are as follows:

| | **Thousands of Euros** | |
|---|---|---|
| | **2016** | **2015** |
| Deposits from central Banks (note 12) | 1,585 | 4,547 |
| Deposits from credit institutions (note 12) | 19,639 | 32,967 |
| Deposits from other creditors (note 12) | 28 | 166 |
| Debt certificates including bonds (note 12) | -- | 879 |
| Rectifications as a result of hedging transactions (note 14) | (6,494) | (1,249) |
| Other interest | 6,921 | 2,646 |
| **Total** | **21,679** | **39,956** |

## 25. Dividend Income

Dividend income includes the dividends and remuneration from equity instruments deriving from profits generated by investees after the acquisition of the equity interest.

Details of dividend income are as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2016** | **2015** |
| Available-for-sale financial assets | 458 | 264 |
| **Total** | **458** | **264** |

## 26. Fee and commission Income

Fee and commission income comprises the amount of all fees and commissions accrued during the year, except those forming an integral part of the effective interest rate on financial instruments.

Details are as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2016** | **2015** |
| Contingent exposures (note 20) | 869 | 847 |
| Contingent commitments (note 20) | 73 | 77 |
| Foreign currency exchange | 489 | 470 |
| Collection and payment service | 2,165 | 1,839 |
| Transfers, giros and other payment orders | 47,166 | 46,000 |
| Sale of non-banking products | 2,073 | 2,139 |
| Other fees and commissions | 1,277 | 1,433 |
| **Total** | **54,112** | **52,805** |

## 27. Fee and commission expense

Fee and commission expense comprises all fees and commissions paid or payable by the Group in the year, except those forming an integral part of the effective interest rate on financial instruments.

Details are as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2016** | **2015** |
| Fees and commissions assigned to other entities and correspondents | 7,862 | 6,628 |
| Fee and commission expenses on securities transactions | 31,988 | 30,675 |
| Other fees and commissions | 141 | 88 |
| **Total** | **39,991** | **37,391** |

## 28. Gains or Losses on Financial Assets and Financial Liabilities and Exchange Difference (Net)

Gains or losses on financial assets and financial liabilities

Gains or losses on financial assets and financial liabilities include valuation adjustments to financial instruments, except those attributable to interest accrued as a result of applying the effective interest method and to impairment of assets recorded in the consolidated income statement, as well as gains or losses on the sale and purchase of financial instruments.

Details by type of instrument are as follows:

| By line item | Thousands of Euros | |
|---|---|---|
| | **2016** | **2015** |
| Gains or losses on derecognition of financial assets and liabilities not measured at fair value through profit or loss, net | 3,066 | 3,941 |
| Gains or losses on financial assets and liabilities held for trading, net | 10,842 | 6,992 |
| Gains or losses on financial assets and liabilities designated at fair value through profit or loss, net | 4 | -- |
| Gains or losses on hedge accounting, net | 11 | -- |
| **Total** | **13,923** | **10,933** |
| **By type of financial instrument** | | |
| Net income from debt securities | 11,404 | 13,499 |
| Net income from other equity instruments | 82 | 332 |
| Net income/expense from derivatives | 2,427 | (2,906) |
| Net income from other items | 10 | 8 |
| **Total** | **13,923** | **10,933** |

"Gains or losses on hedge accounting, net" reflects fair value hedges, distinguishing between hedging instruments and the hedged item, Gains and losses recognised in 2016 and 2015 are as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2016** | **2015** |
| Hedge accounting not included in interest | 11 | -- |
| Hedging derivatives | (9,151) | (10,012) |
| Gains | 29,995 | 123,582 |
| Losses | (39,146) | (133,594) |
| Hedged items | 9,162 | 10,012 |
| Gains | 76,826 | 131,958 |
| Losses | (67,664) | (121,946) |

Exchange differences (net)

Exchange differences include gains and losses on the purchase and sale of foreign currencies and differences arising from the conversion of the different monetary items in the consolidated balance sheet from foreign currency to Euros.

Total net exchange differences amount to Euros 426 thousand at 31 December 2016 (Euros 696 thousand at 31 December 2015) (see note 34-5).

## 29. Personnel Expenses

Personnel expenses comprise all remuneration of permanent and temporary personnel on the payroll, irrespective of their duties or activity, accrued during the year for all items, including the current service cost for pension plans.

Details are as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2016** | **2015** |
| Wages and salaries | 12,449 | 11,410 |
| Social Security | 2,630 | 2,517 |
| Charges to pension plans | 85 | 94 |
| Other personnel expenses | 123 | 155 |
| **Total** | **15,287** | **14,176** |

The average number of employees in the Group, by professional category, is as follows:

| | **2016** | | | **2015** | | |
|---|---|---|---|---|---|---|
| | **Male** | **Female** | **Average** | **Male** | **Female** | **Average** |
| Management team | 12 | 1 | 14 | 13 | 1 | 14 |
| Directors | 16 | 9 | 25 | 16 | 8 | 24 |
| Department managers | 9 | 9 | 19 | 9 | 10 | 21 |
| Technical specialists | 49 | 55 | 92 | 37 | 42 | 74 |
| Administrative personnel | 22 | 46 | 75 | 31 | 50 | 81 |
| **Total** | **108** | **120** | **225** | **106** | **111** | **214** |
| By type of contract | | | | | | |
| Indefinite | 106 | 119 | 221 | 102 | 111 | 212 |
| Temporary | 2 | 1 | 4 | 4 | -- | 2 |
| **Total** | **108** | **120** | **225** | **106** | **111** | **214** |

At 31 December 2016 and 2015, the Group had three disabled employees.

## 30. Other Administrative Expenses

At 31 December 2016 and 2015 three group employees were disabled.

| | Thousands of Euros | |
|---|---|---|
| | **2016** | **2015** |
| Property, fixtures and materials | 578 | 601 |
| Information technology | 2,438 | 2,310 |
| Communications | 1,321 | 1,264 |
| Advertising and publicity | 96 | 96 |
| Legal and lawyer expenses | 366 | 258 |
| Technical reports | 1,137 | 1,317 |
| Security and armoured cash transport services | 233 | 229 |
| Insurance premiums | 178 | 215 |
| Governing and control bodies | 202 | 222 |
| Entertainment and staff travel expenses | 301 | 214 |
| Association membership fees | 319 | 324 |
| Outsourced administrative services | 709 | 640 |
| Contributions and taxes | 591 | 623 |
| Other | 285 | 290 |
| **Total** | **8,754** | **8,603** |

KPMG Auditores S.L., the auditors of the Group's consolidated annual accounts, have invoiced fees and expenses for professional services during the years ended 31 December 2016 and 2015, as follows:

| | Thousands of Euros | | | |
|---|---|---|---|---|
| | Bank | | Group | |
| | **2016** | **2015** | **2016** | **2015** |
| Audit services | 41 | 41 | 48 | 47 |
| Other assurance services | 22 | 59 | 22 | 59 |
| Other services | 3 | 3 | 3 | 3 |
| **Total** | **66** | **103** | **73** | **109** |

The amounts detailed in the above table include the total fees for services rendered in 2016 and 2015, irrespective of the date of invoice.

Other companies forming part of the KPMG Europe, LLP Group invoiced the Bank and the Group the following fees and expenses for professional services during the years ended 31 December 2016 and 2015:

| | Thousands of Euros | |
|---|---|---|
| | **2016** | **2015** |
| Other services | 11 | 45 |

## 31. Segment Reporting

Segmentation criteria

Segment reporting is based on the Group's different lines of business, Geographical distribution is not significant as almost all revenue is obtained in Spain. The following lines of business have been defined based on the Group's organisational structure, taking into account the nature of the products and services, as well as the clients,

The Group focused its activities on the following segments in 2016 and 2015:

- Commercial banking
- Asset management
- Markets
- Corporate activities

Bases and method of business segment reporting

Segment information is based on internal systems for calculating profitability by business area,.

Interest income and revenue from lines of business are calculated by applying transfer prices in line with prevailing market rates to the corresponding assets and liabilities. Administrative expenses include direct expenses and certain allocated expenses of support service units.

| | Commercial banking | | Asset management | | Markets | | Corporate activities | | Total Group | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **Thousands of Euros** | | | | | | | | | |
| | **2016** | **2015** | **2016** | **2015** | **2016** | **2015** | **2016** | **2015** | **2016** | **2015** |
| Gross margin | 17,931 | 17,126 | 10,489 | 11,058 | 45,257 | 44,856 | 10,801 | 11,232 | 84,478 | 84,272 |
| Administrative expenses, amortisation and depreciation | 5,674 | 4,653 | 3,258 | 2,604 | 5,195 | 3,957 | 11,381 | 12,963 | 25,508 | 24,177 |
| Provisions and impairment losses on financial assets | (5,571) | 4,056 | -- | -- | (406) | -- | 3,917 | 3,900 | (2,060) | 7,956 |
| Profit on operating activities | 17,828 | 8,417 | 7,231 | 8,454 | 40,468 | 40,899 | (4,497) | (5,631) | 61,030 | 52,139 |
| Other profit | -- | -- | -- | -- | -- | -- | (1) | (1) | (1) | (1) |
| Profit before income tax | 17,828 | 8,417 | 7,231 | 8,454 | 40,468 | 40,899 | (4,498) | (5,632) | 61,029 | 52,138 |
| Corporate income tax | 4,802 | 2,386 | 1,948 | 2,397 | 10,900 | 11,594 | (1,212) | (1,596) | 16,438 | 14,781 |
| **Consolidated profit for the year** | **13,026** | **6,031** | **5,283** | **6,057** | **29,568** | **29,305** | **(3,286)** | **(4,036)** | **44,591** | **37,357** |

## 32. Related Parties

In addition to the information provided in note 4 on remuneration received, details of balances and transactions with related parties during 2016 and 2015 are as follows:

| | Associates | | Other related parties | |
|---|---|---|---|---|
| **Assets** | **2016** | **2015** | **2016** | **2015** |
| Loans and advances to other debtors | 1,475 | 1,865 | 23 | 69 |
| Allowances and provisions for credit risk | (4) | (31) | -- | (1) |
| **Liabilities** | | | | |
| Deposits from other customers | 1,617 | 778 | 2,524 | 1,448 |
| **Other** | | | | |
| Contingent liabilities | -- | -- | -- | -- |
| Commitments | -- | -- | -- | -- |
| **Profit and loss** | | | | |
| Interest and similar income | 14 | 16 | -- | 2 |
| Interest expense and similar charges | 1 | 1 | 1 | 1 |

## 33. Customer Service Department

In accordance with Article 17 of Ministry of Economy Order ECO/734/2004 of 11 March 2004 on customer service departments and the financial institution ombudsman, the 2015 Annual Report presented by the head of the service to the board of directors at their meeting held on 22 February 2017 is summarised below.

In 2016, the Customer Service Department received eight claims and/or complaints, none of which were rejected and all of which were resolved during the year. Seven of these claims and/or complaints were lodged by individuals, while the eighth came from a property owners' association.

| | Number | |
|---|---|---|
| **Issue** | **2016** | **2015** |
| Loans | 2 | 1 |
| Deposits | 1 | - |
| Other banking products | 1 | 2 |
| Collection and payment service | 1 | 1 |
| Other | 3 | - |
| **Total** | **8** | **4** |

The number of complaints resolved, by autonomous region, is as follows:

| | **2016** | **2015** |
|---|---|---|
| Baleares | - | 1 |
| La Rioja<br>Madrid | 1 | - |
| País Vasco | 5 | 2 |
| Extremadura | 1 | - |
| Galicia | 1 | - |

## 34. <u>Risk Management</u>

The Banco Cooperativo Español Group's risk exposure mainly relates to the assets and liabilities of the Entity, whose total assets account for 99.80% of the Group's total assets at 31 December 2016 and 2015, respectively (see note 1).

### *34.1 Credit risk*

Credit risk is the risk of one party to a contract that meets the definition of a financial instrument ceasing to comply with its obligations, resulting in a financial loss for the other party.

Credit risk therefore represents the risk of loss assumed by the Group in the event that a customer or any counterparty fails to comply with its contractual payment obligations. This risk is inherent in traditional products of banking entities (loans, credit facilities, financial guarantees extended, etc.), as well as in other types of financial assets (fixed-income securities of the Group, derivatives, etc.).

Credit risk affects financial assets carried at amortised cost and assets recognised at fair value in the consolidated financial statements. The Group applies the same credit risk control policies and procedures to these financial assets irrespective of the recognition criteria used.

The Group's credit risk control policies and objectives have been approved by the Bank's board of directors. The Risk Committee, together with the Assets and Liabilities Committee, is in charge of implementing the Group's risk policies that enable compliance with the objectives set by the board. The risk control unit (under the General Audit and Risks Department and, therefore, independent of the business units in charge of implementing policies defined by the Entity) is responsible for establishing the control procedures required to continuously monitor the levels of risk assumed by the Group as well as strict compliance with the objectives set by the Group with respect to credit risks. Together with the Internal Audit Department (under the Internal Audit Committee), the risk control unit also monitors compliance with the Group's risk control policies, methods and procedures, ensuring that these are sufficient, implemented effectively and reviewed regularly, and providing the information required by higher-level governing bodies to implement the necessary corrective measures, where applicable.

The control unit monitors, on an ongoing basis, risk concentration levels, the default rate and the different warning systems in place that enable it to keep an eye on credit risk trends at all times, Any deviations from the forecast performance of any of these parameters are analysed to determine the causes. Once the causes of these deviations are known, they are analysed by the control unit which submits the corresponding reports to the Group's management bodies so that the necessary corrective measures may be taken; for example, defining or correcting established control mechanisms which may not have functioned satisfactorily, or amending policies and limits agreed by the Group. In particular, a more exhaustive analysis will be performed of operations which, for different reasons, have resulted in payment delays or defaults, to determine the effectiveness of the hedges contracted by the entity, in order to take any necessary measures to improve the Group's acceptance policies and credit risk analysis mechanisms.

### *34.1.1 Maximum credit risk exposure level*

The following table shows the maximum credit risk exposure level assumed by the Group at 31 December 2016 and 2015 for each type of financial instrument, without deducting collateral or any other guarantees received to ensure repayment by borrowers:

| | | 2016 | | | | |
|---|---|---|---|---|---|---|
| | | Thousands of Euros | | | | |
| **Type of instruments** | **Other demand deposits** | **Financial assets held for trading** | **Available-for-sale financial assets** | **Loans and receivables** | **Held-to-maturity investments** | **Total** |
| **Instrumentos de deuda** | | | | | | |
| Loans and advances to credit institutions | 1,917,523 | -- | -- | 4,130,378 | -- | 6,047,901 |
| Marketable securities | -- | 2,087,509 | 3,964,416 | 34,083 | 90,014 | 6,176,022 |
| Loans and advances to other debtors | -- | -- | -- | 1.146.201 | -- | 1.146.201 |
| **Total debt instruments** | **1,917,523** | **2,087,509** | **3,964,416** | **5,310,662** | **90,014** | **13,370,124** |
| **Equity instruments** | -- | -- | **24,487** | -- | -- | **24,487** |
| **Guarantees extended** | | | | | | |
| Guarantee deposits | -- | -- | -- | 40,796 | -- | 40,796 |
| Other contingent exposures | -- | -- | -- | 69,702 | -- | 69,702 |
| **Total guarantees extended** | -- | -- | -- | **110,498** | -- | **110,498** |
| **Other exposures** | | | | | | -- |
| Derivatives | -- | 558,226 | -- | -- | -- | 558,226 |
| Contingent commitments | -- | -- | -- | 223,861 | -- | 223,861 |
| **Total other exposures** | -- | **558,226** | -- | **223,861** | -- | **782,087** |
| **Maximum credit risk exposure level** | **1,917,523** | **2,645,735** | **3,988,903** | **5,645,021** | **90,014** | **14,287,196** |

| Type of instruments | 2015 Thousands of Euros Other demand deposits | Trading portfolio | Available-for-sale financial assets | Loans and receivables | Held-to-maturity investments | Total |
|---|---|---|---|---|---|---|
| **Debt instruments** | | | | | | |
| Loans and advances to credit institutions | 2,280,558 | -- | -- | 7,085,409 | -- | 9,365,967 |
| Marketable securities | -- | 2,294,463 | 3,811,691 | 60,669 | 115,454 | 6,282,277 |
| Loans and advances to other debtors | -- | -- | -- | 1,038,416 | -- | 1,038,416 |
| **Total debt instruments** | **2,280,558** | **2,294,463** | **3,811,691** | **8,184,494** | **115,454** | **16,686,660** |
| **Equity instruments** | -- | -- | 17,175 | -- | -- | 17,175 |
| **Contingent exposures** | | | | | | |
| Guarantee deposits | -- | -- | -- | 31,764 | -- | 31,764 |
| Other contingent exposures | -- | -- | -- | 56,232 | -- | 56,232 |
| **Total contingent exposures** | -- | **--** | **--** | **87,996** | **--** | **87,996** |
| **Other exposures** | | | | | | |
| Derivatives | -- | 497,846 | -- | -- | -- | 497,846 |
| Contingent commitments | -- | -- | -- | 180,214 | -- | 180,214 |
| **Total other exposures** | -- | 497,846 | -- | 180,214 | -- | 678,060 |
| **Maximum credit risk exposure level** | **2,280,558** | **2,792,309** | **3,828,866** | **8,452,704** | **115,454** | **17,469,891** |

The following should be taken into consideration in relation to the information shown in the above tables:

- "Debt instruments" recognised under assets in the consolidated balance sheet are reflected at their carrying amount, excluding valuation adjustments (impairment losses, deferred interest, arrangement costs and similar commissions pending deferral, etc.).

- "Contingent commitments" comprise available balances bearing no conditions for debtors,

- Contingent exposures are stated at the maximum amount guaranteed by the Group, In general, most of these balances are estimated to reach maturity without requiring any actual financing by the Entity (see note 20).

- Information on other credit risk exposures, such as counterparty risk related to the contracting of derivative financial instruments, is stated at the carrying amount.

*34.1.2 Credit rating of credit risk exposures*

The Group uses advanced models to measure credit risk, The credit rating of public entities, financial institutions and corporate customers is measured through rating systems, while the credit rating of the retail banking portfolio (individual customers, small companies and freelance professionals) is measured using scoring systems.

The distribution of risk at 31 December 2016 and 2015, based on ratings (external or internal, in line with the credit rating models developed by the Group) is as follows:

| | 2016 | | 2015 | |
|---|---|---|---|---|
| **Credit rating** | **Thousands of Euros** | **%** | **Thousands of Euros** | **%** |
| AAA | 10,358 | 0.1 | 2,024 | 0.0 |
| AA+ | 52,187 | 0.5 | 15,341 | 0.1 |
| AA | 63,143 | 0.6 | 43,294 | 0.3 |
| AA- | 16,283 | 0.1 | 5,287 | 0.0 |
| A+ | 5,143 | 0.0 | 24,576 | 0.2 |
| A | 67,739 | 0.6 | 273,998 | 1.8 |
| A- | 9,092,642 | 80.9 | 12,327,325 | 81.9 |
| BBB+ | 339,236 | 3.0 | 311,564 | 2.1 |
| BBB | 762,064 | 6.8 | 652,974 | 4.3 |
| BBB- | 98,613 | 0.9 | 440,694 | 2.9 |
| BB+ | 72,211 | 0.6 | 100,618 | 0.7 |
| BB | 107,258 | 1.0 | 212,579 | 1.4 |
| Below BB | 307,813 | 2.7 | 439,923 | 2.9 |
| Not rated | 248,179 | 2.2 | 195,576 | 1.3 |
| **Total** | **11,242,869** | **100.0** | **15,045,774** | **100.0** |

*34.1.3 Loans and advances to other debtors Details by counterparty*

The carrying amounts of the total financing classified by counterparty and details of the collateral pledged to secure transactions are as follows:

| | 2016 Thousands of Euros | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | | | **Secured loans Loan to value** | | | | |
| | **Total** | **Of which: Real estate collateral** | **Of which: Other collateral** | **Less than or equal to 40%** | **More than 40% and less than or equal to 60%** | **More than 60% and less than or equal to 80%** | **More than 80% and less than or equal to 100%** | **Loan to value More than 100%** |
| **Spanish general government** | **661,968** | -- | -- | -- | -- | -- | -- | -- |
| **Other financial institutions** | **185,458** | -- | -- | -- | -- | -- | -- | -- |
| **Non-financial companies and individual entrepreneurs** | **173,001** | **14,732** | **1,820** | **4,268** | **11,053** | **1,231** | **--** | **--** |
| Construction and real estate development | **7** | -- | -- | -- | -- | -- | -- | -- |
| Civil works | **19,909** | 94 | -- | 94 | -- | -- | -- | -- |
| Other | **153,085** | 14,638 | 1,820 | 4,174 | 11,053 | 1,231 | -- | -- |
| Large companies | **90,339** | 11,190 | -- | 3,505 | 7,685 | -- | -- | -- |
| SMEs and individual entrepreneurs | **62,746** | 3,448 | 1,820 | 669 | 3,368 | 1,231 | -- | -- |
| **Other households and non-profit institutions serving households** | **90,259** | **68,667** | **904** | **15,901** | **14,701** | **22,321** | **8,874** | **7,774** |
| Homes | **65,147** | 63,796 | -- | 13,325 | 13,358 | 21,666 | 8,396 | 7,051 |
| Consumer | **8,388** | -- | -- | -- | -- | -- | -- | -- |
| Other | **16,724** | 4,871 | 904 | 2,576 | 1,343 | 655 | 478 | 723 |
| **TOTAL** | **1,110,686** | **83,399** | **2,724** | **20,169** | **25,754** | **23,552** | **8,874** | **7,774** |
| MEMORANDUM ITEM | | | | | | | | |
| Refinancing, refinanced and restructured transactions | **24,009** | 10,028 | 2,689 | 2,868 | 187 | 2,004 | -- | 7,658 |

**2015**
**Thousands of Euros**
**Secured loans Loan to value**

| | **Total** | **Of which: Real estate collateral** | **Of which: Other collateral** | **Less than or equal to 40%** | **More than 40% and less than or equal to 60%** | **More than 60% and less than or equal to 80%** | **More than 80% and less than or equal to 100%** | **Loan to value More than 100%** |
|---|---|---|---|---|---|---|---|---|
| **Spanish general government** | **658,157** | **--** | **--** | **--** | **--** | **--** | **--** | **--** |
| **Other financial institutions** | **108,540** | **--** | **--** | **--** | **--** | **--** | **--** | **--** |
| **Non-financial companies and individual entrepreneurs** | **176,449** | **15,541** | **1,946** | **5,892** | **10,449** | **1,032** | **115** | **--** |
| Construction and real estate development | -- | -- | -- | -- | -- | -- | -- | -- |
| Civil works | 23,135 | 100 | -- | 100 | -- | -- | -- | -- |
| Other | 118,617 | 15,441 | 1,946 | 5,792 | 10,449 | 1,032 | 114 | -- |
| Large companies | 67,053 | 11,585 | -- | 3,213 | 8,372 | -- | -- | -- |
| SMEs and individual entrepreneurs | 51,564 | 3,856 | 1,946 | 2,579 | 2,077 | 1,032 | 115 | -- |
| **Other households and non-profit institutions serving households** | **86,893** | **68,771** | **449** | **14,500** | **15,141** | **19,768** | **8,664** | **11,147** |
| Homes | 65,793 | 63,920 | -- | 12,490 | 13,278 | 19,375 | 8,163 | 10,614 |
| Consumer | 3,328 | 13 | -- | 13 | -- | -- | -- | -- |
| Other | 17,772 | 4,838 | 449 | 1,997 | 1,863 | 392 | 502 | 533 |
| **SUBTOTAL** | **995,342** | **--** | **--** | **--** | **--** | **--** | **--** | **--** |
| (-) Valuation adjustment for impairment of assets not allocated to specific operations, | (34,704) | -- | -- | -- | -- | -- | -- | -- |
| **TOTAL** | **995,342** | -- | -- | -- | -- | -- | -- | -- |
| MEMORANDUM ITEM Refinancing, refinanced and restructured transactions | 31,340 | 12,878 | -- | 3,624 | 8,418 | 836 | -- | -- |

*Refinancings and restructurings policies*

The Group's refinancing and restructuring policy is defined in accordance with the specifications laid down in the Banco de España regulation. The objective of this policy is the recovery of all due amounts and it specifies the necessity of immediately recognising those amounts that are considered irrecoverable.

The transaction refinancing policy includes:

- An individual up-to-date analysis of the financial position and payment capacity of the borrowers and guarantors.

- The status and effectiveness of guarantees provided.

- Experience with the borrower: sufficiently extensive repayment history or, in the absence thereof, a repayment on the loan principal of equal value.

- Interruption of arrears. Refinancing or restructuring of transactions in arrears does not interrupt those arrears or lead to their reclassification, unless there is reasonable certainty that the customer can meet its payment obligations or put up new, effective guarantees and, in both cases, at least the outstanding ordinary interest payments are collected.

The following definitions are used for the purposes of Banco de España regulations:

- Refinancing transaction: a transaction which, irrespective of the holder or guarantees, is granted or used for economic or legal reasons related to the holder's (holders') current or foreseeable financial difficulties to settle one or more transactions granted by the bank or other group entities to the holder (or holders), or to other group companies, or a transaction whereby outstanding amounts related to the aforementioned transactions are fully or partially paid up, to facilitate debt (principal or interest) repayment by holders of cancelled or refinanced transactions that are unable, or are expected to become unable, to meet their commitments in the agreed time and manner.

- Refinanced transaction: a transaction that is fully or partially paid up as a result of a refinancing transaction entered into by a bank or another group entity.

- Restructured transaction: a transaction in which the financial conditions are amended for economic or legal reasons related to the holder's (holders') current or foreseeable financial difficulties to facilitate debt (principal and interest) repayment when the holder cannot or is not expected to be able to meet its commitments in the agreed time and manner, even if this amendment was set out in the agreement. Transactions in which the debt is discharged or assets are received to reduce the debt, or the conditions are amended to extend their maturity, change the debt repayment schedule to reduce the amount of the instalments in the short term or diminish their frequency, or establish a grace period or lengthen an existing grace period for principal, interest or both, unless it can be shown that the conditions have been amended for reasons other than the holders' financial difficulties and they are equivalent to market conditions in force on the amendment date for loan transactions granted to customers with a similar risk profile, are considered restructured transactions.

- Novation transaction: a transaction entered into to replace another transaction previously granted by the bank in which a borrower does not have financial difficulties and is not expected to have them in future; thus, a transaction entered into for reasons other than refinancing.

- Renegotiated transaction: a transaction in which the financial conditions are amended although the borrower does not have financial difficulties and is not expected to have them in future; thus, a transaction in which conditions are amended for reasons other than restructuring.

Unless there is evidence to the contrary, transactions shall be deemed to be a restructuring or refinancing in the following circumstances:

- When some or all of the payments of the modified transaction have been due for more than 30 days (without being classified as doubtful) at least once in the three months preceding its modification, or would be due for more than 30 days without said modification.

- When, simultaneously or nearly simultaneously with the granting of additional financing by the entity, the borrower has made payments of interest on another transaction with it, on which some or all of the payments have been due for more than 30 days at least once in the three months prior to the refinancing.

- When the entity approves the use of implicit restructuring or refinancing clauses in relation to borrowers with outstanding amounts 30 days past-due or more than 30 days past-due if such clauses have not been exercised.

This classification may not be changed until all the following requirements are met:

a) That, following an exhaustive review of the borrower's financial situation, it has been concluded that it is not foreseeable that the borrower will encounter financial difficulties and that, it is therefore highly probable that it will be able to comply with its obligations to the entity in the due time and form.

b) That a minimum of two years has elapsed since the later of the date of entry into the restructuring or refinancing transaction or the date of reclassification from the category of doubtful exposures.

c) That the borrower has paid the accrued instalments of principal and interest since the later of the date of entry into the restructuring or refinancing transaction or the date of reclassification from the category of doubtful. Additionally, the borrower must have settled, by means of regular payments, an amount equal to all the amounts (principal and interest) that were past-due or written down at the time of the restructuring or refinancing transaction. Therefore, the existence of contract terms that extend the repayment period, such as grace periods for the principal, will mean that the transaction remains identified as a standard exposure under special monitoring until the amounts described have been repaid by means of regular payments.

d) That the borrower does not have any other transactions with amounts more than 30 days past-due at the end of the probation period.

Transaction restructuring or refinancing entails an up-to-date analysis of the economic and financial situation of the borrower and guarantors, of their ability to pay under the new financial conditions, and of the effectiveness of the (new and original) collateral/guarantees provided. Transactions are classified, on the basis of insolvency risk, in one of the following categories:

- Standard exposures. Refinancing, refinanced or restructured transactions that do not meet the requirements to be classified in other categories.

- Standard exposures under special monitoring. Refinancing, refinanced or restructured transactions that present weaknesses that may lead to the incurrence of losses exceeding those on other similar transactions classified as standard exposures.

When classifying transactions in this category, the following signs relating to the circumstances of the borrower will first of all be taken into account:

a) High debt levels.

b) A drop in turnover or, in general, in recurring cash flows.

c) Narrowing of operating margins or in disposable recurring income.

Additionally, the Bank analyses other signs of possible weakness relating to operations, such as:

a) A fall in the price of the main product.

b) Difficulties accessing markets or deteriorating financing conditions.

c) Significant increases in the debt-service ratio, defined as the ratio of debt to operating cash flows.

d) A slowdown in business or unfavourable trend in the borrower's operations, indicating potential weaknesses in its financial position, without yet having endangered its debt service.

e) For transactions secured with collateral, a worsening of the ratio of their amount to the value of the collateral, due to unfavourable developments in the value of the collateral, or no change or an increase in the outstanding amount due to the payment terms established (such as extended principal payment grace periods, rising or flexible instalments, extended terms).

f) Economic or market volatility that may have a negative impact on the borrower.

g) Unfavourable developments in the borrower's sector of economic activity.

h) The borrower's belonging to a group in difficulties, such as residents of a specific geographical area at sub-country level.

i) Pending legal action that may significantly affect the borrower's financial position.

j) Market trends, such as interest-rate increases or higher requirements for collateral/guarantees, affecting similar transactions causing them to deviate significantly from the conditions originally established for the transaction or group of transactions.

k) Transaction granted at below cost.

l) Amounts more than 30 days past-due in the transaction.

- Doubtful exposures as a result of borrower arrears. Refinancing, refinanced or restructured transactions, any part of whose principal, interest or contractually agreed expenses is more than 90 days past-due, unless such instruments should be classified as being written off.

  This category will also include guarantees given if the guaranteed party has fallen into arrears in the guaranteed transaction.

- Doubtful exposures for reasons other than borrower arrears. Refinancing, refinanced or restructured transactions meeting any of the following criteria:

  - They are supported by inadequate payment plans. The situations in which it will be considered that there is no adequate payment plan shall include, inter alia, the repeated failure to comply with the payment plan, its modification to avoid breaches, or its resting on expectations that are not supported by macroeconomic forecasts.

  - They include contract terms that extend the time for the regular repayment instalments on the transaction, such as grace periods of more than two years for the repayment of the principal.

  - They include amounts derecognised as being irrecoverable that exceed the allowances and provisions resulting from taking into consideration Banco de España's Circular 4/2016 in the methodology for calculating credit risk provisions.

- Write-off. Refinancing, refinanced or restructured transactions for which the entity, after analysing them individually, considers the possibility of recovery to be remote due to manifest and irreversible deterioration of the solvency of the transaction or borrower. Classification in this category entails the writing-off of the full gross carrying amount of the transaction and its total derecognition from assets.

At 31 December 2016 the outstanding refinanced balance totals Euros 32,210 thousand (Euros 40,253 thousand at 31 December 2015). This figure includes loans classified as standard exposures and as doubtful exposures, and represents 1.8% of total loans and advances to other debtors (2.4% in 2015).

**2016**

| | **Thousands of Euros** | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **Credit institutions** | **General government** | **Other financial corporations and sole proprietorships (financial business)** | **Non-financial corporations and sole proprietorships (non-financial business)** | ***Of which: financing of real estate construction and property development (including land*** | **Other household loans** | **Total** | **Additional information: financing classified as non-current assets and disposal groups held for sale** |
| **TOTAL** | | | | | | | | |
| **Unsecured** | | | | | | | | |
| Number of transactions | -- | -- | -- | 11 | 2 | 3 | **14** | -- |
| Gross carrying amount | -- | -- | -- | 11,367 | 414 | 33 | **11,400** | -- |
| **Secured** | | | | | | | | |
| Number of transactions | -- | -- | -- | 14 | 1 | 2 | **16** | -- |
| Gross carrying amount | -- | -- | -- | 20,508 | 3,086 | 302 | **20,810** | -- |
| **Impairment allowances** | -- | -- | -- | (8,142 ) | (3,273) | (59) | **(8,201)** | -- |
| ***Of which: doubtful exposures*** | | | | | | | | |
| ***Unsecured*** | | | | | | | | |
| *Number of transactions* | -- | -- | -- | 3 | -- | -- | **3** | -- |
| *Gross carrying amount* | -- | -- | -- | 414 | -- | -- | **414** | -- |
| ***Secured*** | | | | | | | | |
| *Number of transactions* | -- | -- | -- | 1 | 1 | -- | **1** | -- |
| *Gross carrying amount* | -- | -- | -- | 3,086 | 3,086 | -- | **3,086** | -- |
| ***Specific allowance or provision*** | -- | -- | -- | (3,193) | (3,086) | -- | **(3,193)** | -- |
| **TOTAL** | | | | | | | | |
| Number of transactions | -- | -- | -- | 25 | 3 | 5 | **30** | -- |
| Gross carrying amount | -- | -- | -- | 31,875 | 3,500 | 335 | **32,210** | -- |
| Impairment allowances | -- | -- | -- | (8,142 ) | (3,273) | (59) | **(8,201)** | -- |

**2015**

| | **Thousands of Euros** | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **Credit institutions** | **General government** | **Other financial corporations and sole proprietorships (financial business)** | **Non-financial corporations and sole proprietorships (non-financial business)** | ***Of which: financing of real estate construction and property development (including land*** | **Other household loans** | **Total** | **Additional information: financing classified as non-current assets and disposal groups held for sale** |
| **TOTAL** | | | | | | | | |
| **Unsecured** | | | | | | | | |
| Number of transactions | -- | -- | -- | 21 | -- | 1 | **22** | -- |
| Gross carrying amount | -- | -- | -- | 18,445 | -- | 7 | **18,452** | -- |
| **Secured** | | | | | | | | |
| Number of transactions | -- | -- | -- | 7 | 1 | 2 | **9** | -- |
| Gross carrying amount | -- | -- | -- | 21,469 | 7,237 | 332 | **21,801** | -- |
| **Impairment allowances** | -- | -- | -- | (8,390) | (7,237) | -- | **(8,390)** | -- |
| ***Of which: doubtful exposures*** | | | | | | | | |
| ***Unsecured*** | | | | | | | | |
| *Number of transactions* | -- | -- | -- | 3 | -- | -- | **3** | -- |
| *Gross carrying amount* | -- | -- | -- | 433 | -- | -- | **433** | -- |
| ***Secured*** | | | | | | | | |
| *Number of transactions* | -- | -- | -- | 1 | 1 | -- | **1** | -- |
| *Gross carrying amount* | -- | -- | -- | 7,237 | 7,237 | -- | **7,237** | -- |
| ***Specific allowance or provision*** | -- | -- | -- | (7,346) | (7,237) | -- | **(7,346)** | -- |
| **TOTAL** | | | | | | | | |
| Number of transactions | -- | -- | -- | 28 | 1 | 3 | **31** | -- |
| Gross carrying amount | -- | -- | -- | 39,914 | 7,237 | 339 | **40,253** | -- |
| Impairment allowances | -- | -- | -- | (8,390) | (7,237) | -- | **(8,390)** | -- |

*34.1.4 Credit risk on real estate development and construction*

At 31 December 2016 financing provided for real estate development and construction amounted to Euros 3,480 thousand (Euros 7,237 thousand in 2015), of which Euros 3,086 thousand were classified as "Doubtful assets" (Euros 7,237 thousand in 2015) (consolidated Group data), Total specific provisions at that date amounted to Euros 3,086 thousand (Euros 7,237 thousand in 2015).

The figures above reflect financing extended for real estate development and construction, Consequently, following Bank of Spain instructions, the purpose of the transaction has been taken into account, rather than the debtor's activity, Loans in this table are classified in line with their purpose and not in accordance with the National Classification of Economic Activities (CNAE), As a result, if the debtor is: (a) a real estate company but uses the financing for a purpose other than real estate development or construction, the loan will not be included in these tables, and (b) if the company's principal activity is not real estate development or construction but it uses the loan to finance real estate development, it will be included in the tables.

Quantitative information on real estate credit risk at 31 December 2016 and 2015 is as follows:

| | Thousands of Euros | | | | | |
|---|---|---|---|---|---|---|
| | Gross amount | | Excess over guaranteed amount | | Specific provisions | |
| | 2016 | 2015 | 2016 | 2015 | 2016 | 2015 |
| Loans recognised by Group credit institutions | 3,480 | 7,237 | 1,256 | 4,624 | 3,086 | (7,237) |
| Of which: Doubtful | 3,086 | 7,237 | 1,256 | 4,624 | 3,086 | (7,237) |

Details of loans and advances to other debtors excluding Spanish general government at 31 December 2016 and 2015 are as follows:

| | Thousands of Euros | |
|---|---|---|
| | 2016 | 2015 |
| Total loans and advances to other debtors excluding general government | 484,876 | 380,711 |
| Total consolidated assets | 14,080,179 | 17,442,750 |
| Impairment allowances and provisions for credit risk, Total collective allowances | (34,175) | (39,625) |

Details of credit risk on real estate development and construction by type of related guarantee are as follows:

| | Thousands of Euros | |
|---|---|---|
| | Loans: Gross amount | |
| | 2016 | 2015 |
| 1. Not secured by collateral | 394 | -- |
| 2. Secured by collateral | 3,086 | 7,237 |
| 2.1. Finished buildings | 3,086 | -- |
| 2.1.1. Homes | -- | -- |
| 2.1.2. Other | 3,086 | -- |
| 2.2. Buildings under construction | -- | 7,237 |
| 2.2.1. Homes | -- | -- |
| 2.2.2. Other | -- | 7,237 |
| 2.3. Land | -- | -- |
| 2.3.1. Developed land | -- | -- |
| 2.3.2. Other land | -- | -- |
| **Total** | **3,480** | **7,237** |

Details of home purchase loans extended to individuals are as follows:

| | Thousands of Euros | | | |
|---|---|---|---|---|
| | 2016 | | 2015 | |
| | Gross amount | Gross amount | Gross amount | Of which: Doubtful |
| Home purchase loans | 64,552 | 9 | 65,223 | 256 |
| Not secured by collateral | 1,272 | -- | 1,872 | -- |
| Secured by collateral | 63,280 | 9 | 63,351 | 256 |

The following table shows a breakdown of mortgage loans extended to acquire homes at 31 December 2016 and 2015 by percentage of total risk on the latest available appraisal value (LTV):

| | Thousand of Euros | | | | | |
|---|---|---|---|---|---|---|
| | 2016 | | | | | |
| | LTV Ranges | | | | | |
| | LTV < 40% | 40% < LTV < 60% | 60% < LTV < 80% | 80% < LTV < 100% | LTV > 100% | Total |
| Gross amount | 12,996 | 12,831 | 21,564 | 8,933 | 6,956 | 63,280 |
| Of which Doubtful | 9 | -- | -- | -- | -- | 9 |

| | Thousand of Euros | | | | | |
|---|---|---|---|---|---|---|
| | 2015 | | | | | |
| | LTV Ranges | | | | | |
| | LTV < 40% | 40% < LTV < 60% | 60% < LTV < 80% | 80% < LTV < 100% | LTV > 100% | Total |
| Gross amount | 11,901 | 13,095 | 19,240 | 8,480 | 10,635 | 63,351 |
| Of which Doubtful | 13 | -- | -- | -- | 130 | 143 |

The Group has not recognised any foreclosed assets at 31 December 2016 and 2015.

*34.1.5 Assets impaired due to credit risk*

Details at 31 December 2016 and 2015 are as follows:

| | Thousands of Euros | |
|---|---|---|
| | 2016 | 2015 |
| Doubtful assets: | | |
| Loans and receivables (note 8) | 5,259 | 9,109 |

An ageing analysis of receivables in arrears (past-due and defaults) classified on the basis of the guarantees put up for the transaction is presented in the following table:

| | Thousands of Euros | | |
|---|---|---|---|
| | 31.12.2016 | | |
| | Mortgage | Other | Total |
| Up to 6 months | -- | 813 | 813 |
| 6 to 9 months | -- | 42 | 42 |
| 9 to 12 months | -- | 108 | 108 |
| Over 12 months | 45 | 1,165 | 1,210 |
| **Total** | **45** | **2,128** | **2,173** |

| | Thousands of Euros | | |
|---|---|---|---|
| | 31.12.2015 | | |
| | Mortgage | Other | Total |
| Up to 6 months | -- | 1.641 | 1.641 |
| 6 to 9 months | -- | 2 | 2 |
| 9 to 12 months | -- | 10 | 10 |
| Over 12 months | 179 | 40 | 219 |
| **Total** | **179** | **1,693** | **1,872** |

An analysis of debt instruments for which impairment losses have been determined on an individual basis is as follows:

| | Thousands of Euros | |
|---|---|---|
| | 31.12.16 | 31.12.15 |
| Transactions secured by real estate collateral | | |
| Over 12 months | 3,086 | 7,237 |
| **Total** | **3,086** | **7,237** |

Impaired assets are analysed periodically. The main factors considered when evaluating impairment on each asset are as follows:

- Analysis of the financial statements
- Analysis of the customer's income statements and payment capacity
- Analysis of cash flow forecasts
- Movements in customer capitalisation
- Changes in debt
- History and analysis of cost structure
- Amounts of guarantees and variation therein
- Any present or future event that could affect the customer's payment capacity

*34.1.6. Movement in impairment losses*

Movement in impairment losses recognised by the Group in 2016 and 2015 by type of financial asset is as follows:

**Thousands of Euros**

| | **Balance at 31 December 2014** | Net allowances charged to the income statement | Amounts used | Adjustments for exchange differences and other | **Balance at 31 December 2015** | Net allowances charged to the income statement | Amounts used | Adjustments for exchange differences and other | **Balance at 31 December 2016** |
|---|---|---|---|---|---|---|---|---|---|
| **Available-for-sale financial assets** | **782** | **4,027** | **(3,900)** | **--** | **909** | **3,568** | **(3,918)** | **--** | **559** |
| Estimated individually | -- | 3,900 | (3,900) | -- | -- | 3,918 | (3,918) | -- | -- |
| Estimated collectively | -- | -- | -- | -- | -- | -- | -- | -- | -- |
| Allowance or provision IBNR losses | 782 | 127 | -- | -- | 909 | (350) | -- | -- | 559 |
| **Loans and receivables** | **43,211** | **4,512** | **(1,583)** | **6** | **46,146** | **(7,823)** | **(1,338)** | **(8)** | **36,977** |
| Estimated individually | 7,237 | -- | -- | -- | 7,237 | (2,852) | (1,299) | -- | 3,086 |
| Estimated collectively | 1,438 | 72 | (1,094) | -- | 416 | 845 | (39) | -- | 1,222 |
| Allowance or provision IBNR losses | 34,536 | 4,440 | (489) | 6 | 38,493 | (5,816) | -- | (8) | 32,669 |
| **Contingent exposures and commitments** | **221** | **31** | **(20)** | **--** | **232** | **741** | **(21)** | **(1)** | **951** |
| Estimated individually | 5 | 24 | (20) | -- | 9 | (4) | -- | (1) | 4 |
| Estimated collectively | | | | | | | | | |
| Allowance or provision IBNR losses | 216 | 7 | -- | -- | 223 | 724 | -- | -- | 947 |
| Others Risk | -- | -- | -- | -- | -- | 21 | (21) | -- | -- |
| **Total** | **44,214** | **8,570** | **(5,503)** | **6** | **47,287** | **(3,514)** | **(5,277)** | **(9)** | **38,487** |

Details of specific and general provisions for credit risk, by counterparty and geographical location of risk, are as follows:

| | **Thousands of Euros** | |
|---|---|---|
| | **2016** | **2015** |
| Spain | 38,136 | 47,077 |
| Europe | 284 | 57 |
| United States | 15 | 155 |
| Rest of the World | 52 | -- |
| **Total** | **38,487** | **47,288** |

### *34.1.7. Impaired and derecognised financial assets*

Movement in impaired financial assets not recognised in the consolidated balance sheet as their recovery is considered unlikely, although the Group continues its efforts to collect the amounts receivable, is as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2016** | **2015** |
| **Opening balance** | **7,372** | **6,587** |
| **Additions** | | |
| Recognised in impairment allowances | 1,337 | 1,094 |
| Recognised in the income statement | 1,663 | 95 |
| Past-due income | 62 | 74 |
| Other | 21 | 132 |
| **Disposals** | | |
| Cash recovery of principal | (155) | (148) |
| Cash recovery of past due and uncollected products | (3) | (3) |
| Pardoning of debt | (2,740) | (387) |
| Other reasons | (20) | (72) |
| **Closing balance** | **7,537** | **7,372** |

### *34.2 Liquidity risk*

Liquidity risk management consists of ensuring that the Group always has sufficient liquidity to meet its payment commitments associated with the settlement of its liabilities on their respective maturity dates without compromising its capacity to respond rapidly to strategic market opportunities. This function includes obtaining financing in wholesale markets at the lowest possible cost in the medium and long term, with a view to maintaining an optimum level of liquid assets in keeping with the Group's policy of prudence.

In this context, the key to resolving liquidity problems resides in anticipating them and implementing preventive management techniques. The Bank is aware of this and therefore considers both aspects its first line of defence against the potential adverse effects of liquidity shortages on its results, reputation and creditworthiness.

To enable early identification, the Group continually monitors its liquidity position in the short, medium and long term and the performance of the main monetary and capital markets in which it operates. To this end it relies on: (i) a wide range of quantitative and qualitative indicators, (ii) limits and alerts defined on the basis of maximum tolerance to liquidity risk and (iii) the human, technical and operational support required to properly incorporate these indicators as a strategic and risk management input.

With regard to preventive management, the Asset and Liability Committee (ALCO) focuses structural liquidity management on: (i) the balance between positive and negative cash flows over a long time horizon, (ii) the diversification of uses and sources of funding and (iii) the protection of the Bank's ability to finance its growth and meet its payment obligations on the date and in the manner established in the contract at a reasonable cost and without affecting its reputation.

Finally, in terms of anticipation, the Bank has a buffer of liquid assets free of encumbrances that enable it to comfortably cope with situations of severe stress. The quality, relative liquidity and suitability as collateral of the assets that make up the buffer are periodically verified and these assets are subjected to stress tests to determine their ability to cope with extreme situations.

The main metrics currently used to control liquidity and the results of applying them at 31 December 2016 are:

- *Daily liquidity controls*: the Bank continually monitors its intraday liquidity, the eligibility of securities to be pledged as collateral to obtain financing from Banco de España (credit facility) and the sufficiency of its headroom (buffer of available liquid assets) in dealing with short-term cash outflows, among other indicators, This analysis also envisages further stress tests on its portfolio of eligible assets (those pledged as collateral for the Banco de España credit facility and others), subjecting the securities to scenarios of a reduction in their market value, downgrades in rating and loss of eligibility.

- *Liquidity gap*: provides information on cash inflows and outflows in order to detect timing differences between collections and payments, Very conservative behavioural criteria and assumptions have been established for unknown contractual maturities.

The liquidity gap at 31 December 2016 and 2015 is as follows:

| | **2016** | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **Thousands of Euros** | | | | | | | |
| | **Demand** | **Less than 1 month** | **1 to 3 months** | **3 months to 1 year** | **1 to 5 years** | **Over 5 years** | **Undetermined maturity** | **Total** |
| **Assets** | | | | | | | | |
| Cash, cash balances with central banks and other demand deposits | 2,024,319 | -- | -- | -- | -- | -- | -- | 2,024,319 |
| Loans and advances to credit institutions | 881,634 | 2,647,596 | 296,433 | 73,848 | 227,394 | 3,836 | -- | 4,130,741 |
| Loans and advances to other debtors | 127,921 | 8,516 | 15,222 | 112,624 | 696,097 | 149,675 | 349 | 1,110,404 |
| Fixed income portfolio | -- | 184,520 | 291,238 | 3,822,969 | 1,258,816 | 617,060 | -- | 6,174,603 |
| Other assets | -- | 50,020 | 21,252 | 74,382 | 131,073 | 282,337 | 81,048 | 640,112 |
| **Total assets** | **3,033,874** | **2,890,652** | **624,145** | **4,083,823** | **2,313,380** | **1,052,908** | **81,397** | **14,080,179** |
| **Liabilities** | | | | | | | | |
| Deposits from central banks and credit institutions | 2,545,209 | 4,583,385 | 107,776 | 57,131 | 312,328 | 3,948 | -- | 7,609,777 |
| Deposits from other creditors | 626,234 | 4,252,281 | 151,682 | 5,417 | 3,561 | 590 | -- | 5,039,765 |
| Other liabilities | -- | 284,273 | 20,476 | 71,666 | 159,908 | 372,027 | 522,288 | 1,430,637 |
| **Total liabilities** | **3,171,443** | **9,119,939** | **279,934** | **134,214** | **475,797** | **376,565** | **522,288** | **14,080,179** |
| Simple gap | (137,569) | (6,229,287) | 344,212 | 3,949,609 | 1,837,583 | 676,343 | (440,891) | -- |
| Accumulated gap | (137,569) | (6,366,856) | (6,022,644) | (2,073,035) | (235,452) | 440,891 | -- | -- |

| | 2015 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Thousands of Euros | | | | | | | |
| | **Demand** | **Less than 1 month** | **1 to 3 months** | **3 months to 1 year** | **1 to 5 years** | **Over 5 years** | **Undetermined maturity** | **Total** |
| **Assets** | | | | | | | | |
| Cash, cash balances with central banks and other demand deposits | 2,510,043 | -- | -- | -- | -- | -- | -- | 2,510,043 |
| Loans and advances to credit institutions | 320,072 | 1,021,103 | 621,943 | 508,093 | 4,610,649 | 7,052 | -- | 7,088,912 |
| Loans and advances to other debtors | 62,165 | 1,281 | 5,111 | 381,218 | 394,576 | 150,643 | 349 | 995,343 |
| Fixed income portfolio | -- | 143,607 | 351,413 | 1,710,915 | 3,615,258 | 458,235 | -- | 6,279,428 |
| Other assets | -- | 50,020 | 21,252 | 74,382 | 109,249 | 282,337 | 31,784 | 569,024 |
| **Total assets** | **2,892,280** | **1,216,011** | **999,719** | **2,674,608** | **8,729,732** | **898,267** | **32,133** | **17,442,750** |
| **Liabilities** | | | | | | | | |
| Deposits from central banks and credit institutions | 3,735,854 | 3,597,611 | 123,993 | 38,873 | 3,846,505 | 7,025 | -- | 11,349,861 |
| Deposits from other creditors | 661,261 | 4,248,618 | 2,987 | 4,602 | 3,173 | 1,309 | -- | 4,921,950 |
| Other liabilities | -- | 205,260 | 20,476 | 71,666 | 105,259 | 272,027 | 496,251 | 1,170,939 |
| **Total liabilities** | **4,397,115** | **8,051,489** | **147,456** | **115,141** | **3,954,937** | **280,361** | **496,251** | **17,442,750** |
| Simple gap | (1,504,835) | (6,835,478) | 852,263 | 2,559,467 | 4,774,795 | 617,906 | (464,118) | -- |
| Accumulated gap | (1,504,835) | (8,340,313) | (7,488,050) | (4,928,583) | (153,788) | 464,118 | -- | -- |

As part of its liquidity management, the Group monitors the liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR), and reports the required information to the regulator on a monthly and quarterly basis, respectively.

Liquidity measurement based on these metrics forms part of the liquidity risk control system implemented by the Group.

- *Short-term liquidity coverage ratio (LCR):* under the stress scenario defined in Basel III, the 30-day liquidity ratio at 31 December 2016 stood at 318.83%, a level close to that normally seen and over twice the target rate (80%) established for the date of entry into force of this ratio (January 2016).

- *Net Stable Funding Ratio (NSFR):* the Bank maintains a balanced structure in its long-term financing that is adapted to its liquidity profile, At 31 December 2016, the net stable funding ratio was 105%, higher than the target set in Basel III.

Moreover, the Bank has activated a number of alerts and thresholds that are continually monitored, enabling it to foresee any potential liquidity stress and, where necessary, automatically convene the ALCO for an extraordinary or crisis meeting, depending on the situation, The latter initiative is considered in the liquidity risk contingency plan, the Bank's second line of action against potential adverse effects of liquidity shortages, Essentially, this is an action plan with a practical focus that enables the Bank to optimise the timing, cost and form of its response to high-exposure or critical situations and mitigate possible disturbances and impacts on business continuity during such episodes.

*34.3 Interest rate exposure*

To support management of interest rate risk, the Bank's Assets and Liabilities Committee uses the repricing gap to analyse the overall time difference between maturity and repricing of assets and liabilities. The repricing gap is calculated by grouping assets and liabilities by their carrying amount based on interest rate repricing dates or by maturity considering the outstanding principal. In the case of callable liabilities for which there is no contractual maturity date, the repricing structure is in line with the historical stability of the balances. The maximum period for demand balances with returns under 0.5% is 2.5 years.

The repricing gaps at 31 December 2016 and 2015 are as follows:

| | 2016 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Thousands of Euros | | | | | | |
| | **Less than 1 month** | **1 to 3 months** | **3 months to 1 year** | **1 to 5 years** | **Over 5 years** | **Undetermined maturity** | **Total** |
| **Assets** | | | | | | | |
| "Cash, cash balances with central banks and other demand deposits" | 2,024,319 | -- | -- | -- | -- | -- | 2,024,319 |
| Loans and advances in credit institutions | 3,002,117 | 611,277 | 301,960 | 214,559 | 828 | -- | 4,130,741 |
| Loans and advances to other debtors | 290,446 | 111,886 | 522,908 | 153,363 | 31,801 | -- | 1,110,404 |
| Fixed income portfolio | 212,794 | 332,873 | 4,272,337 | 1,137,391 | 219,208 | -- | 6,174,603 |
| Other assets | 11,916 | 23,831 | 83,410 | 166,756 | 273,152 | 81,047 | 640,112 |
| **Total assets** | **5,541,592** | **1,079,867** | **5,180,615** | **1,672,069** | **524,989** | **81,047** | **14,080.179** |
| **Liabilities** | | | | | | | |
| Deposits from central banks and credit institutions | 4,032,050 | 960,782 | 2,429,358 | 186,759 | 828 | -- | 7,609,777 |
| Debt certificates including bonds | -- | -- | -- | -- | -- | -- | -- |
| Deposits from other creditors | 4,809,787 | 161,502 | 53,523 | 14,953 | -- | -- | 5,039,765 |
| Other liabilities | 338,007 | 24,880 | 87,079 | 174,091 | 284,292 | 522,288 | 1,430,637 |
| **Total liabilities** | **9,179,844** | **1,147,164** | **2,569,960** | **375,803** | **285,120** | **522,288** | **14,080,179** |
| Off-balance sheet operations | 2,482,761 | (37,714) | (1,426,930) | (894,415) | (123,702) | -- | -- |
| Simple gap | (1,155,491) | (105,011) | 1,183,725 | 401,852 | 116,166 | (441,241) | -- |
| Accumulated gap | (1,155,491) | (1,260,502) | (76,777) | 325,074 | 441,241 | -- | -- |

| | 2015 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Thousands of Euros | | | | | | |
| | **Less than 1 month** | **1 to 3 months** | **3 months to 1 year** | **1 to 5 years** | **Over 5 years** | **Undetermined maturity** | **Total** |
| **Assets** | | | | | | | |
| Cash, cash balances with central banks and other demand deposits | 2,510,043 | -- | -- | -- | -- | -- | 2,510,043 |
| Loans and advances in credit institutions | 976,268 | 636,934 | 520,205 | 4,953,624 | 1,880 | -- | 7,088,911 |
| Loans and advances to other debtors | 45,580 | 107,831 | 463,483 | 330,541 | 47,906 | -- | 995,342 |
| Fixed income portfolio | 186,041 | 373,064 | 2,183,947 | 3,376,092 | 160,283 | -- | 6,279,427 |
| Other assets | 50,020 | 21,252 | 74,382 | 109,249 | 282,337 | 31,787 | 569,027 |
| **Total assets** | **3,767,952** | **1,139,081** | **3,242,018** | **8,769,506** | **492,406** | **31,787** | **17,442,750** |
| **Liabilities** | | | | | | | |
| Deposits from central banks and credit institutions | 3,087,865 | 1,024,970 | 2,062,579 | 5,172,567 | 1,880 | -- | 11,349,861 |
| Deposits from other creditors | 4,681,601 | 183,694 | 43,419 | 13,236 | -- | -- | 4,921,950 |
| Other liabilities | 205,260 | 20,476 | 71,666 | 105,259 | 272,027 | 496,251 | 1,170,939 |
| **Total liabilities** | **7,974,726** | **1,229,140** | **2,177,664** | **5,291,062** | **273,907** | **496,251** | **17,442,750** |
| Off-balance sheet operations | 2,960,501 | (22,063) | (44,199) | (2,786,396) | (107,843) | -- | -- |
| Simple gap | (1,246,273) | (112,121) | 1,020,155 | 692,047 | 110,656 | (464,464) | -- |
| Accumulated gap | (1,246,273) | (1,358,394) | (338,239) | 353,808 | 464,464 | -- | -- |

To measure interest rate risk, the risk control unit simulates the financial margin over a 12-month period under different interest rate scenarios, assuming certain historical conditions relating to growth, spreads, repricing periods, stability of receivables on demand, etc, At 31 December 2016 and 2015, the sensitivity of the financial margin to a 100-basis point parallel displacement of the interest rate curve over a 12-month period is as follows:

| | % | |
|---|---|---|
| | **2016** | **2015** |
| Sensitivity of the financial margin | | |
| + 100 b.p. | (7.47) | (4.53) |
| - 100 b.p. | 5.45 | (5.16) |

The interest rate risk is also analysed considering the economic value of equity measured as the effect of changes in the interest rate on the net present value of future expected flows from balance sheet items. The sensitivity of the Bank’s economic value to a 100-basis point parallel displacement of the interest rate curve at 31 December 2016 and 2015 is as follows:

| | % | |
|---|---|---|
| | **2016** | **2015** |
| Sensitivity of equity | (4.39) | (4.52) |

### *34.4 Market risk*

Market risk is managed through the value at risk methodology (VaR), which limits losses incurred as a result of adverse changes in market prices, Value at risk is calculated on a daily basis for the treasury and capital market area as a whole, irrespective of the nature of the portfolios.

The maximum and average VaR are as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2016** | **2015** |
| Average VaR | 1,021 | 1,947 |
| Maximum VaR | 1,698 | 3,595 |

Interest rate variations are the Bank's primary risk factor. The distribution by risk factor at 31 December 2016 and 2015 is as follows:

| | Distribution(%) | |
|---|---|---|
| | **2016** | **2015** |
| Interest rate | 65.0 | 75.6 |
| Variable income | 35.0 | 24.4 |

### *34.5 Currency risk*

Details of the assets and liabilities recognised in the Bank's balance sheet in the most significant currencies at 31 December 2016 and 2015 are as follows:

| | Thousands of Euros | | | |
|---|---|---|---|---|
| | **2016** | | **2015** | |
| | **Assets** | **Liabilities** | **Assets** | **Liabilities** |
| US Dollar | 68,423 | 74,597 | 43,513 | 64,204 |
| Pound Sterling | 3,130 | 15,976 | 10,659 | 12,661 |
| Swiss Franc | 489 | 474 | 327 | 288 |
| Norwegian Krone | 1,307 | 1,302 | 213 | 211 |
| Swedish Krona | 57 | 56 | 26 | 25 |
| Canadian Dollar | 1,350 | 1,350 | 11,040 | 886 |
| Danish Krone | 46 | 42 | 593 | 591 |
| Japanese Yen | 307 | 314 | 47 | 28 |
| Other | 2,993 | 1,142 | 2,137 | 633 |
| **Total** | **78,102** | **95,253** | **68,555** | **79,527** |

A breakdown of the main foreign currency balances, based on the nature of the items, is as follows:

| | Thousands of Euros | |
|---|---|---|
| | **2016** | **2015** |
| **Assets** | | |
| Loans and advances to credit institutions | 67,936 | 49,392 |
| Loans and advances to other debtors | 9,172 | 8,475 |
| Debt securities | -- | 10,144 |
| Other assets | 994 | 544 |
| **Total** | **78,102** | **68,555** |
| **Liabilities** | | |
| Loans and advances to credit institutions | 87,711 | 71,411 |
| Deposits from other creditors | 6,580 | 7,605 |
| Other liabilities | 962 | 511 |
| **Total** | **95,253** | **79,527** |

*34 .6 Risk concentration*

Risk concentration is defined as a risk that could affect the Group's consolidated income statement and its consolidated equity as a result of holding financial instruments of similar characteristics, which could therefore be similarly affected by economic or other types of changes.

The Group has established policies to limit the Group's exposure to certain risks. These policies are defined in coordination with other risk management policies and as part of the Entity's strategic plan. Risk concentration is measured and limits established considering the different risks to which the Group is exposed, taking into account the nature and rating of the different financial instruments of the Group, analysed at different levels (Entity, Group, sector, country, etc.).

The carrying amount of the different financial instruments is used to measure risk concentration.

In addition to information provided in preceding notes to the accompanying annual accounts regarding concentration by foreign currency, type of counterparty and credit rating of financial assets exposed to credit risks, details of the carrying amount of the most significant financial assets (deposits in credit institutions, loans and advances to other debtors, debt securities, equity instruments and trading derivatives) classified by geographical area, counterparty, purpose and segment of activity held by the Bank at 31 December 2016 and 2015 are as follows:

| | 2016 | | | | |
|---|---|---|---|---|---|
| | Thousands of Euros | | | | |
| | **Total** | **Spain** | **Rest of the European Union** | **Americas** | **Rest of world** |
| Credit institutions | 6,905,628 | 6,414,203 | 445,462 | 6,652 | 39,311 |
| General government | 6,337,223 | 6,290,053 | 47,170 | -- | -- |
| Central government | 6.252,159 | 6,204,989 | 47,170 | -- | -- |
| Other | 85,064 | 85,064 | -- | -- | -- |
| Other financial institutions | 536,587 | 269,161 | 258,411 | 259 | 8,756 |
| Non-financial companies and individual entrepreneurs | 263,670 | 236,765 | 24,130 | 1,599 | 1,176 |
| Construction and real estate development | 7 | 7 | -- | -- | -- |
| Civil works | 22,479 | 22,479 | -- | -- | -- |
| Other | 241,184 | 214,279 | 24,130 | 1,599 | 1,176 |
| Large companies | 186,784 | 162,345 | 21,712 | 1,599 | 1,128 |
| SMEs and individual entrepreneurs | 54,400 | 51,934 | 2,418 | -- | 48 |
| Other households and non-profit institutions serving households | 90,259 | 90,154 | 105 | -- | -- |
| Homes | 65,147 | 65,043 | 104 | -- | -- |
| Consumer | 8,388 | 8,388 | -- | -- | -- |
| Other | 16,724 | 16,723 | 1 | -- | -- |
| **TOTAL** | **14,133,367** | **13,300,336** | **775,278** | **8,510** | **49,243** |

| | 2015 | | | | |
|---|---|---|---|---|---|
| | Thousands of Euros | | | | |
| | **Total** | **Spain** | **Rest of the European Union** | **Americas** | **Rest of world** |
| Credit institutions | 10,322,113 | 10,113,381 | 189,355 | -- | 19,377 |
| General government | 6,127,127 | 6,127,127 | -- | -- | -- |
| Central government | 6,049,722 | 6,049,722 | -- | -- | -- |
| Other | 77,405 | 77,405 | -- | -- | -- |
| Other financial institutions | 493,864 | 437,126 | 49,812 | 6,926 | -- |
| Non-financial companies and individual entrepreneurs | 250,610 | 238,823 | 9,437 | 1,086 | 1,264 |
| Construction and real estate development | -- | -- | -- | -- | -- |
| Civil works | 25,931 | 25,931 | -- | -- | -- |
| Other | 224,679 | 212,891 | 9,437 | 1,086 | 1,264 |
| Large companies | 118,378 | 106,595 | 9,433 | 1,086 | 1,264 |
| SMEs and individual entrepreneurs | 106,301 | 106,297 | 4 | -- | -- |
| Other households and non-profit institutions serving households | 89,178 | 89,061 | 113 | -- | 3 |
| Homes | 65,793 | 65,684 | 109 | -- | -- |
| Consumer | 3,328 | 3,327 | -- | -- | -- |
| Other | 20,057 | 20,050 | 4 | -- | 3 |
| **TOTAL** | **17,282,892** | **17,005,518** | **248,717** | **8,012** | **20,644** |

The classification by geographical area and business segment in Spain at 31 December 2016 is presented below:

**RISK CONCENTRATION BY BUSINESS SEGMENT AND GEOGRAPHICAL AREA AT 31 DECEMBER 2016**

| | Miles de euros | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **Total** | **Andalucía** | **Aragón** | **Asturias** | **Baleares** | **Canarias** | **Cantabria** | **Castilla La Mancha** | **Castilla y León** | **Cataluña** |
| Credit institutions | 6,414,204 | 78,849 | 69,382 | 17,757 | -- | 2,292 | 4,164 | 13,577 | 45,120 | 653,984 |
| General government | 6,290,054 | 10,883 | 911 | -- | 654 | 2,000 | -- | 11,499 | 4,750 | -- |
| Central government (*) | 6,204,989 | -- | -- | -- | -- | -- | -- | -- | -- | -- |
| Other | 85,065 | 10,883 | 911 | -- | 654 | 2,000 | -- | 11,499 | 4,750 | -- |
| Other financial institutions | 269,161 | -- | -- | -- | -- | -- | -- | -- | -- | 18 |
| Non-financial companies and individual entrepreneurs | 236,765 | 9,298 | 1,642 | 1,734 | 11,977 | 293 | 1,446 | 2,950 | 4,217 | 26,776 |
| Construction and real estate development | 7 | -- | -- | -- | -- | -- | -- | -- | -- | -- |
| Civil works | 22,480 | 1,308 | 27 | -- | -- | -- | -- | -- | -- | -- |
| Other | 214,278 | 7,990 | 1,615 | 1,734 | 11,977 | 293 | 1,446 | 2,950 | 4,217 | 26,776 |
| Large companies | 162,344 | 2,994 | 512 | 1,727 | 11,976 | -- | 1,446 | 2,851 | -- | 18,950 |
| SMEs and individual entrepreneurs | 51,934 | 4,996 | 1,103 | 7 | 1 | 293 | -- | 99 | 4,217 | 7,826 |
| Other household loans and non-profit institutions serving households | 90,153 | 983 | 175 | 202 | 5 | 7 | 2 | 1,116 | 597 | 3,110 |
| Homes | 65,041 | 39 | 108 | 121 | -- | -- | -- | 827 | 372 | 329 |
| Consumer | 8,389 | 460 | 67 | 81 | 5 | 7 | 2 | 282 | 222 | 787 |
| Other | 16,723 | 484 | -- | -- | -- | -- | -- | 7 | 3 | 1,994 |
| **SUBTOTAL** | **13,300,337** | **100,013** | **72,110** | **19,693** | **12,636** | **4,592** | **5,612** | **29,142** | **54,684** | **683,888** |

(*) Balance not attributable to any specific Autonomous Region

(Continuation)

**RISK CONCENTRATION BY BUSINESS SEGMENT AND GEOGRAPHICAL AREA AT 31 DECEMBER 2016** (Continuation)

| | Thousands of Euros | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | **Extremadura** | **Galicia** | **Madrid** | **Murcia** | **Navarra** | **C. Valenciana** | **País Vasco** | **La Rioja** | **Ceuta y Melilla** |
| Credit institutions | 1,822 | 8,154 | 4,935,503 | 152 | 10 | 88,820 | 494,618 | -- | -- |
| General government | 1,102 | 4,493 | 22,566 | 8,056 | 3,502 | 10,236 | 56 | 4,357 | -- |
| Central government (*) | -- | -- | -- | -- | -- | -- | -- | -- | -- |
| Other | 1,102 | 4,493 | 22,566 | 8,056 | 3,502 | 10,236 | 56 | 4,357 | -- |
| Other financial institutions | -- | -- | 269,143 | -- | -- | -- | -- | -- | -- |
| Non-financial companies and individual entrepreneurs | -- | 8,826 | 149,779 | 6,899 | -- | 3,409 | 7,398 | 121 | -- |
| Construction and real estate development | -- | -- | 7 | -- | -- | -- | -- | -- | -- |
| Civil works | -- | -- | 21,145 | -- | -- | -- | -- | -- | -- |
| Other | -- | 8,826 | 128,627 | 6,899 | -- | 3,409 | 7,398 | 121 | -- |
| Large companies | -- | 7,736 | 108,164 | 2,497 | -- | 750 | 2,741 | -- | -- |
| SMEs and individual entrepreneurs | -- | 1,090 | 20,463 | 4,402 | -- | 2,659 | 4,657 | 121 | -- |
| Other household loans and non-profit institutions serving households | 15 | 229 | 82,507 | 61 | 2 | 519 | 5 | 614 | 4 |
| Homes | -- | 184 | 62,787 | 48 | -- | 76 | -- | 150 | -- |
| Consumer | 15 | 45 | 6,242 | 13 | 2 | 150 | 5 | -- | 4 |
| Other | -- | -- | 13,478 | -- | -- | 293 | -- | 464 | -- |
| **SUBTOTAL** | **2,939** | **21,702** | **5,459,498** | **15,168** | **3,514** | **102,984** | **502,077** | **5,092** | **4** |

(*) Balance not attributable to any specific Autonomous Region

**RISK CONCENTRATION BY BUSINESS SEGMENT AND GEOGRAPHICAL AREA AT 31 DECEMBER 2015**

| | Thousands of Euros | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **Total** | **Andalucía** | **Aragón** | **Asturias** | **Baleares** | **Canarias** | **Cantabria** | **Castilla La Mancha** | **Castilla y León** | **Cataluña** |
| Credit institutions | 10,113,381 | 755,682 | 8,710 | 4,385 | 304,295 | 86,955 | 3,696,253 | 685,974 | 472,080 | -- |
| General government | 6,127,127 | 1,633 | 303 | -- | 8,864 | 5,839 | 1,373 | 4,036 | 57 | -- |
| Central government (*) | 6,049,722 | -- | -- | -- | -- | -- | -- | -- | -- | -- |
| Other | 77,405 | 1,633 | 303 | -- | 8,864 | 5,839 | 1,373 | 4,036 | 57 | -- |
| Other financial institutions | 437,126 | -- | -- | -- | -- | -- | 58,321 | -- | 112,986 | 527 |
| Non-financial companies and individual entrepreneurs | 238,823 | 8,277 | 10,802 | 1,980 | 4,000 | 7 | 33,912 | 2,288 | 6,257 | 15,775 |
| Construction and real estate development | | | | | | | | | | |
| Civil works | 25,931 | 2,238 | 27 | -- | -- | -- | 1,700 | -- | -- | -- |
| Other | 212,892 | 6,039 | 10,775 | 1,980 | 4,000 | 7 | 32,212 | 2,288 | 6,257 | 15,775 |
| Large companies | 106,596 | 969 | -- | 1,980 | 4,000 | -- | 30,712 | 2,214 | 0 | 6,296 |
| SMEs and individual entrepreneurs | 106,296 | 5,070 | 10,775 | -- | -- | 7 | 1,500 | 74 | 6,257 | 9,479 |
| Other household loans and non-profit institutions serving households | 89,061 | 656 | 127 | 173 | 3 | 5 | 132 | 1,020 | 360 | 2,904 |
| Homes | 65,682 | 142 | 114 | 130 | -- | -- | -- | 934 | 299 | 348 |
| Consumer | 3,327 | 98 | 13 | 37 | 3 | 5 | 8 | 75 | 58 | 41 |
| Other | 20,051 | 416 | -- | 6 | -- | -- | 124 | 11 | 4 | 2,515 |
| **SUBTOTAL** | **17,005,518** | **766,248** | **19,942** | **6,538** | **317,162** | **92,806** | **3,789,991** | **693,318** | **591,740** | **19,206** |

(*) Balance not attributable to any specific Autonomous Region

| | Thousands of Euros | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | **Extremadura** | **Galicia** | **Madrid** | **Murcia** | **Navarra** | **C, Valenciana** | **País Vasco** | **La Rioja** | **Ceuta y Melilla** |
| Credit institutions | 2,295 | 12,077 | 4,040,244 | 292 | -- | 36,333 | 7,806 | -- | -- |
| General government | 1 | -- | 55,299 | -- | -- | -- | -- | -- | -- |
| Central government (*) | -- | -- | -- | -- | -- | -- | -- | -- | -- |
| Other | 1 | -- | 55,299 | -- | -- | -- | -- | -- | -- |
| Other financial institutions | -- | -- | 265,291 | -- | -- | -- | -- | -- | -- |
| Non-financial companies and individual entrepreneurs | 6 | 3,529 | 136,516 | 6,957 | 67 | 3,576 | 4,852 | 22 | -- |
| Construction and real estate development | -- | -- | -- | -- | -- | -- | -- | -- | -- |
| Civil works | -- | -- | 21,966 | -- | -- | -- | -- | -- | -- |
| Other | 6 | 3,529 | 114,550 | 6,957 | 67 | 3,576 | 4,852 | 22 | -- |
| Large companies | 0 | 2,126 | 52,922 | 1,632 | -- | 1,816 | 1,929 | -- | -- |
| SMEs and individual entrepreneurs | 6 | 1,403 | 61,628 | 5,325 | 67 | 1,760 | 2,923 | 22 | -- |
| Other household loans and non-profit institutions serving households | 8 | 124 | 82,135 | 65 | 7 | 628 | 10 | 704 | -- |
| Homes | -- | 64 | 63,275 | 54 | -- | 168 | -- | 154 | -- |
| Consumer | 8 | 42 | 2,882 | 10 | 7 | 30 | 10 | -- | -- |
| Other | -- | 18 | 15,978 | -- | -- | 430 | -- | 550 | -- |
| **SUBTOTAL** | **2,310** | **15,730** | **4,579,485** | **7,314** | **74** | **40,537** | **12,668** | **726** | **--** |

(*) Balance not attributable to any specific Autonomous Region

### Sovereign debt risk

At 31 December 2016 and 2015 the Group's only sovereign debt risk related to the Spanish government.

| | 31 December 2016 | | | |
|---|---|---|---|---|
| | **Held for trading** | **Available-for-sale** | **Held-to-maturity** | **Total** |
| España | 1,736,647 | 3,469,615 | 80,166 | 5,286,428 |
| Italia | -- | 24,667 | -- | 24.667 |
| Portugal | -- | 22,503 | -- | 22,503 |
| **Total** | **1,736,647** | **3,516,785** | **80,166** | **5,333,598** |

At 31 December 2015 the Group's only sovereign risk is vis-à-vis Spanish general government.

## 35. Responsible Lending

Banco Cooperativo Español, S,A, has adopted best practices for responsible lending to consumers, and it has the related policies and procedures in place, thereby complying with the provisions of Ministry of Economy and Finance Order EHA/2899/2011 of 28 October 2011 on transparency and protection of banking services customers and responsible lending, Specifically, the policies on commercial banking risk and the specific regulations derived therefrom stipulate the policies, methods and procedures for responsible granting of consumer loans and credit.

Pursuant to Banco de España Circular 3/2014 of 30 July 2014, a summary of the aforementioned policies adopted by Banco Cooperativo Español, S.A. on commercial banking risk is provided below:

- The need to tailor payment plans to revenue sources;
- Requirements for evaluating payment capacity;
- The need to take into account the borrower’s foreseeable level of income at retirement;
- The need to consider existing financial payment obligations;
- Where appropriate for commercial reasons or due to the type of rate/currency, offering to include hedging clauses or arrange interest and exchange rate hedges in transactions with borrowers;
- The need, when collateral is pledged, to establish a prudent relationship between the amount of the loan and potential extensions, and the value of the collateral pledged, without taking into account any revaluations of the latter;
- The need to exercise extreme prudence in the use of appraisal values for credit transactions in which real estate assets are pledged as collateral in addition to the borrower’s personal guarantee;
- The periodic review of the value of collateral pledged to secure the loans granted;
- Several management elements to ensure the appraisal company’s independence;
- The need to warn customers of the potential consequences of persistent non-payment in terms of late payment interest and other expenses;

- The criteria for debt renegotiation (refinancing and restructuring);
- The minimum documentation required in transactions for the granting thereof and during the period they are current.

Banco Cooperativo Español, S.A. has the following mechanisms in place to control the effective monitoring of the aforementioned policies:

- Computer validation and controls incorporated into the workflow for analysis, decision-making and arrangement of transactions for the purpose of embedding these management principles;
- Alignment of product catalogue specifications and responsible lending policies;
- Different penalties to ensure appropriate levels of contrasting of decisions in accordance with the complexity of the transaction;
- A reporting framework for monitoring the correct application of responsible lending policies.

# Appendix I. a.
## BANCO COOPERATIVO ESPAÑOL, S.A. – balance sheets at 31 December 2016 and 2015

| (in thousands of Euros) | NOTE | | |
|---|---|---|---|
| ASSETS | | **2016** | **2015(*)** |
| **CASH, CASH BALANCES WITH CENTRAL BANKS AND OTHER DEMAND DEPOSITS (**)** | **5** | **1,641,275** | **1,845,066** |
| **FINANCIAL ASSETS HELD FOR TRADING** | **6** | **2,645,735** | **2,792,309** |
| Derivatives | | 558,226 | 497,846 |
| Equity instruments | | - | - |
| Debt securities | | 2,087,509 | 2,294,463 |
| Loans and advances | | - | - |
| Central banks | | - | - |
| Credit institutions | | - | - |
| Other debtors | | - | - |
| *Memorandum item: loaned or pledged as collateral with the right to sell or pledge* | | 1,794,856 | 2,083,853 |
| **FINANCIAL ASSETS DESIGNATED AT FAIR VALUE THROUGH PROFIT OR LOSS** | | **-** | **-** |
| Equity instruments | | - | - |
| Debt securities | | - | - |
| Loans and advances | | - | - |
| Central banks | | - | - |
| Credit institutions | | - | - |
| Other debtors | | - | - |
| *Memorandum item: loaned or pledged as collateral with the right to sell or pledge* | | - | - |
| **AVAILABLE-FOR-SALE FINANCIAL ASSETS** | **7** | **3,707,684** | **3,803,569** |
| Equity instruments | | 20,780 | 13,455 |
| Debt securities | | 3,686,904 | 3,790,114 |
| *Memorandum item: loaned or pledged as collateral with the right to sell or pledge* | | 3,175,536 | 3,442,294 |
| **LOANS AND RECEIVABLES** | **8** | **5,906,018** | **8,803,688** |
| Debt securities | | 33,223 | 57,819 |
| Loans and advances | | 5,872,795 | 8,745,869 |
| Central banks | | - | - |
| Credit institutions | | 4,130,459 | 7,088,910 |
| Other debtors | | 1,742,336 | 1,656,959 |
| *Memorandum item: loaned or pledged as collateral with the right to sell or pledge* | | 29,487 | 49,145 |
| **HELD-TO-MATURITY INVESTMENTS** | **9** | **90,014** | **115,454** |
| *Memorandum item: loaned or pledged as collateral with the right to sell or pledge* | | 69,747 | 51,150 |
| **DERIVATIVES - HEDGE ACCOUNTING** | **15** | **839** | **23** |
| **CHANGES IN THE FAIR VALUE OF THE HEDGED ITEMS IN PORTFOLIO HEDGES OF INTEREST RATE RISK** | | **-** | **-** |
| **INVESTMENTS IN JOINT VENTURES AND ASSOCIATES** | **10** | **11,256** | **11,256** |
| Jointly controlled entities | | 11,256 | 11,256 |
| Associates | | - | - |
| **TANGIBLE ASSETS** | | | |
| Fixed assets | **11** | **1,962** | **1,710** |
| For own use | | 1,962 | 1,710 |
| Leased out under operating leases | | 1,962 | 1,710 |
| Investment property | | - | - |
| Of which: leased out under operating leases | | - | - |
| *Memorandum item: acquired under a finance lease* | | - | - |
| | | - | - |
| **INTANGIBLE ASSETS** | | | |
| Goodwill | **12** | **1,742** | **1,393** |
| Other intangible assets | | - | - |
| | | 1,742 | 1,393 |
| **TAX ASSETS** | | | |
| Current tax assets | **20** | **33,291** | **33,145** |
| Deferred tax assets | | 8,639 | 5,692 |
| | | 24,652 | 27,453 |
| **OTHER ASSETS** | | | |
| Insurance contracts linked to pensions | **14** | **5,115** | **3,123** |
| Inventories | | - | - |
| Other assets | | - | - |
| | | 5,115 | 3,123 |
| **NON-CURRENT ASSETS AND DISPOSAL GROUPS CLASSIFIED AS HELD FOR SALE** | | | |
| | | **-** | **-** |
| **TOTAL ASSETS** | | **14,044,931** | **17,410,736** |

| (in thousands of Euros) | NOTE | | |
|---|---|---|---|
| **LIABILITIES** | | **2016** | **2015(*)** |
| **FINANCIAL LIABILITIES HELD FOR TRADING** | **6** | **817,055** | **625,034** |
| Derivatives | | 582,782 | 430,012 |
| Short positions | | 234,273 | 195,022 |
| Deposits | | - | - |
| Central banks | | - | - |
| Credit institutions | | - | - |
| Other creditors | | - | - |
| Debt securities issued | | - | - |
| Other financial liabilities | | - | - |
| **FINANCIAL LIABILITIES DESIGNATED AT FAIR VALUE THROUGH PROFIT OR LOSS** | | **4,731** | **4,731** |
| Deposits | | 4,731 | 4,731 |
| Central banks | | 4,731 | 4,731 |
| Credit institutions | | - | - |
| Other creditors | | - | - |
| Debt securities issued | | - | - |
| Other financial liabilities | | - | - |
| *Memorandum item: subordinated liabilities* | | - | - |
| **FINANCIAL LIABILITIES AT AMORTISED COST** | **13** | **12,659,425** | **16,281,370** |
| Deposits | | 12,644,277 | 16,270,306 |
| Central banks | | 774,299 | 4,672,671 |
| Credit institutions | | 6,828,076 | 6,674,632 |
| Other creditors | | 5,041,902 | 4,923,003 |
| Debt securities issued | | - | - |
| Other financial liabilities | | 15,148 | 11,064 |
| *Memorandum item: subordinated liabilities* | | - | - |
| **DERIVATIVES - HEDGE ACCOUNTING** | **15** | **62,570** | **49,654** |
| **CHANGES IN THE FAIR VALUE OF THE HEDGED ITEMS IN PORTFOLIO HEDGES OF INTEREST RATE RISK** | | | |
| | | **-** | **-** |
| **PROVISIONS** | | | |
| Pensions and other post-employment defined benefit obligations | **16** | **951** | **232** |
| Other long-term employee benefits | | - | - |
| Outstanding legal proceedings and litigation in relation to taxes | | - | - |
| Commitments and guarantees extended | | - | - |
| Other provisions | | 951 | 232 |
| | | - | - |
| **TAX LIABILITIES** | | | |
| Current tax liabilities | **20** | **7,992** | **6,020** |
| Deferred tax liabilities | | 421 | 476 |
| | | 7,571 | 5,544 |
| **SHARE CAPITAL REPAYABLE ON DEMAND** | | | |
| | | **-** | **-** |
| **OTHER LIABILITIES** | | | |
| | **14** | **43,495** | **39,427** |
| **LIABILITIES INCLUDED IN DISPOSAL GROUPS CLASSIFIED AS HELD FOR SALE** | | | |
| | | **-** | **-** |
| **TOTAL LIABILITIES** | | **13,596,219** | **17,006,468** |

| (in thousands of Euros) | NOTA | | |
|---|---|---|---|
| **EQUITY** | | **2016** | **2015(*)** |
| **SHAREHOLDERS' EQUITY** | **18** | **435,135** | **394,823** |
| Capital | | 106,957 | 99,036 |
| Paid-in share capital | | 106,957 | 99,036 |
| Called-up unpaid share capital | | - | - |
| Memorandum item: uncalled capital | | - | - |
| Share premium | **18** | 85,972 | 85,972 |
| Equity instruments issued other than capital | | - | - |
| Equity component of compound financial instruments | | - | - |
| Other equity instruments issued | | - | - |
| Other equity | | - | - |
| Retained earnings | **19** | 201,884 | 174,428 |
| Revaluation reserves | | 158 | 160 |
| Other reserves | | (158) | (160) |
| (-) Own shares | | - | - |
| Profit attributable to the owners of the Parent | **3** | 40,322 | 35,387 |
| (-) Interim dividends | | - | - |
| **ACCUMULATED OTHER COMPREHENSIVE INCOME** | **17** | **13,577** | **9,445** |
| Items that will not be reclassified to profit or loss | | - | - |
| Actuarial gains or losses on defined benefit pension plans | | - | - |
| Non-current assets and disposal groups classified as held for sale | | | |
| Other valuation adjustments | | - | - |
| Items that may be reclassified to profit or loss | | - | - |
| Hedges of net investments in foreign operations (effective portion) | | 13,577 | 9,445 |
| Translation of foreign currency | | - | - |
| Hedging derivatives. Cash flow hedges (effective portion) | | - | - |
| Available-for-sale financial assets | | (728) | 8 |
| Debt instruments | | 14,305 | 9,437 |
| Equity instruments | | 14,969 | 10,090 |
| Non-current assets and disposal groups classified as held for sale | | (664) | (653) |
| | | - | - |
| **TOTAL EQUITY** | | **448,712** | **404,268** |
| **TOTAL LIABILITIES AND EQUITY** | | **14,044,931** | **17,410,736** |
| ***Memorandum item*** | | | |
| **GUARANTEES EXTENDED** | **21** | **110,639** | **88,488** |
| **CONTINGENT COMMITMENTS GIVEN** | **21** | **226,032** | **182,652** |

## *Appendix I.b.*

### Banco Cooperativo Español, S.A.

### Income statements for the years ended 31 December 2016 and 2015

| (in thousands of Euros) | NOTE | 2016 | 2015(*) |
|---|---|---|---|
| Interest income | 24 | 81,957 | 102,643 |
| (Interest expense) | 25 | (21,680) | (39,956) |
| **INTEREST MARGIN** | | **60,277** | **62,687** |
| Dividend income | 26 | 458 | 2,494 |
| Fee and commission income | 27 | 17,930 | 17,997 |
| (Fee and commission expense) | 28 | (9,851) | (8,578) |
| Gains or losses on derecognition of financial assets and liabilities not measured at fair value through profit or | 29 | 3,066 | |
| loss, net | 29 | 10,842 | 3,910 |
| Gains or losses on financial assets and liabilities held for trading, net | | | 6,992 |
| Gains or losses on financial assets and liabilities designated at fair value through profit or loss, net | 29 | 4 | - |
| Gains or losses on hedge accounting, net | 29 | 11 | - |
| Exchange differences, net | 29 | 426 | 696 |
| Other operating income | | 1,491 | 1,112 |
| (Other operating expenses) | | (7,983) | (9,092) |
| **GROSS MARGIN** | | **76,671** | **78,218** |
| (Administrative expenses) | | (22,090) | (20,594) |
| (Personnel expenses) | 30 | (14,089) | (13,060) |
| (Other administrative expenses) | 31 | (8,001) | (7,534) |
| (Depreciation and amortisation) | 11 y 12 | (1,184) | (1,110) |
| (Provisions or reversals of provisions) | 16 y 34 | (739) | (31) |
| (Impairment or reversal of impairment on financial assets not measured at fair value through profit or loss) | | | |
| (Financial assets carried at cost) | 34 | 2,814 | (7,919) |
| (Available-for-sale financial assets) | | (3,918) | (3,900) |
| (Loans and receivables) | | 407 | (54) |
| (Held-to-maturity investments) | | 6,325 | (3,965) |
| **RESULTS FROM OPERATING ACTIVITIES** | | **55,472** | **48,564** |
| (Impairment or reversal of impairment on investments in joint ventures or associates) | | - | - |
| (Impairment or reversal of impairment on non-financial assets) | | - | - |
| (Tangible assets) | | - | - |
| (Intangible assets) | | - | - |
| (Other) | | - | - |
| Gains or losses on derecognition of non-financial assets and investments, net | | - | - |
| Negative goodwill recognised in profit or loss | | - | - |
| Gains or losses on non-current assets and disposal groups classified as held for sale not qualifying as discontinued operations | | (1) | - |
| **PROFIT OR LOSS BEFORE TAX FROM CONTINUING OPERATIONS** | | **55,471** | **48,564** |
| Income tax expense or income related to profit or loss from continuing operations | 20 | 15,149 | 13,177 |
| **PROFIT OR LOSS AFTER TAX FROM CONTINUING OPERATIONS** | | **40,322** | **35,387** |
| Profit or loss after tax from discontinued operations | | - | - |
| **PROFIT FOR THE YEAR** | | **40,322** | **35,387** |
| | | | |
| **EARNINGS PER SHARE (EUROS)** | | **22.66** | **21.48** |
| Basic | | - | - |
| Diluted | | - | - |

# *Appendix I.c.*

## Banco Cooperativo Español, S.A.

## STATEMENT OF RECOGNISED INCOME AND EXPENSE
## for the years ended 31 December 2016 and 2015

(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails.)

| (in thousands of Euros) | NOTE | 2016 | 2015(*) |
|---|---|---|---|
| **PROFIT FOR THE YEAR** | | **40,322** | **35,387** |
| **OTHER COMPREHENSIVE INCOME** | | **4,132** | **(9,261)** |
| Items that will not be reclassified to profit or loss | | - | - |
| Actuarial gains or losses on defined benefit pension plans | | - | - |
| Non-current assets and disposal groups held for sale | | - | - |
| Share of other recognised income and expense arising from investments in joint | | - | - |
| ventures and associates | | - | - |
| Income tax on items that will not be reclassified | | | |
| | 17 | 5,903 | (13,230) |
| Items that may be reclassified to profit or loss | | | |
| | | - | - |
| Hedges of net investments in foreign operations (effective portion) | | - | - |
| Valuation gains or losses recognised in equity | | - | - |
| Amounts transferred to profit or loss | | - | - |
| Other reclassifications | | - | - |
| Translation of foreign currency | | - | - |
| Exchange gains or losses recognised in equity | | - | - |
| Amounts transferred to profit or loss | | - | - |
| Other reclassifications | | (1,051) | 11 |
| Cash flow hedges (effective portion) | 17 | (1,051) | 11 |
| Valuation gains or losses recognised in equity | | - | - |
| Amounts transferred to profit or loss | | - | - |
| Amounts transferred to the initial carrying amount of hedged items | | - | - |
| Other reclassifications | | 6,954 | (13,241) |
| Available-for-sale financial assets | | 10,022 | (9,089) |
| Valuation gains or losses recognised in equity | | (3,068) | (4,152) |
| Amounts transferred to profit or loss | | - | - |
| Other reclassifications | | - | - |
| Non-current assets and disposal groups held for sale | | - | - |
| Valuation gains or losses recognised in equity | | - | - |
| Amounts transferred to profit or loss | | - | - |
| Other reclassifications | | | |
| | 17 | (1,771) | 3,969 |
| Income tax on items that may be reclassified to profit or loss | | | |
| **TOTAL COMPREHENSIVE INCOME FOR THE YEAR** | | **44,454** | **26,126** |

# *Anexo I.d.*

## Banco Cooperativo Español, S.A.

## STATEMENTS OF TOTAL CHANGES IN EQUITY for the years ended 31 December 2016 and 2015

(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails.)

| Source of changes in equity | Capital | Share premium | Equity instruments issued other tan capital | Other equity | Retained earnings | Revaluation reserves | Other reserves | Own shares | Profit attributable to the owners of the parent | Interim dividends | Accumulated other comprensive income | TOTAL |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1. Opening balance 31/12/2015(*) | **99,036** | **85,972** | **-** | **-** | **174,428** | **160** | **(160)** | **-** | **35,387** | - | **9,445** | **404,268** |
| 1.1 Effects of correction of errors | - | - | - | - | - | - | - | - | - | - | - | **-** |
| 1.2 Effects of changes in accounting policies | - | - | - | - | - | - | - | - | - | - | - | **-** |
| 2. Opening balance 31/12/2015 (*) | **99,036** | **85,972** | **-** | **-** | **174,428** | **160** | **(160)** | **-** | **35,387** | **-** | **9,445** | **404,268** |
| 3. Total comprehensive income for the year | - | - | - | - | - | - | - | - | 40,322 | - | 4,132 | **44,454** |
| 4. Other changes in equity | **7,921** | **-** | **-** | **-** | **27,456** | **(2)** | **2** | - | **(35,387)** | **-** | **-** | **(10)** |
| 4.1 Issuance of ordinary shares | 7,921 | - | - | - | (7,921) | - | - | - | - | - | - | **-** |
| 4.2 Issuance of preference shares | - | - | - | - | - | - | - | - | - | - | - | **-** |
| 4.3 Issuance of other equity | - | - | - | - | - | - | - | - | - | - | - | |
| 4.4 Redemption or maturity of other equity instruments issued | - | - | - | - | - | - | - | - | - | - | - | **-** |
| 4.5 Conversion of debt to equity | - | - | - | - | - | - | - | - | - | - | - | **-** |
| 4.6 Capital Reduction | - | - | - | - | - | - | - | - | - | - | - | **-** |
| 4.7 Dividends (or shareholder remuneration) (**) | - | - | - | - | (10) | - | - | - | - | - | - | **(10)** |
| 4.8 Purchase of own shares | - | - | - | - | - | - | - | - | - | - | - | **-** |
| 4.9 Sale or cancellation of own shares | - | - | - | - | - | - | - | - | - | - | - | **-** |
| 4.10 Reclassification of financial instruments from equity to liabilities | - | - | - | - | - | - | - | - | - | - | - | **-** |
| 4.11 Reclassification of financial instruments from liabilities to equity (***) | - | - | - | - | - | - | - | - | - | - | - | **-** |
| 4.12 Transfers between equity line items | - | - | - | - | 35,387 | (2) | 2 | - | (35,387) | - | - | **-** |
| 4.13 Increase or decrease in equity due to business combinations | - | - | - | - | - | - | - | - | - | - | - | **-** |
| 4.14 Share based payments (****) | - | - | - | - | **-** | - | **-** | - | **-** | - | - | **-** |
| 4.15 Other increases or (decreases) in equity | **-** | **-** | **-** | **-** | **-** | **-** | - | **-** | **-** | **-** | **-** | **-** |
| 5. Closing balance 31/12/2016 | **106,957** | **85,972** | **-** | **-** | **201,884** | **158** | **(158)** | **-** | **40,322** | **-** | **13,577** | **448,712** |

## *Anexo I.d.*

# Banco Cooperativo Español, S.A.

## STATEMENTS OF TOTAL CHANGES IN EQUITY for the years ended 31 December 2015 and 2014

(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails.)

| Source of changes in equity | Capital | Share premium | Equity instruments issued other tan capital | Other equity | Retained earnings | Revaluation reserves | Other reserves | Own shares | Profit attributable to the owners of the parent | Interim dividends | Accumulated other comprensive income | TOTAL |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1. Opening balance 31/12/2014(*) | **91.009** | **85,972** | **-** | **-** | **137,053** | **161** | **(161)** | **-** | **45,416** | - | **18,706** | **378.156** |
| 1.1 Effects of correction of errors | - | - | - | - | - | - | - | - | - | - | - | **-** |
| 1.2 Effects of changes in accounting policies | - | - | - | - | - | - | - | - | - | - | - | **-** |
| 2. Opening balance 31/12/2014 (*) | **91,009** | **85,972** | **-** | **-** | **137,053** | **161** | **(161)** | **-** | **45,416** | **-** | **18,706** | **378.156** |
| 3. Total comprehensive income for the year | - | - | - | - | - | - | - | - | 35,387 | - | (9,261) | **26.126** |
| 4. Other changes in equity | **8,027** | **-** | **-** | **-** | **37,375** | **(1)** | **1** | **-** | **(45,416)** | **-** | **-** | **(14)** |
| 4.1 Issuance of ordinary shares | 8,027 | - | - | - | (8,027) | - | - | - | - | - | - | **-** |
| 4.2 Issuance of preference shares | - | - | - | - | - | - | - | - | - | - | - | **-** |
| 4.3 Issuance of other equity | - | - | - | - | - | - | - | - | - | - | - | **-** |
| 4.4 Redemption or maturity of other equity instruments issued | - | - | - | - | - | - | - | - | - | - | - | **-** |
| 4.5 Conversion of debt to equity | - | - | - | - | - | - | - | - | - | - | - | **-** |
| 4.6 Capital Reduction | - | - | - | - | - | - | - | - | - | - | - | **-** |
| 4.7 Dividends (or shareholder remuneration) (**) | - | - | - | - | (14) | - | - | - | - | - | - | **(14)** |
| 4.8 Purchase of own shares | - | - | - | - | - | - | - | - | - | - | - | **-** |
| 4.9 Sale or cancellation of own shares | - | - | - | - | - | - | - | - | - | - | - | **-** |
| 4.10 Reclassification of financial instruments from equity to liabilities | - | - | - | - | - | - | - | - | - | - | - | **-** |
| 4.11 Reclassification of financial instruments from liabilities to equity (***) | - | - | - | - | - | - | - | - | - | - | - | **-** |
| 4.12 Transfers between equity line items | - | - | - | - | 45,416 | (1) | 1 | - | (45,416) | - | - | **-** |
| 4.13 Increase or decrease in equity due to business combinations | - | - | - | - | - | - | - | - | - | - | - | **-** |
| 4.14 Share based payments (****) | - | - | - | - | **-** | - | **-** | - | **-** | - | - | **-** |
| 4.15 Other increases or (decreases) in equity | **-** | **-** | **-** | **-** | **-** | **-** | - | **-** | **-** | **-** | **-** | **-** |
| 5. Closing balance 31/12/2015 | **99,036** | **85,972** | **-** | **-** | **174,428** | **160** | **(160)** | **-** | **35,387** | **-** | **9,445** | **404,268** |

## *Appendix I.e.*

# CASH FLOW STATEMENTS
## for the years ended 31 December 2016 and 2015

(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails.)

| (in thousands of Euros) | | 2016 | 2015(*) |
|---|---|---|---|
| **FLUJOS DE EFECTIVO DE LAS ACTIVIDADES DE EXPLOTACIÓN** | **NOTE** | **(148,733)** | **(60,597)** |
| Profit for the year | 3 | 40,322 | 35,387 |
| Adjustments to obtain cash flows from operating activities | 11 y 12 | 13,520 | 22,207 |
| Depreciation and amortisation | | 1,184 | 1,110 |
| Other adjustments | | 12,336 | 21,097 |
| Net increase/decrease in operating assets | | 3,227,363 | (2,531,661) |
| Financial assets held for trading | | 146,574 | (863,795) |
| Financial assets designated at fair value through profit or loss | | - | - |
| Available-for-sale financial assets | | 100,017 | (76,394) |
| Loans and receivables | | 2,981,586 | (1,591,496) |
| Other operating assets | | 814 | 24 |
| Net increase/decrease in operating liabilities | | (3,417,008) | (2,624,808) |
| Financial liabilities held for trading | | 192,021 | 70,515 |
| Financial liabilities designated at fair value through profit or loss | | - | - |
| Financial liabilities at amortised cost | | (3,621,944) | (2,711,645) |
| Other operating liabilities | 8 y 4 | 12,915 | 16,322 |
| Income tax received/paid | | (12,930) | (25,044) |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | **21,515** | **9,769** |
| Payments | | (3,924) | (18,961) |
| Tangible assets | | (577) | (366) |
| Intangible assets | | (1,207) | (651) |
| Investments in joint ventures and associates | | - | - |
| Subsidiaries and other business units | | - | - |
| Non-current assets and liabilities classified as held for sale | | - | - |
| Held-to-maturity investments | | - | - |
| Other payments relating to investing activities | | (2,140) | (17,944) |
| Receipts | | 25,439 | 28,730 |
| Tangible assets | | - | - |
| Intangible assets | | - | - |
| Investments in joint ventures and associates | | - | 196 |
| Subsidiaries and other business units | | - | - |
| Non-current assets and liabilities classified as held for sale | | - | - |
| Held-to-maturity investments | | 25,439 | 28,534 |
| Other receipts relating to investing activities | | - | - |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | **4,529** | **13,742** |
| Payments | | (10) | (15) |
| Dividends (**) | | (10) | (15) |
| Subordinated liabilities | | - | - |
| Redemption of own equity instruments | | - | - |
| Acquisition of own equity instruments (**) | | - | - |
| Other payments relating to financing activities | | - | - |
| Receipts | | 4,539 | 13,757 |
| Subordinated liabilities | | - | - |
| Issuance of own equity instruments | | - | - |
| Disposal of own equity instruments (**) | | - | - |
| Other receipts relating to financing activities | | 4,539 | 13,757 |
| **EFFECT OF EXCHANGE RATE FLUCTUATIONS** | | **-** | **-** |
| **NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS** | | **(122,689)** | **(37,086)** |
| **CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR** | | **229,485** | **266,571** |
| **CASH AND CASH EQUIVALENTS AT YEAR END** | | **106,796** | **229,485** |
| **MEMORANDUM ITEM** | | | |
| **COMPOSITION OF CASH AND CASH EQUIVALENTS AT YEAR END** | 5 | | |
| Cash | | 748 | 843 |
| Cash equivalents in central Banks | | 106,048 | 228,642 |
| Other financial assets | | - | - |
| Less: bank overdrafts repayable on demand | | - | - |

This Appendix I forms an integral part of Note 1 to the consolidated annual accounts for 2016, in conjunction with which it should be read.

# *Appendix II*

Fully consolidated subsidiaries

| 31.12.2016 | | | % ownership | | Thousands of Euros | | | | |
|---|---|---|---|---|---|---|---|---|---|
| **Company** | **Registered offices** | **Activity** | **Direct** | **Indirect** | **Amount of interest** | **Capital and reserves** | **Total assets** | **Profit** | **Revenues** |
| Rural Informática. S.A. | Madrid | IT services | 99.8 | 0.2 | 6,822 | 13,422 | 530,352 | 438 | 3,135 |
| Gescooperativo. S.A. S.G.I.I.C. | Madrid | Collective investment management | -- | 100 | 1,893 | 13,943 | 22,027 | 3,357 | 6,131 |
| Rural Inmobiliario. S.L. | Madrid | Real-estate holding | 100 | -- | 3,486 | 10,115 | 131,552 | 216 | 701 |
| BCE Formación. S.A. | Madrid | Training services | 100 | -- | 60 | 775 | 1,132 | 259 | 534 |
| Espiga Capital Gestión. S.G.E.C.R. SA. | Madrid | Venture capital management | 80 | -- | 288 | 351 | 349 | (3) | -- |
| Rural Renting. S.A. | Madrid | Financing services | 100 | -- | 600 | 1,173 | 5,149 | 17 | 90 |

| 31.12.2015 | | | % ownership | | Thousands of Euros | | | | |
|---|---|---|---|---|---|---|---|---|---|
| **Company** | **Registered offices** | **Activity** | **Direct** | **Indirect** | **Amount of interest** | **Capital and reserves** | **Total assets** | **Profit** | **Revenues** |
| Rural Informática. S.A. | Madrid | IT services | 99.8 | 0.2 | 6,822 | 13,062 | 559,636 | 2,359 | 3,126 |
| Gescooperativo. S.A. S.G.I.I.C. | Madrid | Collective investment management | -- | 100 | 1,893 | 10,561 | 18,931 | 3,382 | 6,283 |
| Rural Inmobiliario. S.L. | Madrid | Real-estate holding | 100 | -- | 3,486 | 9,891 | 131,447 | 224 | 766 |
| BCE Formación. S.A. | Madrid | Training services | 100 | -- | 60 | 557 | 991 | 218 | 801 |
| Espiga Capital Gestión. S.G.E.C.R. SA. | Madrid | Venture capital management | 80 | -- | 288 | 362 | 352 | (9) | -- |
| Rural Renting. S.A. | Madrid | Financing services | 100 | -- | 600 | 1,136 | 3,244 | 37 | 140 |

Appendix II forms an integral part of note 1 to the consolidated annual accounts for 2016, in conjunction with which it should be read.

***Appendix III***

*(Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails.)*

Information on the Banco Cooperativo Español Group pursuant to Article 87 of Law 10/2014 of 26 June 2014

**ANNUAL BANKING REPORT**

This information has been prepared to fulfil the provisions of Article 87 and the twelfth transitional provision of Law 10/2014 of 26 June 2014 on the regulation, supervision and solvency of credit institutions published in the Official State Gazette ("BOE") on 27 June 2014, which transposes into Spanish Law Article 89 of Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC (CRD IV) and repealing Directives 2006/48/EC and 2006/49/EC.

In accordance with the aforementioned legislation, as from 1 July 2014 credit institutions are required to publish the following consolidated information for the last full reporting period, broken down by the countries in which they are established:

a) Name, nature and geographical location of the activity.
b) Volume of business.
c) Number of FTE employees.
d) Profit before tax.
e) Income tax.
f) Government grants and subsidies received.

Pursuant to the foregoing, the aforementioned required information is detailed below:

**a) Name, nature and geographical location of the activity**

Banco Cooperativo Español, S.A. was incorporated on 31 July 1990 in a public deed attested by Madrid notary public Mr, Francisco Lucas Fernández, recorded as entry 2656 in his notarial record book and filed at the Madrid Mercantile Registry on 7 September 1990.

The Bank has its registered office in Madrid, at calle Virgen de los Peligros, 4 and 6, where public information on the company is available for consultation. The by-laws may be viewed at the Madrid Mercantile Registry and at the offices of the Bank's legal counsel.

The by-laws stipulate the activities in which the Bank may engage; these comprise activities typical of credit institutions, specifically those that comply with the provisions of Law 26/1988 of 29 July 1988 on discipline and intervention in credit institutions.

In addition to the transactions it carries out directly, the Bank is the parent of a group of subsidiaries that engage in various activities (see Appendix II to the Group's consolidated annual accounts) and which, together with the parent, constitute the Banco Cooperativo Español Group. As a result, the Bank is required to prepare the consolidated annual accounts of the Group in addition to its own individual annual accounts.

The consolidated Group conducts its business in Spain.

**b) Volume of business and number of FTE employees**

Information on Banco Cooperativo Español Group’s volume of business and FTE employees at the 2016 close is shown below, together with explanatory notes on the basis of presentation of this information.

- Volume of business: Euros 83 million.
- FTE employees: 228.

For purposes of this report, the volume of business is considered to be the gross margin, as defined and presented in the consolidated income statement that forms part of the Group’s consolidated annual accounts.

**c) Profit before tax and Income tax**

The accompanying consolidated income statement of the Banco Cooperativo Español Group for the year ended 31 December 2016 shows profit before tax of Euros 61,029 thousand and an income tax expense of Euros 16,438 thousand.

**d) Government grants and subsidies received**

The Banco Cooperativo Español Group received no public aid in 2016 or previously.

## Directors' Report

(Free translation from the original in Spanish, In the event of discrepancy, the Spanish-language version prevails.)

This directors' report summarises the activity carried out by the Banco Cooperativo Español Group from 1 January to 31 December 2016, the Bank's twenty-sixth year since its incorporation in July 1990.

### 1. Position of the Entity

#### *1.1 Description*

Banco Cooperativo Español is a financial group that performs the role of banking headquarters for its associated rural savings banks. As such, considering the particular characteristics of the business activity carried out and the varying requirements of its customers, the Group has adopted a segmented structure that facilitates business activities while increasing the quality of services and improving cost efficiency. The shareholder savings banks engage in traditional banking activities and, therefore, the main objective of Banco Cooperativo Español is to assist these savings banks in achieving a leading position in the market, taking advantage of synergies and the competitive advantage derived from their association.

At 31 December 2016 the Group had assets totalling Euros 14,080 million, shareholders' equity of Euros 466 million and 228 employees.

Within the Group's organisational structure, the board of directors has the greatest decision-making power and the most extensive authority in managing the Company, except in matters to be approved by the shareholders, Its main function is oversight of the Group and it delegates routine management tasks to the executive bodies and the management team.

The members of the board of directors do not have executive powers.

The Group primarily operates in Spain and its activities are structured into the following business areas:

- **Treasury and Capital Markets Area**:

    - The particular characteristics of the Bank as a provider of wholesale services mean that the Money Markets and Foreign Currency Area generates the greatest volume of business and is where the Bank makes its presence felt.

    - The Capital Markets Area is responsible for the design, structure and placement of fixed and variable income securities transactions both in Spain and abroad, flotations and privatisations, syndicated loans in Spain and abroad and balance sheet hedging operations of the rural savings banks.

- **Retail Banking**: provides financial services to individuals and businesses with the basic aim of meeting their requirements through a comprehensive offering of products and services, providing the possibility of arranging services and performing operations through various means (branch offices, internet banking, telephone banking, mobile banking, ATMs, etc,), As these products and financial services are the cornerstone of our savings banks' relationship with their customers, the Bank has focused the activity of the various units engaged in retail banking on developing, promoting and fostering these products in order to increase the volume and profitability of their business and of Banco Cooperativo Español itself through its two branch offices in Madrid.

- **Corporate Banking**: the Bank follows two basic lines of action in the provision of services to active companies and institutions: commercial support; arranging contracts with customers either individually or in conjunction with the savings banks; and acting as advisor or promoter for the development of new products, commercial undertakings or any initiatives to improve the commercial capacity of this customer segment.

- **Private Banking**: comprised of two distinct business lines:

    - Own business: this area renders services to the Bank's own private banking customers and engages in attracting new customers.

    - Savings bank business: the main aim is to provide support to the shareholder rural savings banks.

- **International Area**: facilitates access by the rural savings banks and the Bank itself to international payment systems and to cooperation and service provision agreements that enable access to the global economy.

The Group also has various support units such as Human Resources, Organisation and Technology, General Secretaries' Offices and Legal Advisory, Operations, Analysis Services, General Audit and Risks and Internal Audit.

***1.2 Business model***

The basic pillars of Banco Cooperativo's business model are as follows:

- Banco Cooperativo, as head of banking services for rural savings banks, aims to achieve sustained and profitable growth with the basic objectives of rendering quality services to its shareholder savings banks, strengthening its business and focusing its own activity on the wholesale and corporate banking areas.

- The global risk profile of the Banco Cooperativo Group is low, Most notably it has high capital ratios, estimated profit volatility at the lower end of available benchmarks, low risk exposure (derived mainly from its activity in capital markets) and a robust liquidity position.

- Commercial focus on shareholder savings banks and end customers, professional and speedy decision-making and extensive use of information technology.

- Active management of intellectual capital, training, motivation and development of employees, The employees of the Banco Cooperativo Group are a cornerstone of the business model.

The Group's activity is subject to the same risks as that of other financial institutions, which can give rise to adverse consequences, Activity is conditioned by other factors such as strong competition, market volatility, the cyclical nature of certain business activities, losses due to litigation and other factors that impact negatively on the Group's profitability and solvency.

A description of these and other specific risks related to banking activity, such as credit, liquidity, market risks, etc., is provided in note 35.

## 2. Business performance

| | Thousands of Euros | |
|---|---|---|
| | **2016** | **2015** |
| **Balance sheet** | | |
| Total assets | 14,080,179 | 17,442,750 |
| On-balance sheet customer funds | 5,039,765 | 4,921,950 |
| Other funds managed | 5,351,521 | 5,154,036 |
| Loans and advances to other debtors (net) | 1,110,404 | 995,342 |
| Shareholders' equity | 466,068 | 421,484 |
| | | |
| **Profit/(loss)** | | |
| Gross margin | 84,478 | 84,272 |
| Margin on operating activities | 61,030 | 52,139 |
| Profit before income tax | 61,029 | 52,138 |
| Attributable profit | 44,591 | 37,359 |
| | | |
| **Significant ratios (%)** | | |
| Overheads/gross margin | 28.46 | 28.69 |
| Net profit/average shareholders' equity (ROE) | 9.57 | 8.86 |
| Net profit/average total assets (ROA) | 0.20 | 0.16 |
| Solvency ratio | 21.9 | 21.0 |

### *2.1 Economic environment*

After a lacklustre outturn in 2016, the projections from the International Monetary Fund (IMF) indicate that economic activity is expected to pick up pace in 2017 and 2018, especially in emerging market and developing economies (EMDEs).

However, there is a wide dispersion of possible outcomes around the projections, given uncertainty surrounding the policy stance of the U.S. administration and its global ramifications.

Global growth for 2016 is now estimated at 3.1%. Economic activity in both advanced economies and EMDEs is forecast to accelerate in 2017–18, with global growth projected to be 3.4% and 3.6%, respectively.

The outlook for advanced economies has improved for 2017–18, reflecting somewhat stronger activity in the second half of 2016 as well as a projected fiscal stimulus in the United States.

Advanced economies are now projected to grow by 1.9% in 2017 and 2.0% in 2018. As noted, this forecast is particularly uncertain in light of potential changes in the policy stance of the United States under the administration. The projection for the United States is the one with the highest likelihood among a wide range of possible scenarios. It assumes a fiscal stimulus that leads growth to rise to 2.3% in 2017 and 2.5% in 2018, a cumulative increase in GDP of ½ percentage point relative to the October forecast.

Growth projections for 2017 have also been revised upward for Germany, Spain, Japan and the United Kingdom, mostly on account of a stronger-than-expected performance during the latter part of 2016. These upward revisions more than offset the downward revisions to the outlook for Korea and Italy.

The primary factor underlying the strengthening global outlook over 2017–18 is, however, the projected pickup in EMDEs' growth. This projection reflects to an important extent a gradual normalisation of conditions in a number of large economies that are currently experiencing macroeconomic strains. EMDE growth is currently estimated at 4.1% in 2016, and is projected to reach 4.5% for 2017. A further pickup in growth to 4.8% is projected for 2018.

This forecast is based on the assumption of a changing policy mix under the new administration in the United States and its global spillovers.

Notably, the growth forecast for 2017 was revised up for China (to 6.5%) on expectations of continued policy support. However, continued reliance on policy stimulus measures, with rapid expansion of credit and slow progress in addressing corporate debt, especially in hardening the budget constraints of state-owned enterprises, raises the risk of a sharper slowdown or a disruptive adjustment. These risks can be exacerbated by capital outflow pressures, especially in a more unsettled external environment.

Growth forecasts for 2017 were instead revised down in a number of other regions:

In India, the growth forecast for the current (2016–17) and next fiscal year were trimmed by one percentage point and 0.4 percentage point, respectively, primarily due to the temporary negative consumption shock induced by cash shortages and payment disruptions associated with the recent currency note withdrawal and exchange initiative. The growth prospects also were revised down for a number of other large economies – most notably Brazil and Mexico.

Staff now project some near-term fiscal stimulus and a less gradual normalisation of monetary policy. This projection is consistent with the steepening U.S. yield curve, the rise in equity prices, and the sizeable appreciation of the U.S. Dollar since the November 8 election.

The IMF forecast also incorporates a firming of oil prices following the agreement among OPEC members and several other major producers to limit supply.

While the balance of risks is viewed as being to the downside, there are also upside risks to near-term growth. Specifically, global activity could accelerate more strongly if policy stimulus turns out to be larger than currently projected in the United States or China.

Recent political developments highlight a fraying consensus about the benefits of cross-border economic integration. A potential widening of global imbalances coupled with sharp exchange rate movements, should those occur in response to major policy shifts, could further intensify protectionist pressures. Increased restrictions on global trade and migration would hurt productivity and incomes, and take an immediate toll on market sentiment.

Notable negative risks to activity include a possible shift toward inward-looking policy platforms and protectionism, a sharper than expected tightening in global financial conditions that could interact with balance sheet weaknesses in parts of the Euro area and in some emerging market economies, increased geopolitical tensions, and a more severe slowdown in China.

In those advanced economies where balance sheets remain impaired, an extended shortfall in private demand and inadequate progress on reforms (including bank balance sheet repair) could lead to permanently lower growth and inflation, with negative implications for debt dynamics.

In addition to the risks already mentioned, underlying vulnerabilities remain among some other large emerging market economies. High corporate debt, declining profitability, weak bank balance sheets, and thin policy buffers imply that these economies are still exposed to tighter global financial conditions, capital flow reversals, and the balance sheet implications of sharp depreciations. In many low-income economies, low commodity prices and expansionary policies have eroded fiscal buffers and led in some cases to a precarious economic situation, heightening their vulnerability to further external shocks.

More broadly, accommodative macroeconomic policies must be accompanied by and support structural reforms that can counteract waning potential growth – including efforts to boost labour force participation, encourage investments in skills, improve the matching process in labour markets, liberalise entry into closed professions, increase dynamism and innovation in product and service markets, and promote business investment, including in research and development.

With growth weak and policy space limited in many countries, continued multilateral effort is required in several areas to minimise risks to financial stability and sustain global improvements in living standards.

This effort must proceed simultaneously on a number of fronts. To share the long-term benefits of economic integration more broadly, policymakers must ensure that well-targeted initiatives are in place to help those adversely affected by trade opening and to facilitate their ability to find jobs in the sectors of the economy that are expanding. Economic fairness also calls for multilateral and national efforts to crack down on tax evasion and prevent tax avoidance practices.

Efforts to strengthen the resilience of the financial system must continue, including by recapitalising institutions and cleaning up balance sheets where necessary, ensuring effective national and international banking resolution frameworks, and addressing emerging risks from nonbank intermediaries. A stronger global safety net can protect economies with robust fundamentals that may nevertheless be vulnerable to cross-border contagion and spillovers.

Last but not least, multilateral cooperation is also indispensable to address important longer-term global challenges, such as meeting the 2015 Sustainable Development Goals, mitigating and coping with climate change, and preventing the spread of global epidemics.

### 2.2 Balance sheet

- Total assets decreased by 19,3% to Euros 14,080,179 thousand.

- At 31 December 2016 “Loans and receivables” stood at Euros 1,110,404 thousand, more 11,6% compared to 31 December 2015.

- Deposits from other creditors increase by 2,4% to Euros 5,039,765 thousand.

- Deposits from credit institutions and central banks decreased 33.0% to Euros 7,609,777 thousand.

- Shareholders’ equity rose by 10.6% to Euros 466,068 thousand.

### 2.3 Income statement

- The interest margin was Euros 60,772 thousand, representing a decline of 4.1% on 2015.

- The gross margin grew by 0.2% to Euros 84,478 thousand due to the performance of the various components of this margin: interest (as mentioned previously), net fees and commissions (down 4.1% to Euros 14,121 thousand), gains and losses on financial assets and financial liabilities and exchange differences (up 23.4% to stand at Euros 14,349 thousand). Other operating income net of other operating expenses improved to a negative balance of Euros 5,222 thousand, mainly as a result of the contribution to the Single Resolution Fund.

- Administrative and personnel expenses grew by 5.5% to stand at Euros 24,041 thousand, Depreciation and amortisation totalled Euros 1,467 thousand, up 4.9% on 2015. The sum of provisions and impairment losses on assets decreased to Euros 2,061 thousand (7,956 on 2015). Consequently, results from operating activities stood at Euros 61,030 thousand, 17.1% up on 2015.

- Profit attributable to the Group amounted to Euros 44,592 thousand, 19.4% higher than in 2015.

### 2.4 Business units

The results of the different business segments comprising the Bank's activity and their performance in 2016 and 2015 are summarised below. Further information can be found in note 32.

| | **Thousand of Euros** | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | **Commercial banking** | | **Asset management** | | **Markets** | | **Corporate activities** | | **Total Group** | |
| | **2016** | **2015** | **2016** | **2015** | **2016** | **2015** | **2016** | **2015** | **2016** | **2015** |
| Gross margin plus other operating income (net) | 17,931 | 17,126 | 10,489 | 11,058 | 45,257 | 44,856 | 10,802 | 11,232 | 84,478 | 84,272 |
| Results from operating activities | 17,828 | 8,418 | 7,231 | 8,454 | 40,468 | 40,899 | (4,498) | (5,631) | 61,030 | 52,139 |
| Profit/(loss) before income tax | 17,828 | 8,418 | 7,231 | 8,454 | 40,468 | 40,899 | (4,497) | (5,632) | 61,029 | 52,138 |
| Income tax | 4,802 | 2,386 | 1,948 | 2,397 | 10,900 | 11,594 | (1,212) | (1,596) | 16,438 | 14,781 |
| **Consolidated profit/(loss) for the year** | **13,026** | **6,031** | **5,283** | **6,057** | **29,568** | **29,304** | **(3,287)** | **(4,036)** | **44,591** | **37,357** |

### 2.5 Environmental issues

Environmental preservation is a priority of the Bank when performing its activity and it seeks to promote initiatives to protect the environment and prevent and mitigate environmental damage. The Bank has a recycling protocol aimed at minimising the waste generated by activity, which is generally very limited; and it is especially concerned with financing projects for the protection and improvement of the environment.

### 2.6 Human resources

Banco Cooperativo's human resources management model is aimed at promoting professional growth and development within the organisation, prioritising promotion and internal rotation, in order to foster a workforce with breadth of knowledge and ensure equal conditions and opportunities.

Management practices are therefore characterised by close relationships and personalised treatment. Each employee is considered key and essential to achieving the Entity's objectives.

Our core values revolve around respect, integrity, commitment, team spirit and especially the quality of internal and external customer service.

| | 2016 | 2015 |
|---|---|---|
| Average length of service (years) | 11.4 | 11.5 |
| Average age | 41.2 | 41.2 |
| Training: | | |
| (%) University graduates | 82 | 80 |
| No, of hours of training | 5,284 | 4,628 |
| Hours of training/employee | 23 | 21 |
| Diversity (%) | | |
| Female | 53 | 48 |
| Male | 47 | 52 |
| HR management (%) | | |
| Internal promotion | 18 | 9 |
| Permanent contracts | 99 | 98 |

## 3. Liquidity and capital

### 3.1 Liquidity

Liquidity risk management consists of ensuring that the Group always has sufficient liquidity to meet its payment commitments associated with the settlement of its liabilities on their respective maturity dates without compromising its capacity to respond rapidly to strategic market opportunities. This function includes obtaining financing in wholesale markets at the lowest possible cost in the medium and long term, with a view to maintaining an optimum level of liquid assets in keeping with the Group's policy of prudence.

In this context, the key to resolving liquidity problems resides in anticipating them and implementing preventive management techniques. The Bank is aware of this and therefore considers both aspects its first line of defence against the potential adverse effects of liquidity shortages on its results, reputation and creditworthiness.

To enable early identification, the Group continually monitors its liquidity position in the short, medium and long term and the performance of the main monetary and capital markets in which it operates. To this end it has: (i) a wide range of quantitative and qualitative indicators, (ii) limits and alerts defined based on the maximum tolerance to liquidity risk and (iii) the human, technical and operational support required to properly incorporate these indicators as a strategic and risk management input.

With regard to preventive management, the Asset and Liability Committee (ALCO) focuses structural liquidity management on: (i) the balance between positive and negative cash flows over a long time horizon, (ii) the diversification of uses and sources of funding and (iii) the protection of the Bank's ability to finance its growth and meet its payment obligations on the date and in the manner established in the contract at a reasonable cost and without affecting its reputation.

Finally, in terms of anticipation, the Entity has a buffer of liquid assets free of encumbrances that allow it to comfortably cope with situations of severe stress. The quality, relative liquidity and suitability as collateral of the assets that make up the buffer are periodically verified and these assets are subjected to stress tests to determine their ability to cope with extreme situations.

The main metrics currently used to control liquidity and the results thereof at 31 December 2016 are:

- ***Daily liquidity controls***: the Bank continually monitors its intraday liquidity, the eligibility of securities to be pledged as collateral to obtain financing from Banco de España (credit facility) and the sufficiency of its headroom (buffer of available liquid assets) in dealing with short-term cash outflows, among other indicators. This analysis also envisages further stress tests on its portfolio of eligible assets (those pledged as collateral for the Banco de España credit facility and others), subjecting the securities to scenarios of a reduction in their market value, downgrades in rating and loss of eligibility.

- ***Liquidity gap***: provides information on cash inflows and outflows in order to detect timing differences between collections and payments. Very conservative behavioural criteria and assumptions have been established for unknown contractual maturities.

- ***Short-term liquidity coverage ratio (LCR):*** under the stress scenario defined in Basel III, the 30-day liquidity ratio at 31 December 2016 stood at 318.83%, a level close to that normally seen and over twice the target rate (80%) established for the date of entry into force of this ratio (December 2016).

- ***Net Stable Funding Ratio (NSFR):*** the Bank maintains a balanced structure in its long-term financing that is adapted to its liquidity profile. At 31 December 2016, the net stable funding ratio was 105%, higher than the target set in Basel III.

Moreover, the Bank has activated a number of alerts and thresholds that are continually monitored, enabling it to foresee any potential liquidity stress and, where necessary, automatically convene the ALCO for an extraordinary or crisis meeting, depending on the situation. The latter initiative is considered in the liquidity risk contingency plan, the Bank's second line of action against potential adverse effects of liquidity shortages, Essentially, this is an action plan with a practical focus that enables the Bank to optimise the timing, cost and form of its response to high-exposure or critical situations and mitigate possible disturbances and impacts on business continuity during such episodes.

Further information on residual maturities and the Bank's financing structure can be found in note 34 to the consolidated annual accounts.

### *3.2 Capital*

Capital management seeks to guarantee the solvency of the Entity and ensure compliance with internal capital targets and regulatory requirements, and is a fundamental decision-making tool.

The Entity's target capital is defined as the capital which the Entity considers it necessary to hold both now and in the future as per its capital planning and which is in keeping with the risks inherent in its activity, the economic environment in which it operates, the governance, management and risk control systems, the strategic business plan, the quality of available capital, regulatory requirements (current and future requirements insofar as the latter are known) and the real possibilities of obtaining more capital if so required.

| | **Thousands of Euros** | |
|---|---|---|
| | **2016** | **2015** |
| Capital | 106,957 | 99,036 |
| Reserves | 361,376 | 285,304 |
| Deductions | (1,765) | (1,410) |
| **Common Equity Tier 1 (CET1) capital** | **466,568** | **382,930** |
| Additional CET1 elements | -- | -- |
| **Tier 1 capital** | **466,568** | **382,930** |
| General provision | 13,340 | 11,214 |
| **Tier 2 capital** | **13,340** | **11,214** |
| **Total eligible capital** | **479,908** | **394,144** |
| | 104,351 | |
| For credit, counterparty, dilution and delivery risk | 104,351 | 99,125 |
| For price, currency and commodity position risk | 34,612 | 18,354 |
| Operational risk and other | 36,231 | 32,792 |
| **Total minimum capital requirement** | **175,194** | **150,271** |
| **Surplus** | **304,714** | **243,873** |
| **Capital ratio (%)** | **21.9** | **21.0** |
| **Tier 1 capital (%)** | **21.3** | **20.4** |

Eligible capital amounts to Euros 479,908 thousand while capital requirements are Euros 175,194 thousand, giving rise to a surplus of Euros 304,714 thousand, i.e. 273.9% over the minimum requirement.

The majority of this amount is Common Equity Tier 1 (CET1) capital, which stands at Euros 466,568 thousand and accounts for 97.2% of total eligible capital.

Tier II capital, comprised of the general provision, amounted to Euros 13,340 thousand at 31 December 2016 and represents 2.8% of the capital base.

The most significant figure in eligible capital corresponds to credit, counterparty, dilution and delivery risks, which stand at Euros 104,351 thousand and represent 66.0% of total capital requirements calculated in accordance with Banco de España regulations.

As a result, the solvency ratio was 21.9% and the Tier I capital ratio stood at 21.3%.

## 4. Risk

A summary of the principles governing risk management at Banco Cooperativo is as follows:

- A risk profile adapted to strategic objectives, which include a high level of solvency.
- Involvement of senior management.
- Segregation of duties, guaranteeing the independence of the control function and comprehensive management of risks by the areas giving rise to them.
- Clear focus on supporting the business, without prejudice to the foregoing principle and maintaining the quality of risk in line with the Group's risk profile.
- Power allocation policies and control mechanisms structured and adapted to the various phases of the risk circuit, thereby ensuring adequate risk management and a risk profile that is in keeping with the parameters defined by the board of directors and senior management.
- Use of appropriate systems for the identification, measurement, control and monitoring of risks.
- Policies and procedures to reduce risks through mitigation techniques.
- Allocation of capital that is adapted to the level of risk assumed and the economic environment in which the Entity operates.

These principles are reflected in internal policies related to the approval, monitoring and control of risks and are set forth in the corresponding manuals and monitored on an ongoing basis, as explained further on.

### *4.1 Credit risk*

Credit risk is the risk of one party to a contract that meets the definition of a financial instrument ceasing to comply with its obligations, resulting in a financial loss for the other party.

Credit risk therefore represents the risk of loss assumed by the Bank in the event that a customer or any counterparty fails to comply with its contractual payment obligations, This risk is inherent in traditional products of banking entities (loans, credit facilities, financial guarantees extended, etc.). as well as in other types of financial assets (fixed-income securities of the Group, derivatives, etc.).

Credit risk affects financial assets carried at amortised cost and assets recognised at fair value in the consolidated financial statements. The Bank applies the same credit risk control policies and procedures to these financial assets irrespective of the recognition criteria used.

The Bank’s credit risk control policies and objectives have been approved by the board of directors. The Risk Committee, together with the Assets and Liabilities Committee, is in charge of implementing the Bank’s risk policies that enable compliance with the objectives set by the board. The risk control unit (under the General Audit and Risks Department and, therefore, independent of the business units in charge of implementing policies defined by the Entity) is responsible for establishing the control procedures required to continuously monitor the levels of risk assumed by the Entity as well as strict compliance with the objectives set by the Bank with respect to credit risks. Together with the Internal Audit Department (under the Internal Audit Committee), the risk control unit also monitors compliance with the Bank's risk control policies, methods and procedures, ensuring that these are sufficient, implemented effectively and reviewed regularly, and providing the information required by higher-level governing bodies to implement the necessary corrective measures, where applicable.

The control unit monitors, on an ongoing basis, risk concentration levels, the default rate and the different warning systems in place that enable it to keep an eye on credit risk trends at all times. Any deviations from the forecast performance of any of these parameters are analysed to determine the causes. Once the causes of these deviations are known, they are analysed by the control unit which submits the corresponding reports to the Bank's management bodies so that the necessary corrective measures may be taken; for example, defining or correcting established control mechanisms which may not have functioned satisfactorily, or amending policies and limits agreed by the Bank. In particular, a more exhaustive analysis will be performed of operations which, for different reasons, have resulted in late payment or default, to determine the effectiveness of the hedges arranged by the Entity, in order to take any necessary measures to improve the Bank's acceptance policies and credit risk analysis mechanisms.

### *4.2 Market risk*

Market risk management is carried out on a two-tier basis:

a) Positions derived from trading activity, which includes portfolios held to benefit from gains on short-term price variations.

b) Balance sheet positions, namely financial instruments and portfolios which are generally used to manage the overall risk structure, as well as structural fixed-income positions which are accrued in the margin.

The basic functions of the risk analysis and control unit include measuring, controlling and monitoring market risks, evaluating exposure and adapting that exposure to the limits assigned, as well as contrasting, implementing and maintaining tools.

The market risk limit structure is based on the value at risk (VaR) calculation, stop-loss limits, comparative tests and stress-testing and limits on the size of positions.

Management of this risk is geared towards limiting losses on positions stemming from adverse changes in market prices. Potential losses are estimated using a value at risk model, which is the main control and measuring tool employed in trading operations.

VaR is calculated using the parametric model, with a 99% confidence level for a time period of one day, Value at risk is obtained using historical or Monte Carlo simulations for those portfolios or unusual products with special characteristics for which the covariations model cannot be used.

VaR is calculated centrally on a daily basis for the treasury and capital market activity as a whole, irrespective of the nature of the portfolios.

The objectives of this risk valuation methodology are:

- To establish a benchmark for defining the structure of limits.

- To provide the Group with a unique and standard multi-level measure of market risk, and to provide the regulator with a global measure of market risk assumed by the Entity.

In addition to monitoring market risk, the risk control tools are also complemented by warning systems called stop-loss orders. The reason behind establishing warning systems is to limit maximum trading strategy losses to the desired level by automatically closing positions where allowable losses have been exceeded.

The measurement and control of market risk are complemented by contrast tests which involve comparing the theoretical generation of daily profits and losses under the assumption that positions have remained unchanged, i.e. in the absence of daily trading and using the estimates created by the risk model. Back-testing is used to determine whether the number of times losses exceed estimated VaR is consistent with the expected results according to the 99% confidence level applied in the model. The application of this technique shows that risk measurements fall within generally accepted validation standards.

To further supplement market risk measurement and control, stress estimates are performed in order to quantify the maximum decline in value of a portfolio when faced with extreme risk factor movements. Stress-testing analysis includes the application of historical financial market crisis scenarios as well as extreme values of market variables.

The market risk limit structure is completed with specific limits to the size of positions on certain operations individually approved, analysed and monitored by the Bank's Assets and Liabilities Committee.

### *4.3 Interest rate risk*

Interest rate risk on the overall balance sheet is measured using the gap calculation and the sensitivity of the financial margin and net worth to interest rate fluctuations.

- The interest rate gap is based on analyses of variations in the maturities or repricing profile of different bundles of assets and liabilities over various time intervals.

- Financial margin sensitivity is estimated by projecting the financial margin to twelve months using the expected interest rate scenario and certain behaviour of the balance sheet bundles.

- Net worth sensitivity provides an overview of the long-term interest rate risk assumed by the Entity. Through the concept of duration, the effect of interest rate fluctuations on the economic value of the Entity can be approximated.

To manage interest rate risk, the Assets and Liabilities Committee analyses the overall time difference between maturity and repricing of assets and liabilities. In the case of liabilities with no contractual maturity date, assumptions based on the historical stability of these balances are used.

Each month the financial margin over a 12-month period is simulated under certain scenarios, such as growth of each balance sheet item, spread renewal assumptions, repricing periods for each type of operation, as well as different interest rate scenarios.

Interest rate risk is also analysed considering the economic value, measured as the effect of changes in the interest rate on the present value of equity, discounting expected future flows.

### *4.4 Counterparty risk*

Control of counterparty risk is carried out in real time using an integrated system which allows the line of credit available with any counterparty, in any product and period and for each market area, to be known at any given time.

Lines of credit are approved following established authorisation procedures, as are any instances when credit limits are surpassed.

Counterparty risk is measured using the present value of each position plus the estimated increase in market value until maturity, Future variations in market prices are based on a hypothetical worst-case scenario considering the term of the operation and the risk factors to which the operation is exposed.

With respect to counterparty risk of derivative positions, credit risk is offset on positions where the counterparty is a financial institution that is party to the financial operations framework agreement, which allows parties to offset positions with negative market values against positions with positive market values in the same entity. At 31 December 2016 offset agreements have been implemented with 53 entities (50 in 2015).

The risk analysis unit continuously monitors the level of credit risk concentration by country, sector or counterparty. The Bank's Assets and Liabilities Committee reviews the appropriate exposure limits in order to adequately manage the level of credit risk concentration.

Note 34 to the consolidated annual accounts contains detailed information on the risks to which the Group's activity is exposed, including credit risk, market risk, interest rate risk, refinancing risk, exchange rate risk and risk concentration.

## 5. Outlook

In 2016, the Bank will design and launch new areas of business, allowing it to enhance its market presence and that of the shareholder rural savings banks, reinforce control of the different activities and improve the quality of services rendered.

## 6. Research, development and innovation activities

The Group has continued to develop technological applications to save costs and increase the quality of the services rendered to our customers, and so as to address new requirements to update technological and functional areas. The main work carried out has allowed the Group to continue with its policy to make the most of resources, leading to improved efficiency and the streamlining of processes.

## 7. Acquisition and sale of own shares

No transactions were carried out with own shares in 2016.

## 8. Other relevant information

The rating agencies commissioned all highlighted the Bank's low risk profile due to its robust levels of capitalisation, estimated profit volatility at the lower end of the benchmarks applied and low estimated exposure to various risks as a result of its policies and practices.

At the date of this report, the ratings assigned to the Bank are as follows:

| | |
|---|---|
| Moody's | Ba1 |
| Fitch | BBB |
| DBRS | BBB |

**APPROVAL BY THE BOARD OF DIRECTORS OF THE GROUP'S CONSOLIDATED ANNUAL ACCOUNTS FOR 2016**
**BANCO COOPERATIVO ESPAÑOL, S,A,**

In accordance with article 253 of the revised Spanish Companies Act, the members of the board of directors of Banco Cooperativo Español, S.A., whose names are provided below, subscribe to and countersign these annual accounts for the year ended 31 December 2016 of Banco Cooperativo Español, S.A. and Subsidiaries, which were authorised for issue at the board of directors' meeting held on 29 March 2017 in Madrid and comprise the consolidated balance sheet, consolidated income statement, consolidated statement of recognised income and expense, consolidated statement of total changes in equity, consolidated statement of cash flows, notes thereto comprising 46 sheets (pages 10 to 102) and three appendices (pages 103 to 113), as well as a consolidated directors' report of 8 sheets (pages 114 to 127).

All pages have been initialled by the secretary and this page and the following page signed by the directors, Directors.

Madrid, 29 March 2017

Mr. José Luis García Palacios
- Chairman -

Mr. José Luis García-Lomas Hernández
- First Vice-chairman -

Mr. Pedro García Romera
- Second Vice-chairman -

Mr. Ignacio Arrieta del Valle
- Director -

Mr. Fernando Bergé Royo
- Director -

Mr. Luis Esteban Chalmovsky
- Director -

Mr. Carlos de la Sierra Torrijos
- Director-

Mr. Cipriano García Rodriguez
- Director

Mr. Carlos Martinez Izquierdo
- Director-

Mr. Jesús Méndez Álvarez-Cedrón
- Director

Mr. José María Quirós Rodríguez
- Director-

Mr. Dimas Rodríguez Rute
- Director

Ms, Dagmar Werner
- Director -